W A Wijewardena: Microfinance – issues in the current context

Keynote address by Mr W A Wijewardena, Deputy Governor of the Central Bank of Sri Lanka, at the Seminar on Microfinance Services in Sri Lanka, Colombo, 29 June 2009.

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A new word that has been added to Sri Lanka's vernacular usage recently has been *"sakvithi"*. This word has so far not got into lexicographers' lexicon in its new sense. Literarily, it means the "Chief God of Heavens". But, the contemporary media have used it in a different sense, drawing on a recent episode of fraud that had ended up pauperising many investors who were ambitious of high gains. Hence, its contemporary meaning has been clear even to its first-time spotters. The picture created in the mind when one hears the word is not that of a god but a man: a man bent on deceiving others with false promises of unusually high gains, but at the end, finishes up by appropriating to him their wealth. It is also the picture of a man who has played with the psychological frailties of people with crafty marketing and propaganda by projecting himself as a saint, friend and saviour. Those who fall for his artful schemes will get one thing for sure: complete loss of their life-time savings. It, therefore, foretells of shattering of hopes which they may have cherished about a better future as well.

Sakvithi's lessons for microfinance

Sakvithi episode is not an isolated incident of breach of trust. It received so much of media attention due to three reasons: sheer magnitude of the amounts defrauded, high-society profile of some of the investors and the glamorous sainthood that had long been afforded to the man responsible for losing people's money. There are many more such schemes where people willingly invest without properly assessing the risk and the return. They often fail to ask the simple question which anyone with a fortune may have asked before parting with his money: could the schemes continue to generate a high income to pay a high return indefinitely in the future. But the desire to become rich quickly mars their rational mind and they unknowingly fall victim to the promise of high returns.

What can microfinance learn from this? A lot. When one analyses the sakvithi episode, by disaggregating its tragic final outcome into sub components of devices employed, each such sub component teaches us a valuable lesson. These lessons, when viewed from a centric point, boil down to two important aspects of microfinance: the governance structure which microfinance institutions have to adopt and the self-discipline which microfinance beneficiaries should cultivate. Both these important elements in microfinance should not be mere eye-washes to satisfy someone who demands of such behaviour by the respective parties. They should be faithfully and vigorously followed in order to prevent the microfinance industry from meeting with an untimely death.

What normally happens in Sakvithi-style investment schemes?

Sakvithi episode is a classic example of the ability of shrewd persons to exploit society's desire for accumulating quick wealth by skipping the hard path which it should normally take. Hence, it is also an exploitation of people's desire to become rich. This desire is embedded equally in both the poor and the rich: the poor to get out of poverty quickly and the rich to become richer and more influential.

Hence, the schemes of quick high returns are craftily designed to satisfy this psychological desire. Many schemers who pose as micro-financiers too resort to this tactic and the poor unknowingly fall victim to their schemes.

The modus operandi of such schemers has been the same. They would form a microfinance institution because it is in high vogue today and the society is ready to accept it as social responsibility which one should perform for community's benefit. This explicit social legitimacy allows them to operate under the umbrella of microfinance which is artificially boosted by appropriate marketing and fitting propaganda. In this manner, savings are mobilised from the poor and funds are raised from the donors. Eventually, the end-use of resources is not for helping the poor, but for siphoning for other activities. When such activities do not generate a continuous income sufficient to meet the obligations to depositors, the micro-financier is not left with a choice, but to default the savers who had placed their trust in him.

The end result is the deep suspicion which the poor would have about the entire microfinance industry. The authorities too would view microfinance as a destabilising and fraudulent element in the financial system. This leads to a credibility issue and a reputation risk in microfinance industry. Once the industry loses its reputation, it is difficult to regain the same irrespective of whatever is being done by some genuine microfinance practitioners.

The damage to the industry is done by some "black sheep" who are not controllable by other genuine performers. In this manner, the quick returns are earned by "ill-willed" practitioners, but the social cost has to be borne by the entire industry.

Hence, the major challenge faced by microfinance industry today is to save itself from the spurious micro-financiers.

Who is a poor person?

The poor are normally defined by reference to income level or calorie intake or the level of opportunities available. All these definitions represent some aspects of the poor which are important. Yet, they do not accurately depict the real nature of the poor.

