BANKING THE UNBANKED

By Dimantha N. Seneviratne
Head of Credit Risk Management - HSBC

"Let us touch the dying, the poor, the lonely and the unwanted according to the graces we have received, and let us not be ashamed or slow to do the humble work" - Mother Teresa

1. Introduction

Nearly half of the world population, some 3 billion people live on less than $2 a day. Despite pledging of billions of dollars of aid in the name of helping the poor by the Governments of the developed nations and global multilateral lending institutions, the position still remains unchanged. In Sri Lanka, things are no different. 42% of our population earn less than USD2 per day and a further 6% below USD1 per day. No matter the amount of aid pledged, unless there is an effective well directed strategy to uplift the poor out of poverty, the results will hardly bear fruit. Instead of pouring aid, the global organizations have now realized that a well structured microfinance programme, where the low income people participate and improve their quality of life, is the way forward.

Recent research has revealed the extent to which individuals around the poverty line are vulnerable to shocks such as illness of a wage earner, weather, theft or other such events. These shocks produce a huge claim on the limited financial resources of the family unit and non-availability of effective financial services to these unbanked, can drive a family deeper into poverty that it can take years to recover.

The poor and low income households need tools to lift themselves out of poverty and Microfinance is often considered one of the most effective and flexible strategies in the fight against global poverty. The poor and their microenterprises in the region are a diverse group. Their demand for micro-financial services reflects this diversity. The collective demand of these groups for financial services is large and the types of services they demand vary across households and microenterprises and over time. This large demand and the heterogeneity of services needed over time have created scope for financial intermediation on a commercial scale.

The interest in microfinance has burgeoned during the last three decades; multilateral lending agencies, donor agencies, governments, NGOs all support the development of microfinance. More importantly, a variety of private banking institutions has also joined the group in recent years. As a result, microfinance services have grown rapidly during the last decade, from initial low level to the forefront of developmental discussions on poverty reduction.

However, researchers and practitioners generally agree that the poorest of the poor are yet to benefit from microfinance programs in most countries partly because most MFIs do not offer products and services that are attractive to this category. Thus, to increase the overall impact of microfinance on poverty reduction, it is essential to extend a wide range of services on a continuing basis to the poor who are still excluded from the benefits of microfinance.

This paper will broadly discuss about Microfinance, the need for a development strategy for bringing banking to the unbanked through microfinance, the opportunities for the commercial banks and the challenges it poses. Some financial institutions and NGOs have already started microfinance in Sri Lanka in a limited way and the paper will discuss some of the practical aspects and scope for growth of this untapped area.

2. Why Would the Poor Need Financial Services?

It is easy to imagine that poor people do not need financial services, but when we think about it, they are using these services already, although they might look a little different. They do save although mostly in informal ways. They invest in assets such as gold, jewellery, domestic animals, building materials and things that can be easily sold for cash. They bury cash in the garden or stash it under the mattress. They participate in informal saving groups where everyone contributes a small amount of cash each day, week or month and is successfully awarded the pot (Seeitu) on a rotating basis. Some groups allow members to borrow from the pot as well.

2.1 Demand for Savings

Poor and low-income households and their microenterprises have a large demand for safe and convenient deposit services. This demand reflects the importance of savings for these households and microenterprises for a variety of reasons. The poor need to save for emergencies, investment, consumption, social obligations, education of their children and many other purposes. They have the capacity and willingness to save. Savings are important for microenterprises and provide them with a major source of investments funds. The large demand for deposit services among the poor is confirmed by empirical evidence. The cooperative rural banks in Sri Lanka had 5 million deposit accounts at the end of 2005. Extensive use of informal savings arrangements by poor households is another indicator of their demand for savings facilities. In some countries, the poor pay high prices to those providing deposit services. The demand for deposit services is particularly strong among poor women in the region.

However widely used, these informal savings mechanisms have serious limitations. In kind savings are subject to fluctuations in commodity prices, destruction by insects, fire, theft or illness (in the case of livestock). Informal rotating saving groups tend to be small and rotate limited amounts of money. Often these groups require rigid amounts of money at set intervals and do not react to changes in the members ability to save. Perhaps, most of the time poor are more likely to lose their money through fraud and mismanagement in informal savings arrangements than depositors in formal financial institutions.

