globalvoices

When microfinance & megafinance meet

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GLOBAL VOICES

Global Voices is a non-profit organisation seeking to promote an understanding of and participation in international diplomacy by young Australians.

We do this through regular events and research & development opportunities in Australia, and the coordination of youth delegations to important diplomatic forums abroad.

***Our mission** is to provide opportunities to young Australians to research, discuss and contribute to foreign policy both at home and abroad.*

***Our vision** is for young Australians to be heard and engaged on the world stage.*

G20

The Group of Twenty (G20) Finance Ministers and Central Bank Governors was initially established in 1999 to connect leading industrial and developing economies to discuss key issues that are affecting the global economy. The first Leaders' Summit was held in Washington in November 2008.

The G20 replaced the older and more exclusive Group of Seven (G7) nations and Group of Eight (G8) nations and has now established itself as the premier forum for international economic development, particularly in the wake of the economic crisis that affected the world in 2008.

The constituent nations of the G20 are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Republic of Korea, Mexico, Russia, Saudi Arabia, South Africa, Turkey, United Kingdom and the United States of America. The European Union is also represented, with the Managing Directors of the International Monetary Fund (IMF) & World Bank participating in an ex-officio capacity.

Australia's role in the G20 has grown significantly since 2009, with former Prime Minister and current Foreign Minister, Kevin Rudd, noting the transition to the G20 marked the 'first time ever that [Australia] has had a place at the top economic table of global economic decision-making'

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Executive Summary

Sustainable and effective methods of eradicating global poverty are of high priority on the agenda of the G20. This is because poverty reduction is generally associated with an increased standard of living, a higher level of education and greater economic opportunities for individuals. Furthermore, nation states which engage in poverty reduction strategies can simultaneously transition their economies from dependent ones to diverse and sustainable ones.

The paper assesses microfinance collectively as a tool and through its main services, namely credit, savings and insurance, highlighting merits and limitations of each. Analysis of the above leads to innovative ways for the G20 to add value to this movement.

Motivation for the G20's involvement is evident with social inclusion as a permanent agenda item. The G20 has recognised microfinance as a key to reduction of poverty. I recommend that more concrete action be taken by the G20, through funding of MFIs and supporting the introduction, development and efficiency of microfinance by working alongside governments to fulfil the Nine Principles for Innovative Financial Inclusion.

The issue of women in microfinance is identified and analysed. The oppression of women as individuals and as a community is addressed. Microfinance enables women to develop their capacity for financial management. The G20 is a catalyst to change the systematic disadvantage of women, drawing the significance from the experience of the Grameen Bank of Bangladesh of the transition for women.

The paper concludes that microfinance is valuable for the reduction of poverty. . It also recognises that poverty cannot be solved with microfinance as the only model. The limitations of microfinance are examined, identifying the appropriate context for microfinance institutions (MFIs).

Introduction

Microfinance is the provision of financial services to those who are excluded from borrowing from commercial banks. This is particularly important for women. Many countries of the Global South need greater access to an integrated set of financial and health services to secure stable income and better access to health services. This in turn can help individuals escape the self-perpetuating poverty cycle and move from economic dependency to sustainability.

Microfinance was initiated during the 1970s, when Muhammad Yunus founded the Grameen Bank in Bangladesh, the oldest and most known microfinance institution (MFI) in the world. Today, microfinance continues to grow at a significant rate, reflecting the continual support from governments and positive feedback from the poor.

This paper has three main aims. Firstly, to analyse the effectiveness of microfinance as a tool to reduce global poverty and to discuss what other tools should be used in conjunction with microfinance. Secondly, to assess whether the G20 has sufficient motivation to extend beyond being a political forum for economic agendas to encompass social agendas as well. If so, I will assess the influence the G20 can have to promote financial inclusion globally. Finally, I will highlight the particular importance of microfinance for women and investigate how the G20 can further promote this strong movement for women in the Global South. I will subsequently draw conclusions on the issues above and suggest action today and into the future.

The effectiveness of Microfinance

The principle of microfinance is to provide financial services such as credit, savings and insurance to those who lack access to commercial banking. Muhammad Yunus said that the only thing the Global

South was missing was opportunity.[1] His theory suggests that microfinance allows the poorer communities to partake in the economy. They will have the opportunity to become micro-entrepreneurs and begin small businesses in an economy. Hence, they will experience and understand what is necessary to maintain a business and escape the cycle of poverty. Microfinance is a tool to educate the poor by simulating the characteristics of a developed economy. Therefore, microfinance firstly helps individuals out of poverty but also educates them on the workings of any advanced economy. Furthermore, the optimism microfinance gives to people can be the catalyst for their escape from poverty. For example, a recent study by an economist from Massachusetts Institute of Technology found that people believe that 'getting out of poverty seems to require a quantum leap'. The optimism 'makes it very possible for the poor to hope for more than mere survival'[2]. To escape the cycle of poverty, the poor must become independent. The education, experience and optimism of escaping poverty through their efforts develop the independence this requires. They must understand that for any capital received, there is an expectation of returning it. The motivation for microfinance is that pure charity encourages dependency which lacks long term sustainability, particularly when coupled with mechanisms which improve the efficiency of microfinance including education, record keeping capacity and group solidarity.