A poor person is a person who is unable to assess the risks faced by him and take the required mitigating measures to avoid them. The risk factor is more suitable to identify the poor, because the poor have to operate in a market which is full of risks. If he can successfully wade through the risks, he could succeed in the market as well. If he fails, he would remain a poor forever having to depend on outside help.

Greed is the killer

Not many in a society would be able to correctly assess the risks faced by them. If they are unable to assess the risks, then, they cannot expect to take risk mitigating measures as well. Many reasons can be adduced to this general failure of individuals to assess risks appropriately. They may not have been taught to assess risks. Or, their risks would have been assumed by others, chiefly the government, and as a result, the moral hazard behaviour would have prompted them to take unnecessary risks. Even when they are educated and there are no opportunities for moral hazard practices, they may still take risks purely guided by their extreme greed. When the greed overtakes the rational mind, the individual may be blind to what he would get if the scheme fails. People belonging to both rich and poor categories fall into this last category. It is these people who normally fall easy prey to cunning tricksters who are planning to strip them of their wealth by making false promises.

All that is necessary is to arouse, by means of a well-orchestrated marketing plan, their greed. The spurious micro-financiers use person to person contact method to outreach potential victims and lure them to leave their wealth in the hands of total strangers. The promise of high returns is so tempting that individuals who are in other circumstances perfectly rational and ready even to advise others of good investment outlets get carried by enchanting talks and end up losing their money.

The responsibility of microfinance practitioners

The wide-spread existence of spurious microfinance institutions in the society projects the entire microfinance industry as a fraudulent activity in the eyes of the public and law enforcement authorities. This is not a healthy sign for the future of microfinance industry at all.

Microfinance practitioners should put a stop to this unhealthy development by establishing a proper governance structure in microfinance institutions. They teach the poor of the importance of and the need for leading a responsible life. This responsible life includes behavioural traits like being truthful, being honest, being respectful and being exemplary. The cultivation of these qualities in life makes the poor wholesome individuals and that is the ultimate goal of any microfinance intervention in the society.

If the microfinance practitioners do not practise what they preach, then, it is a serious lapse of the governance structure of microfinance institutions. Since governance principles are rules of good behaviour and there is no effective way of ensuring their proper practice, the practitioners should make an extra effort to follow them. It requires full commitment and devotion on the part of microfinance practitioners and, in turn, depends on the personal qualities which they have cultivated in themselves. Such quality developments come from long-term training, discipline and fear of losing credibility and reputation. In other words, microfinance practitioners should have the long-term sustainability, and not quick profit, as their goal.

It is, therefore, necessary to develop microfinance practitioners before they are allowed to develop microfinance beneficiaries.

Noble eight-fold path is a guide for everyone

The Buddha preached the Noble Eight-fold Path to be followed by both the kings and the subjects alike. It is a complete personal development programme for those who aspire to become successful and be of help to others in the society.

It is a moral code that requires people to speak rightly, act rightly, live rightly, make efforts rightly, know rightly, concentrate rightly, think rightly and understand rightly.

The Noble Eight-fold Path is not a moral code that should be enforced by means of a moral law. It is simply a voluntary action which everyone should follow for his own benefit and for the benefit of others.

In essence, the Noble Eight-fold Path converts the followers to be truthful, honest, respectful and exemplary. When these qualities become essential traits of the personality of those who run organisations, such organisations do not have to worry about governance principles. That is because, in such organisations, right practice and right men become totally inseparable from each other.

Above all, such organisations would not attempt to cheat their customers by offering them seemingly attractive, but spurious investment programmes.

Moral development is equally important as technical development

Laws can promote good governance but they cannot ensure its adoption in organisations. The experience of many regulators is that, on many occasions, organisations vociferously announce of governance principles, but in practice, totally disregard them. In other words, with respect to governance, there is a wide gap between what is on paper and what is actually practised.

In the case of microfinance institutions, this gap has to be eliminated totally. A sure way to do it is to develop microfinance practitioners both morally and technically. To attain a high performance level, technical developments are necessary; but, without moral development, its sustainability cannot be guaranteed.

Hence, the moral development of microfinance practitioners must receive the highest priority in any microfinance training programme. In simple terms, they should cultivate truthfulness, honesty, respectfulness and exemplar in them. A mere technical knowledge without these quality traits in-built into their personality would be meaningless as far as the future of microfinance industry is concerned.