2.2 Demand for Credit

The demand for microcredit that originates both from households and microenterprises is also large. Poor households in the region require microcredit to finance livelihood activities, for consumption smoothening, and to finance some lumpy nonfood expenses for purposes such as education (e.g. school fees and books), housing improvements, and migration. Many Asian countries have numerous small farms and their operators also require microfinance services. The other source of demand is nonfarm microenterprises, which cover a wide array of activities such as food preparation and processing, weaving, pottery, mat and basket making, furniture making, and petty trading.

2.3 Demand for Insurance & Other Services

The demand for other financial services among poor and low-income households and their microenterprises could also be significant. A good share of rural households borrow, many more save, but all seek to insure against the vagaries of life and therefore the demand for insurance services among the poor is vast. A private insurance company in Bangladesh that started to provide micro-insurance services to low-income households on a commercial basis, for example, found that its client base was expanding rapidly. At the end of 1999, this company had over 800,000 clients, about 50,000 of which are considered poor. This experience shows that the supply of such services creates its own demand because the real demand for such services remains hidden when suitable products are not available in the market.

2.4 Why there is limited access to financial services for the poor?

There are a number of reasons for the limited access of formal financial services by the poor.

(i) lack of money to open savings accounts
(ii) lack of knowledge about various savings products
(iii) not having collateral to secure a loan
(iv) no credit record or no formal employment to be eligible for a personal credit line
(v) inability to complete necessary paper work, since illiterate.

On the other hand, traditional Banking System or the formal institutions are not designed to help those who do not already have finance records. In summary a variety of reasons contribute for financial exclusion of the poor and low income households. In remote, hilly and sparsely populated areas with poor infrastructure, physical access itself acts as a deterrent. From the demand side, lack of awareness, low income / assets social exclusion, illiteracy act as barriers. From the supply side, distance from branch, branch timings, cumbersome documentation and procedures, unsuitable products, language, staff attitudes are common reasons for exclusion. All these result in higher transaction cost apart from procedural hazards. Hence, the poor usually approach informal commercial and non-commercial money lenders without getting into the formal financial service market. The ease of availability of informal credit sources makes them popular even if they are considered costlier.

The informal credit market is thriving and in Sri Lanka, total money circulated is estimated at almost 50% of the formal financial market and the interest rate charged is enormous, between 5% - 15% per month (ie effective rate of 60% - 180% p.a.). Sometimes on a daily basis the effective interest rates charged are much higher, reaching 300% p.a. On the other hand, research indicates a very high recovery rate for such informal facilities due to various recovery practices, ruthless in a sense, and used by the informal lenders. The informal finance market in Sri Lanka is the subject of another paper in this volume.

3. What is Microfinance? How it Defers from Microcredit?

To most, microfinance means providing very poor families with very small loans (microcredit) to help them engage in productive activities or grow their tiny businesses. Over time, microfinance has come to include a broader range of services (credit, savings, insurance, etc.) as we have come to realize that the poor and the very poor who lack access to traditional formal financial institutions require a variety of financial products.

As per ADB's definition of microfinance, it includes provision of a broad range of financial services such as deposits, loans, payment services, money transfers, insurance to poor and low income households and their micro enterprises.

ADB categorise microfinance service providers as

(i) formal institutions such as rural banks and Corporations
(ii) semi informal institutions, such as NGOs
(iii) informal sources such as money lenders and shopkeepers

3.1 Emergence of Microfinance

Whilst microfinance refers to loans, savings, insurance, transfer services and other financial products targeted at low-income clients, "Microcredit" refers to a small loan to a client made by a bank or other institution. Microcredit can be offered, often without collateral, to an individual or through group lending.

Microcredit came to prominence in the 1980s, although early experiments date back 30 years in Bangladesh, Brazil and a few other countries. The important difference of microcredit was that it avoided the pitfalls of an earlier generation of targeted development lending, by insisting on repayment, by charging interest rates that could cover the costs of credit delivery, and by focusing on client groups whose alternative source of credit was the informal sector. Emphasis shifted from rapid disbursement of subsidized loans to prop up targeted sectors towards the building up of local, sustainable institutions to serve the poor. Microcredit has largely been a private (non-profit) sector initiative that avoided becoming overtly political, and as a consequence, has outperformed virtually all other forms of development lending.