While the primary focus of microfinance is on credit, microfinance also includes the provision of other forms of financial services to poor clients. Microsavings and microinsurance add significant value to these micro-economies. The formal system of microsavings adds the value of extra security, higher returns, quicker access to money and greater anonymity. The movement forward from poverty needs to be a holistic system and savings are paramount for the development of such countries. In everyday activities, credit and savings are the core financial services. However we should also note the poor are not exempt from personal emergencies and disasters. These

[1] *"Creating a World Without Poverty"*, 13 May 2012 from <http://www.muhammadyunus.org/Publications/creating-a-world-without-poverty/>.
[2] *"Hope springs a trap"*, 13 May 2012 from <http://www.economist.com/node/21554506>.

unfortunate circumstances do create a circular nature to poverty and discourage families and communities whose efforts have been lost due to the financial and social implications of such events. Just like in developed economies, the value of insurance is unparalleled. Any project which implements microfinance must promote insurance. Additionally, these projects must create understanding of the value of insurance amongst communities and strong incentives for individuals to purchase insurance. The scale of microinsurance has been significant over the last few years, with large multi-national insurers such as Allianz Insurance[3] and Swiss RE[4] investing resources into this market. In 2011 in Ethiopia, Swiss RE made a total of $17,392 to more than 1,800 farmers who experience drought conditions. This is evidence of how microinsurance in poorer communities has added value and prevented these individuals from spiralling back into poverty from disaster. It is important to note that microinsurance should not be provided exclusively from foreign insurers. There should be the development of small domestic insurers to avoid the dependency of international support.

Whilst the advantages of microfinance seem quite evident above, there are significant flaws. Poverty is a complex issue and microfinance alone cannot eradicate poverty. There is significant division amongst those considered poor. Microfinance is a movement which targets relative poverty. Microfinance can only address communities with access to some income earning opportunities. These communities are ones with certain levels of infrastructure and education. Microfinance would fail for those communities which lack even basic infrastructure. There is no value in credit in such communities. Communities with absolute poverty need aid so that these very basic necessities are met. From there, they can hope to form some sort of independent economy, perhaps through microfinance. Furthermore, the small scale business of many clients makes it impractical to devote

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[3] "*Microinsurance*", retrieved 12 May 2012 from <https://www.allianz.com/en/about_allianz/sustainability/microinsurance/index.html>.
[4] "*Pilot Microinsurance Program Has a Successful Payout to over 1,800 Ethiopian Farmers after Drought*", retrieved 12 May 2012 from <http://microfinanceafrica.net/tag/swiss-re/>.

ample time and significant incomes and saving amounts. Providing a viable financial system for such clients would be unrealistic.

Earlier described as the more "sustainable" approach to poverty, microfinance is not self-sufficient. Economically speaking, the poor are still quite dependent on developed nations. A savings rate cannot simply be higher than the borrowing rate, particularly in a community where any borrower has significant credit risk. Microfinance institutions are not completely self-sustainable and need continual funding to encourage people to use such resources. Just as microcredit and microsavings are unsustainable, insurance is much the same. Many of the multi-national companies who have shown interest and support for microinsurance are doing it as a part of their aid program. Whether it is possible and they decide to maintain this as a new long-term contribution to the marketplace is unknown. With little data, proper valuation is difficult, as is providing cheap and affordable premiums for policyholders. Apart from pricing, the lack of structure sees many communities contributing to unrealistically high expenses and opportunities for fraudulent claims.

Therefore realistically, microfinance cannot solve the complex issue of poverty alone. It can add significant value for relativity poor economies, contributing to facilitating the transition from poverty to economic independence. This transition is evidently still dependent on the support of developed economies and/or the rich in their own countries and does provide significant challenges. Evidence of the success of microfinance is the Grameen Bank founded in 1983. In 2010, the bank had over 8.3 million members, with over 96% of them women and a 96% loan recovery rate.[5] However as suggested, it still receives much funding, with most coming from issuance of bonds guaranteed by the Government of Bangladesh.[6]

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[5] "*2010 Annual Report – Highlights*", retrieved 12 May 2012 from <http://www.grameen-info.org/index.php?option=com_content&task=view&id=1109&Itemid=960>.

