Opening remarks: financial inclusion and the regulation of microfinance

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Financial crises illustrate a fundamental flaw in the way the current financial system is organised. The financial institutions and banking systems of advanced economies focused on big banks and big customers. This system embodies a kind of financial apartheid; two thirds of the world's population are excluded. Unless we bring these people into the financial system, crises will keep recurring.

Grameen finances everyone. It has demonstrated that even beggars can be financed. We have around 100,000 beggars in the programme: they borrow small amounts of money to buy goods that they can offer for sale when begging from door to door. Some have left begging this way and started their own businesses.

Grameen Bank has 8.3 million borrowers, of whom 97% are women. The bank borrows no money from the outside, it is entirely self-financed. It takes deposits from people and gives small loans to poor people. So far it has given more than $10 billion in microloans, with a recovery rate of 97%.

The issue for this audience is how to make this story happen in Africa. Women in Africa are at the forefront of the fight for equality of financial access. Microfinance already exists in Africa. But, in my view, it should be done by specialised institutions, not commercial banks or NGOs. The issue is how to make such microfinance institutions part of the mainstream banking system. In Bangladesh, a special banking law was created for Grameen Bank. I think we should aim for a banking law for banks for the poor.

Grameen is the reverse image of existing banking systems. Banks finance rich people; Grameen finances the poor. Banks finance men; we finance women. Banks lend in cities; we lend in villages. Banks lend money against collateral; we ask for no collateral. Banks depend on lawyers; Grameen has no lawyers. In fact, we knew nothing about banking when we set out to establish Grameen. But, in a way, this did not matter – our goal was to create self-employment, not profit.

Today it is easier to establish such a bank with the new technology that is available. Young people should be job-givers, not job-seekers. They should think of how to create jobs, not how to make themselves employable. Developing an open financial system and making available the benefits of new technologies will help us reach the UN's Millennium Development Goals.

Recently there has been some controversy about microfinance in Mexico, and lately also in India. The controversy stems from the fact that the original goal of microfinance from the 1970s was abandoned when microfinance institutions turned to profit-making rather than supporting self-employment and job creation. Microfinance led some people to strive for profit rather than social goals.

This is the reason why a special legal framework is needed to support microfinance. Microfinance cannot operate in a vacuum; it has to be regulated. But the regulatory authority needs to be separate from the central bank because regulating microfinance is different from regulating conventional banks. Microfinance is about "social business", not profit-making business. The social dimension concerns the selfless part of human beings, ie solving problems such as creating jobs for others, not the selfish part, which is concerned with profit-making. Traditional banking regulation deals with banking as a profit-making business. It is not equipped to regulate microfinance.

Question and answer session between central bank governors from Africa and Muhammad Yunus

Q: What can central banks do to facilitate microfinance? How should regulation of microfinance differ from regulation of commercial banking?

A: Some banks in the West, such as Raiffeisen and Banque Populaire, started out as credit cooperatives, taking deposits from members and granting them small loans. But, over time and with commercial success, they have all turned to conventional banking. That is why a special law is needed for microfinance. Without such a law, microfinance will end up being a collection of different lending programmes.

Central banks can help draft and pass microfinance legislation. But they are not well placed to regulate microfinance. One needs a separate institution, where people with different skills and a different mindset work. It should work as a fully separate entity. Central banks don't understand the concept of lending without collateral. To use an analogy, you can't hire a coach from a European football team to train an American football team.

Q: Some central banks have a special unit in charge of microfinance regulation, but have observed that microfinance providers do not like to be regulated. They often lend for consumption. Their main problem is the cost of funds. Some borrow from commercial banks to fund their loans. Others find it difficult to collect microsavings. In view of this, should governments provide seed money for microfinance, eg allocate grants from which low-interest rate loans could be given?

A: Microfinance should not provide loans for consumption. It should provide loans for income-generating activities, not for food purchases.

Regarding funding, promoting microfinance through government funding is not a good idea. Rather, microfinance should be proper banking, ie it should take deposits and lend money, in this case to the poor.

Borrowers can also have savings accounts. Even the poorest women understand how such an account works. Half the deposits in Grameen Bank come from borrowers' deposits.

Q: Taking issue with the idea of separate regulators, some countries had separate regulators for commercial and cooperative banks, the latter often funded by donor money. But cooperative banks in many countries have nevertheless failed. In small countries in particular it might be better for the government to finance targeted groups of the poor via the budget. This would eliminate worries that non-payment problems could contaminate the rest of the banking system.

A: Cooperative banks in Bangladesh are a disaster as well. They are regulated from the ministry of finance, they are politicised and engage in rent-seeking. A group of people can create a cooperative bank in order to catch a pot of government money. In contrast to cooperative banking, microfinance is transparent and does not serve special interests. In Bangladesh, 16 million families are involved in microfinance.

The minute the government gets involved, microfinance gets a very different dynamic: if government money is involved, borrowers take it that they don't have to pay it back. And the government wants to control lending for its own purposes. This is the reason why one needs a separate regulator for microfinance.

Q: Who should supervise microfinance institutions if not the central bank or the government? If the microfinance system fails, the consequences in a poor country could be worse than if the banking system had failed.

A: It should be a separate, specialised institution, preferably outside the central bank, where it is not likely to get enough attention. It can have separate managing and oversight boards, the former working under central bank governor's direction. In Bangladesh, the central bank governor heads the authority for regulating microfinance. But this institution is outside the central bank.

The point on systemic importance is well taken. Remember that 70% of the population in poorer countries doesn't have access to the commercial banking system.

Q: How can one ensure that microfinance institutions fund investment and not consumption? The poor do not all have business acumen.

A: Microfinance should only support income-generating activities, never consumption. The motive behind consumption lending is selling goods and services to the borrowers. The motive behind microfinance is giving people the chance to get out of poverty through self-help and belief in their own abilities. All human beings are entrepreneurial; this is something innate. The human race came into being through work. Society must give opportunities to unlock that potential. Microfinance is in essence a self-exploration process.

Q: How does microfinance differ from lending to small and medium-sized enterprises?

A: Microfinance is about the poor. SMEs are far removed from the object of microfinance. We lend beggars in Bangladesh $12–15. An average microfinance project loan is for less than $200. Microfinance starts from the bottom and grows up. It is about poverty eradication, using the potential that people have.

Q: How far and in what capacity should commercial banks be involved in microfinance?

A: Some commercial banks are starting to promote microfinance as a boutique programme. But they seem to take it up mainly for public relations reasons. It is not where their minds and hearts are. Microfinance institutions should be built outside the conventional banking system.

Commercial bankers do not understand microfinance; they are simply not equipped for it. They try to impose the lending conditions they are familiar with. With microfinance one has to be innovative and take the view that it is also a social responsibility.

Q: How do new technologies such as mobile phones and financial innovation more generally affect the environment for microfinance?

A: We have only started to scratch the surface of the possibilities that mobile phone technology has opened up for microfinance. We all have to think very hard about ways to explore this new technology.