With the emergence of Microfinance those who were previously considered "un-bankable" because of lack of collateral were offered financial services. Once given the opportunity, not only did clients of Microfinance Institutions (MFIs) expand their businesses and increase their incomes, but their high repayment rates demonstrated that the poor are capable of transforming their own lives given the chance. This model of lending disproved all conventional thinking. Thus, microfinance was born. Since then, microfinance has become one of the most sustainable and effective tools in the fight against global poverty.

Developing countries in the region have used microfinance services to reduce poverty. About 21 percent of the Grameen Bank borrowers and 11 percent of the borrowers of the Bangladesh Rural Advancement Committee, a microfinance NGO, managed to lift their families out of poverty within about four years of participation. These services also had a significant positive impact on the depth (severity) of poverty among the poor. Extreme poverty declined from 33 percent to 10 percent among Grameen Bank participants. The studies have, in general, shown that microfinance services have also had a positive impact on specific socioeconomic variables such as children's schooling, household nutrition status, and women's empowerment. MFIs have also brought the poor, particularly poor women, into the formal financial system and enabled them to access credit and accumulate small savings in financial assets, reducing their household poverty.

3.2 How Microfinance Works

The most common microfinance product is a microcredit loan - usually less than $100. These tiny loans are enough for hardworking micro-entrepreneurs to start or expand small businesses such as weaving baskets, raising chickens, or buying wholesale products to sell in a market. Income from these businesses provides better food, housing, health care and education for entire families, and most important, additional income provides hope for a better future.

In addition, the poor, like all of us, need a secure place to save their money and access to insurance for their homes, businesses and health. MFIs are now innovating to help meet these needs, empowering the world's poor to improve their own lives. The global repayment rate for microcredit loans is higher than 95 percent, which allows MFIs to re-lend these funds to even more clients. By giving the world's poor a hand up, not a handout, microfinance can help break the cycle of poverty in as little as a single generation.

3.3 Why Microfinance is Successful

The traditional banking system requires that a borrower has collateral to obtain a loan. The world's poorest people have no such collateral. Further, traditional banks are not generally interested in issuing small loans - $50 to $150 - as the interest benefits do not exceed the transaction costs.

Then how has microfinance been so successful?

Microfinance institutions exist in many forms - credit unions, commercial banks and, most often, non-governmental organizations (NGOs). Many microfinance institutions (MFIs) use social collateral in the form of peer groups to ensure loan repayment. Borrowers take out loans in groups of five to eight individuals. If a borrower defaults on her loan, the entire group typically is penalized and sometimes barred altogether from taking further loans. This peer pressure encourages borrowers to be very selective about their peer group members and to repay loans in full and on time, resulting in the higher than 95 percent repayment rates industry-wide.

Microcredit loan cycles are usually shorter than traditional commercial loans - typically six months to a year with capital payments plus interest, payable weekly. Shorter loan cycles and weekly payments help the borrowers stay current and not become overwhelmed by large payments.

Clearly the transaction-intense nature of weekly payment collections, often in rural areas, is more expensive than running a bank branch that provides large loans to economically secure borrowers in a metropolitan area. As a result, MFIs must charge interest rates that might sound high - the average global rate is about 35 percent annually — to cover their costs.

For a financial institution to scale and remain sustainable, at a bare minimum it has to cover its costs. In the example below, a large bank (big lender) can charge anything over 14 percent to recoup its costs, whereas the MFI has to charge a rate of at least 31 percent to cover its costs.