[6] Morduch, Jonathan, "*The role of subsidies in microfinance: evidence from the Grameen Bank*", retrieved 12 May 2012 from <http://www.nyu.edu/projects/morduch/documents/microfinance/Role_of_Subsidies.pdf>.

Therefore, there is significant evidence that microfinance can add value to the Global South in certain circumstances. I have highlighted that microfinance must be used in conjunction with aid in such contexts. In such circumstances, I believe there is strong evidence to suggest that microfinance adds more value than if the funds are used in other ways.

Impact of the G20 on Microfinance

The G20 was established as a group of finance ministers and central bank governors from 20 major economic nations who periodically meet to cooperate and consult on major issues pertaining to the international monetary system. The G20 aims to bring upon both financial and social stability in the monetary system. Microfinance should therefore be a key priority of discussion for the G20. It was upgraded to head of government in 2008 as a response to the global financial crisis.

The motivation for the G20 to support microfinance is firstly because of the principles on which the G20 is founded on. They 'help create an enabling policy and regulatory environment for innovative financial inclusion'.[7] There is still mixed opinions on the effectiveness of microfinance due to the difficulty of monitoring and measuring the impact. However, Nicholas Kristof stated there is no evidence for negative influences from microfinance. Rather the countless examples of people now looking at the bigger picture and saving for better things should be celebrated.[8] As seen above, certain circumstances do cultivate microfinance principles of help to transition individuals and communities from poverty into a more independent state.

Consequently, the G20 leaders' documents have continued to include further discussion on social inclusion and microfinance, particularly in the 2010 Toronto and 2010 Seoul Summits. The growing support sees financial inclusion as a 'permanent policy priority by establishing the Global

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[7] *"Principles for Innovative Financial Inclusion"*, retrieved 12 May 2012 from <http://www.g20.utoronto.ca/2010/to-principles.html>.
[8] Kristof, Nicholas, *"The Role of Microfinance"*, retrieved 12 May 2012 from <http://kristof.blogs.nytimes.com/2009/12/28/the-role-of-microfinance/>.

Partnership for Financial Inclusion and committing to the Principles of Innovative Financial Inclusion'[9].

There is no doubt that the G20 has motivation to support microfinance but there are questions on the extent they can impact the success of microfinance programs on a global scale. The key impact that the G20 can have on microfinance is through providing the framework and consultation to governments who should perhaps use microfinance as a tool as well as providing aid to help fund the movement.

Despite the important role that microinsurance plays, it still remains a very minor component within the broad field of microfinance. The G20 has potential to help microinsurance gain scale by providing stronger incentives for multi-national insurers to enter the market. These primary barriers of entry can be reduced by the G20's support for microinsurance. Firstly, they must facilitate an education facility so that policyholders can see the value of insurance, just as they have for other financial services. Secondly, the G20 should work closely with the International Monetary Fund to collate and distribute data on the Global South. Sufficient data gives confidence towards insurers to price appropriately. With both potential clients and appropriate data for premium valuation, many insurers will enter this new market both for financial and social benefits for their company. It is important to note that the G20 should help facilitate independence from external insurers. A government guaranteed domestic insurer would be in the best interests of a domestic economy compared with a multi-national insurer. The G20 should help facilitate and regulate this transition to ensure the creation of microinsurers and help this subset of microfinance continue to gain scale as required.

The Nine Principles for Innovative Financial Inclusion highlights that the G20 want to cooperate with governments to empower and protect the individuals and communities by bringing leadership and

[9] "*Microfinance and Financial Inclusion"*, retrieved 13 May 2012 from <http://go.worldbank.org/XZS4R3M2S0>.

framework to the economy.[10] The G20 consists of the top economists and finance ministers of the world and hence is arguably the best positioned organisation to create an environment that promotes the social inclusion required. It is paramount that the G20 does not take sovereignty of a nation while trying to assert their opinion.

Women and Microfinance

Women suffer a disproportionate percentage of the world's poor. This suggests that significant efforts should channel into poverty alleviation strategies specifically designed for women.

Within poorer (and better off) nations, women are systemically disadvantaged. The term "feminism of poverty" describes political, social and cultural disadvantages of women in the world's poor. Women in many countries of the Global South tend to work longer hours for significantly less pay, are restricted to lower class jobs, are often the victims of physical and sexual abuse and tend to be the most disadvantaged in terms of access to health care and education.[11] Cultural patriarchy and domestic violence are obstacles inhibiting the ability of many women to save their incomes and gain economic independence. These social and cultural disadvantages are the barriers preventing the empowerment of women and eradicating the feminism of poverty.