TOTAL COST OF ADMINISTERING A LOAN		
	Big lenders (eg.Banks)	Microfinance Institutions
Cost of Capital	10%	10%
Loan loss	1%	1%
Total cost of capital	11%	11%
Total amount of loan disbursed	$1,000,000	$1,000,000
Loan size	$1,000,000	$100
Number of loans	1	10,000
Yearly transactions	4-12	120,000-520,000
Cost of administering loan	3%	20%
Total Cost to Institution	**14% (11% + 3%)**	**31% (11% + 20%)**

Source: www.unitus.com

It should be noted that although MFIs may charge rates of 30 to 70 percent to cover their costs, these interest rates are still significantly lower than the 300 percent to 3,000 percent annual rates that many borrowers were previously paying to informal money lenders, and are typical of the local credit card interest rates.

3.4 Impact of Microfinance on Women

There are many reasons why women have become the primary target of microfinance services. At a macro level, it is because 70 percent of the world's poor are women. Women have a higher unemployment rate than men in virtually every country and make up the majority of the informal sector of most economies. They constitute the bulk of those who need microfinance services.

Targeting women has also proved to be a successful, efficient economic development tool. Research performed by the United Nations Development Programme (UNDP) and the World Bank, among others, indicates that gender inequalities inhibit overall economic growth and development. A recent World Bank report confirms that societies that discriminate on the basis of gender pay the cost of greater poverty, slower economic growth, weaker governance, and a lower living standard for all people.

Women are usually the primary or sole family caretakers in many developing countries. Helping them gain additional daily income improves the condition of their entire household. Putting extra income in women's hands is often the most efficient way to affect an entire family, as women typically put their children's needs before their own. Children are more likely to complete their education and escape the poverty trap than their parents. Giving women access to microcredit loans therefore generates a multiplier effect that increases the impact of a microfinance institution's activities, benefiting multiple generations.

HSBC in Sri Lanka together with SAPSRI (an NGO assisting low income women in urban and rural areas) commenced a microfinance programme in 2006 to assist 400 low income families to achieve a sustainable livelihood. All beneficiaries are women who are engaged in small scale businesses such as operating small salons, sewing apparels, selling of lunch packets, fish, etc. In addition to microfinance, they are also taught to manage their money. Disbursement is carried out by HSBC whilst loan monitoring and recovery is handled by field officers attached to SAPSRI. So far this project has shown very good progress and is promising.

3.5 When Microfinance is not an Applicable Tool

Running a program with substantial default rates undermines the very notion of credit and destroys credit discipline among those who could repay promptly but who look foolish given that many do not.

Microcredit is only useful in certain situations, and with certain types of clients. As we are finding out, a great number of poor, and especially extremely poor clients exclude themselves from microcredit as it is currently designed. Extremely poor people who do not have any stable income – such as the very destitute and the homeless – should not become microfinance clients, as they will only be pushed further into debt and poverty by loans that they cannot repay. As currently designed, microcredit requires sustained, regular, and often significant payments from poor families. At some level, the very cause of poverty is the lack of a sustained regular and significant income. Even though a family may have a significant income for extended periods, it may also face months of no income, thereby reducing its ability to enter into the type of commitment demanded today by most MFIs. Some people are just too poor, or have incomes that are too undependable to enter into today's loan products. These extremely poor people, at the bottom percentiles of those living below the poverty line, need safety net programmes that can help them with basic needs; some of these are working to incorporate plans to help 'graduate' recipients to microfinance programmes.

Microcredit serves best, those who have identified an economic opportunity and who are in a position to capitalize on that opportunity if they are provided with a small amount of ready cash. Thus, those poor who work in stable or growing economies, who have demonstrated an ability to undertake the proposed activities in an entrepreneurial manner, and who have demonstrated a commitment to repay their debts (instead of feeling that the credit represents some form of social re-vindication), are the best candidates for microcredit. The universe of potential clients expands exponentially, once we take into account the broader concept of 'microfinance'.

4. Banks Entry to Microfinance and their Strategies

In the 1970s, a new wave of microfinance initiatives introduced many new innovations into the sector. Several pioneering enterprises began experimenting with loaning to the poor and underserved.

The first fully-incorporated microfinance and community development bank was ShoreBank, founded in 1973 in Chicago.

Economics professor Muhammad Yunus is often credited with disbursing the first microloan in Bangladesh in 1974. He later went on to found the Grameen Bank and was awarded the 2006 Nobel Prize for his efforts.

Grameen Bank pioneered the model of providing small loans, usually to groups of five rural women for economic activities such as small-scale textile production. Commercial banks have shunned the concept, but its success speaks for itself. Of the $5.72 billion total Grameen has disbursed over the years, over $5.07 billion has been repaid (as at August 2006). Grameen is unique in that it would extend its loan repayment time by six months, or even a year if the borrower is unable to pay back and never writes off a loan. Given that social alienation from a peer group can be detrimental to survival in a rural community, borrowers are said to always repay their loans. The loan recovery rate exceeds 98% and presently they have 6.67Mn of borrowers of which 97% are women. The bank has 2,250 branches covering over 72,000 villages with total staff of over 18,000 and now has branches in India, Pakistan, China, Indonesia, Philippines, USA, Latin America and the Middle East.

Given the success of these models, several MFIs stepped in and now banks are striving to bring banking to the poor. Empowering the unbanked, who comprise some 80 percent of the world's population, is a mission some of the world's biggest players also have taken on. The sector, growing between 20-40 percent per year for the last 10 years has attracted the likes of global banking giants Citigroup, Deutsche Bank and HSBC to name but a few, so much that this phenomenon is "not so micro" anymore.

In the case of Citigroup, microfinance has not only proven lucrative, but has staying power. The bank first became involved in the field back in 1965 with a $5,000 grant and today has been active in over 50 countries providing grants to 178 microfinance partners. In 2004, it launched Global Microfinance, a business group that focuses on developing commercial relationships with MFIs enabling the latter to offer a wider range of services to the poor.

Citigroup uses a wholesale strategy - develops commercial relationships with MFIs. Their approach has been not to go direct to microlending. In fact, we bankers have a lot to learn before embarking on microlending. However, the cost of originating loans through this model of dealing directly with MFIs is higher than say a Grameen or a financial institution devoted to the cause. The losses associated with the strategy are mainly connected to high risk of penetration from the outside.

The model, however, is win-win for both sides: for banks without the network, domestic knowledge, and grassroots know-how reach to enter this hitherto untapped sector, while MFIs strive to accomplish their noble mission of empowering the poorest of the poor. As downscaling is difficult for global banks, Citi indirectly reaches the poor and books both the assets and risks on their balance sheet, while MFIs continue to conduct the intimate day-today handling of the loan disbursement and repayment process among microfinance loan recipients.

Some banks however are going straight for the bulls-eye. Those with ground presence and ambition can afford this strategy.

In Sri Lanka, HNB started Microfinance way back in the 1990s through their "Gami Pubuduwa" scheme where loans ranging from LKR25,000 are being distributed for borrowing groups and individuals through the branches. At present HNB employs approximately 100 field officers to disburse and monitor payments and so far over LKR5Bn have been disbursed with a very high recovery rate of over 95%.

Ceylinco Grameen is another institution involved in Microfinance in a larger scale employing over 2400 field officers operated through 81 branches. Over LKR11Bn has been disbursed by Ceylinco Grameen to-date with an average loan size ranging from LKR30,000 to 350,000. A unique feature in this microfinance scheme is the insurance cover provided to the recipient of microcredit. The recovery rate is near 100% whilst interest rate of approximately 25% is charged.

5. Microfinance - Current Position

The World Bank estimates that there are now more than 7,000 microfinance institutions, serving some 16 million poor people in developing countries. Experts estimate that 500 million households benefit from these small loans. Cambodia and Kenya were put forward as examples. Asia and the Pacific region represent 83% of the opened accounts in developing countries, which is equivalent to 17 accounts for 100 persons. In November 1997, more than 2000 delegates from 100 countries gathered at a Microcredit Summit in Washington DC, with the goal of reaching 100 million of the world's poorest families, with credit for self-employment and other financial and business services by the year 2005. Support for these goals has come from prominent world leaders and major financial institutions.