Microfinance programs have the potential to empower women in developing nations, with anonymity of microfinance being particularly important for women. There are very few microfinance products to address gender specific needs. These include safety deposit boxes and match savings.[12] While most microfinance programs are not gender-specific, females are the primary users of microfinance. In 2010, Grameen Bank of Bangladesh had over 96% of members being women.[13] Such

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[10] *"Principles for Innovative Financial Inclusion"*, retrieved 12 May 2012 from <http://www.g20.utoronto.ca/2010/to-principles.html>
[11] *"Women and Poverty"*, retrieved 13 May 2012 from <http://www.globalpovertyproject.com/infobank/women>
[12] Vonderlack, Rebecca & Schreiner, Mark, *"Women, Microfinance, and Savings: Lessons and Proposals"*, retrieved 12 May 2012 from <http://www.microfinance.com/English/Papers/Women_Microfinance_and_Savings.pdf>
[13] *"2010 Annual Report – Highlights"*, retrieved 12 May 2012 from <http://www.grameen-info.org/index.php?option=com_content&task=view&id=1109&Itemid=960>

institutions can facilitate an improvement in a woman's socioeconomic status by enabling them to control their own income and allow proactive choices regarding quality of life. Positive impacts can also be transferred to a woman's family.

Contrary to the social prejudice that poorer women are not creditworthy, disadvantaged women proved to be good risks and efficient users of credit.[14] Despite this, in many traditional societies such as South Asia and East and Central Africa[15], women have been excluded from the market economy. Family and community ties may contribute to the success of the creditworthiness of women.

The value microfinance adds for women is profound. The empowerment of women as individuals and family members is evident. However, women as members of society and larger environment are still yet to be seen as equals. There has been minimal shift in values and expectations about roles in society. The traditional stance of the status of a woman still stands, with political and cultural forces dominating over the individual woman's empowerment. This is the largest shortcoming of microfinance for the development of gender inequality among the Global South.

The G20 should intervene such that it promotes microfinance schemes and eliminates the systematic discrimination of the political and cultural stigma attached to women.

The general analysis of the impact that the G20 can have for microfinance can be extended to females as they are the primary users of microfinance. Furthermore, the G20 should a have particular focus on engineering women-specific products such as safety deposit boxes and match savings. Also a significant proportion of funding from the G20 members should be allocated towards women-specific programs. The additional funding allocation to safety deposit boxes and match savings is important because both products are not self-sustainable. However they are fundamentally important mechanisms that eliminate the feminism of poverty through the

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[14] *IFAD in the News: Poverty Reduction - A little credit goes a long way Poverty Reduction: A little credit goes a long way*, retrieved 13 May 2012 from <http://www.ifad.org/media/news/2004/150204.htm>
[15] *Ibid.*

development of poor women. The benefit of this empowerment is more beneficial than the financial costs associated with facilitating them.

It is paramount that the G20 not only address the sustainable empowerment of women but also influence the political and cultural forces that limit the capabilities of women. The G20 is a uniquely positioned political body that can help women overcome their oppression within their country. The G20 should cooperate with the involved governments and MFIs, presenting the facts about the profound impact that women can have to the economy. Funding through the G20 should be conditional on the involved nature of women in microfinance. Historically, MFIs recognise the contribution of females and are activists for the development and equality of women in the Global South. The G20 should assert this opinion to governments, on behalf of women, to attempt to break down the sigma of the traditional societies. The financial incentive, the overwhelming evidence for women's success in microfinance and support from MFIs will help influence the government to adopt such practices and eradicate the feminism of poverty. Bangladesh evidenced this shift. Women involved in microfinance today have a changed role in their families and their community. Women in Bangladesh no longer believe they should be dependent or confined to the home with these beliefs accepted in the wider community.

Conclusion

This paper offers evidence that microfinance is an effective tool. By providing financial services such as credit, savings and insurance, many communities of the Global South are given experience, education, opportunity and optimism. These are fundamental components in breaking the cycle of poverty and are essential to empower individuals to become economically independent members of society. While microfinance cannot address all the issues pertaining to poverty, there exist communities where microfinance, financed by foreign aid, is the optimal tool. The G20 does have sufficient motivation to support the financial inclusion microfinance creates and henceforth can help this movement gain scale. The core actions that should be taken include providing consultation and framework for economies that are positioned to embrace microfinance for their development and support many of the existing and emerging MFIs.

With the feminism of poverty and a majority of microfinance clients being women, gender-specific microfinance is paramount. The women are given the experience, education, opportunities and optimism. However, this paper has highlighted the necessity to liberate women as a community collectively. This difficult and multifaceted task is one which can be addressed by the influence and significance of the G20. There must be goals to empower the women of the Global South.

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