Numbers of MFIs and Total Client Numbers Reporting to
Microcredit Summit

Year	Number of MFIs	Number of Total Clients	Number of "Poorest" Clients*
1997	618	13.5 million	7.6 million
1998	925	21 million	12.2 million
1999	1,065	23.6 million	13.8 million
2000	1,567	30.7 million	19.3 million
2001	2,186	55 million	26.9 million
2002	2,572	67.6 million	41.6 million
2003	2,931	80.9 million	54.8 million
2004	**3,164**	**92.3 million**	**66.6 million**
***(< $1 per day or bottom half of those living below national poverty line when first loan is received)**			

Source: State of the Microcredit Summit Campaign Report 2005

The Economic and Social Council of the United Nations proclaimed the year 2005 as the International Year of Microcredit to call for building inclusive financial sectors and strengthening the powerful, but often untapped, entrepreneurial spirit existing in communities around the world. There are five goals associated with "The Year of Micro Credit" which are:

1. Assess and promote the contribution of microfinance and microcredit to the MDGs;
2. Increase public awareness and understanding of microfinance and microcredit as vital (parts of the development equation;)
3. Promote inclusive financial sectors;

4. Support sustainable access to financial services, and
5. Encourage innovation and new partnerships by promoting and supporting strategic partnerships to build and expand the outreach and success of microcredit and microfinance for all.

6. Market for Microcredit

The prospect for the microcredit industry in general is strong. The market is growing rapidly and supply can hardly keep up with demand. It is estimated that only 4 percent of global demand for microfinance services is being met. It is noted that the potential global microfinance market is worth roughly $300 billion, although estimates vary widely. Also with the growing development of the microfinance sector, sources of funding for MFIs have diversified. Official donors are no longer the primary source, as tens of microfinance funds and more and more private sector investors are also offering capital to MFIs and are rapidly commercializing microfinance. These investors are typically private-sector funding arms of donors and socially motivated, privately-managed investment funds financed by public and private capital. Although both types of investors generally take a commercial approach in the rigor of their investment analysis and monitoring, they are not always fully commercial in the sense of trying to maximize profit.

Microfinance has great potential to financial institutions in the region provided traditional models are changed. "Barefoot Banking" which is a new concept for the financial institutions to approach rural areas, understand the lifestyles and provide microfinance is fast emerging. These institutions have realized that it is the traditional and established way of doing microfinance centrally, that makes it a costly challenge for the banks. However, if both deposit and lending sides of the consumer is captured, a lender would be in an ideal position to monitor the credit.

For example, in Fiji where difficulties of penetrating the market with branches are synonymous with rural areas, ANZ Bank goes direct to the poor people with mini kiosks in the back of small banking trucks traveling in convoy from village to village providing banking to the poor, not just micro credit. Deposit taking activities are also carried out as these visits are made on regular basis at a prefixed time / day of the week.

7. Challenges for the Future

If we truly wish to succeed in providing microfinance services to the poor on a large scale, further contributions are desperately needed. This is not only an issue of financing. Regulators and governments, in particular, need to develop legal and regulatory frameworks for microfinance, consumer protection, and financial infrastructure. Also prudential supervisors can contribute to the growth of microfinance by defining clear criteria for microfinance institutions.

Recent developments in the industry is opening new opportunities. Today, microfinance institutions are providing a wide range of services to their clients such as savings, remittances, transfers and increasingly, micro-insurance. In the Philippines, advanced technology is being used as new vehicles for delivery of microfinance services. The use of mobile phones in selected microfinance transactions is a specific example. Here low value payments that characterize microcredits are linked with electronic cash platforms of telecommunication companies to lower transaction costs, increase productivity, minimize cash on hand risk and to increase overall accessibility of financial services. Microcredit model is now extensively used in the Philippines to deliver micro-agric credit (to cater to the needs of agriculture sector, especially poor farming households). The regulators in Philippines, Bangkok are now reviewing the provision of housing microfinance which could boost the needs of low cost housing sector.

The regulator in Philippines has conducted networking meetings between commercial banks and microfinance institutions. To encourage lending to this sector, it now recognizes microfinance loans of commercial banks to non-bank microfinance institutions as alternate compliance to the mandatory credit allocation to small enterprises.

7.1 Regulatory Developments In Sri Lanka

Given the diverse entities including NGOs that are carrying out microfinance services in Sri Lanka, establishment of a regulatory and supervisory mechanism for this sector has been a long felt need. Since funds held by MFIs are those of the poor and vulnerable, if such funds are mismanaged, the poor will inevitably sink further into poverty and lose confidence in the financial system, thereby impeding their savings activities. Given the growing microcredit sector, failure of several MFIs could also pose a threat to financial system stability. On these considerations, drafting of Microfinance Institutions Act has been formulated.

Microfinance for the purpose of this act is defined to be the "acceptance of deposits or receiving and/or obtaining external funds and providing financial accommodation in any form and other financial services, particularly to low income persons and to small and micro enterprises". The act is expected to cover licencing of MFIs and regulation of their activities by the Central Bank. However, licenced commercial banks, specialised banks, finance companies, cooperative societies registered under the Cooperative Societies Law and non-profit organizations which accept deposits only from registered members with the approval of the Monetary Board are exempt from licencing requirement. Further the Act recognizes MFIs operating at 4 different levels, namely the National Level, Provincial Level, District Level and Divisional Secretariat Level and specifies a minimum capital requirement for each operating level. The core capital requirement for operating at National Level is expected to be LKR 50 Mn.

Going forward, once enacted Licenced Microfinance Institutions (LMFIs) are required to publish their financial statements within 5 months after the expiry of each financial year. Another important aspect of the Act is the requirement that LMFIs maintain a Deposit Protection Fund and the power given to the Monetary Board to take necessary action to safeguard the depositors through deposit insurance. The MFI Act is now being finalized and is expected to become law in latter part of 2007, which is a welcome move.

8. Conclusion

A new microfinance paradigm is taking shape, with the goal of developing full-service for-profit banks for all poor people. These banks and financial institutions will be able to support their clients' effort to control family risks as well as capitalize on business opportunities. They will offer saving, insurance, remittance services, and personal and business loans, to help clients grow their assets while increasing their incomes.

There is however, criticism towards microfinance institutions as well. On a larger scale, some argue that an over-emphasis on microfinance to combat poverty will lead to a reduction of other assistance to the poor, such as government welfare. Some argue that microcredit as a privatization of public safety-net program. There is also criticism that success of the microcredit model has been judged disproportionately from a lender's perspective (repayment rates, financial viability) and not from the borrowers. For example, high repayment rate does not reflect the numbers of women who are repeat borrowers, and have become dependant on loans for household expenditure rather than capital investment. Some experts argue that microfinance institutions are overly dependent on external capital.

Despite the criticism, Microfinance as a financial solution has grown in the last decade and is fast catching up in the Asian and South American regions since it helps the poor to increase income, build viable business and reduce their vulnerability to external shock. It is a powerful instrument for self empowerment of the poor, especially women, to become agents of change. Some local banks and financial intuitions have already made in-roads into microfinance and before long other financial institutions will enter into this untapped economic segment to bear promising results not only for fiscal purposes but also to develop the wider socio-economic fabric so that they all build a financial community on egalitarian principles.

References

1. The Asian Banker Journal Issues No. 60 & 63 on Retail Banking and Sub-Prime Lending by Christopher Howells.
2. Microfinance Development Strategy, Asian Development Bank website www.adb.org.
3. Financial Inclusion – The Indian Experience, speech by Ms Usha Thorat, Deputy Governor of Reserve Bank of India at Financial Inclusion Conference, London, 19 June 2007.
4. Graham Wright and Leonard Mutesasina, "The relative risks to the savings of poor people" Small Enterprise Development, September 2001.
5. The Economist: The hidden wealth of the poor; A Survey of Microfinance, November 2005.
6. Providing Wider and Deeper Access to Microfinance, speech by Mr Amondo M Tetongo, Governor of Central Bank of Philippines, June 2007
7. "Microfinance – Small Loans, Big Difference" speech by Dr Nout Wellink, President of Netherlands Bank and Chairman of the Basel Committee on Bank Supervision at the Roosevelt Academy, June 2007

8. Central Bank of Sri Lanka - Annual Report 2006

External Links

9. United Nations Capital Development Fund (http://www.undef.org)
10. www.unius.com
11. Grameen Bank at a Glance (http://www.grameen-infor.org)