Muhammad bin Ibrahim: Rethinking microfinance norms

Special address by Mr Muhammad bin Ibrahim, Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Global Symposium on Microfinance, Kuala Lumpur, 22 May 2017.

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Thank you for the opportunity to speak today at this Symposium. Bank Negara Malaysia is pleased to host this event together with the World Bank. We are also pleased to have Finance Minister II, Yang Berhormat Datuk Seri Johari Abdul Ghani present with us to address the audience here today.

It has been almost six decades since the economist John Kenneth Galbraith observed that few things are more evident in modern social history than the declining interest in inequality as an economic issue. Today, financial and economic inclusion is given priority as a policy agenda, as the global economy confronts an environment of rising income inequality and tepid global growth. According to the World Bank, the distribution of income globally is highly unequal today with a Gini coefficient of 70.7, up from 68.4 in the 1980s. In some countries, income inequality has in fact risen sharply.

The challenge of income inequality is even more prominent in Asia. A Working Paper published by the IMF in 2016, highlighted that in Asia, the average Gini coefficient has risen by 4 points from 36 in 1990 to 40 in 2013. Over the same period, the average Gini coefficient for the rest of the world rose by only 2 points. This is against the backdrop that Asia experienced an average GDP growth rate of 9.6 percent. This suggests that trickle-down economics has failed to deliver equitable growth.

We should expect that if significant segments of the population are systematically excluded from the tools that drive success, there will be economic consequences. Financial access and education are arguably two of the most critical tools that enable individuals to achieve success. Yet, around 50% of the global population live on less than USD2.50 per day, most of them without access to formal financial services.

That is almost one in two people who, given the opportunities that come with financial access, could be making much greater contributions to society, and consequently, raising economic potential. We also learnt that, stagnating median wages have discouraged the low and middle-income from saving and investing.

Against this backdrop, microfinance has captured the global imagination of policymakers, development institutions, private enterprises and donors alike to promote greater financial inclusion. Yet over the last few decades, since Grameen Bank entered the world's consciousness, microfinance has had a mixed experience. World views on this subject have also become more polarised. Some consider microfinance to be the panacea (which it is not) to end poverty, others have been highly critical of its abuse to exploit the poor.

These characterizations are very diverse but it is useful feedback that we should ponder. These contrasting views illustrate the complexities and challenges associated with the subject. Microfinance, like all public policies, faces the challenge of implementation. From a financial stability perspective, it is about introducing riskier and less experienced borrowers into the financial system. Hence, the implementation aspect is critical, especially in the attempt to balance the trade-offs between financial stability and inclusion. This is never an easy task. For every success of microfinance, we have seen some failures. One example that comes to mind is the case of a large Asian economy in 2010 where the unrestrained growth of micro lending led to high debt stress among borrowers, financial instability, and sensationalized newspaper accounts of suicide among borrowers.

However, these challenges must not sway our resolve to further the cause of microfinance. We must continue to find new and more efficient implementation strategies. Forums such as this give us an opportunity to examine these issues more closely, and share successes and pitfalls so that others might benefit. We therefore welcome the publication of the World Bank's report on financial inclusion in Malaysia which we hope will also hold useful lessons for others.

Malaysia has devoted significant focus to the sustainable development of microfinance over many years to boost growth and improve welfare. More than 75% of businesses in Malaysia are micro enterprises, and 40% of Malaysia's households earn incomes below USD850 (RM3,650) a month. The view that distribution, not just aggregate growth matters, is therefore, a view that resonates strongly with us.

William Faulkner, the famed American writer and Nobel laureate, once spoke of the all-important virtue of "trying until we get it right". He urged writers to "throw away anything that is false, no matter how much he might love that page or paragraph". In a similar vein, Malaysia's microfinance journey has been one of trial and error, as we continuously strived to increase the social and economic impact of microfinance, sometimes working against the tide of popular thinking. This has led to a more nuanced approach to the development of microfinance over time, and an ongoing process of rethinking norms which we may take for granted today.

Today, I would like to talk about three perspectives that have shaped the way we approach and implement microfinance in Malaysia.

First, technology when used in a clever way, can be of great use. While technological advancements hold great promise for expanding access to financial services for the poor, we need to invest time and resources to understand the factors that affect the poor, and the suitable approach to generate income and create wealth. These insights are what will determine whether technology is central or peripheral to the inclusion agenda.

Second, the tradeoffs between financial stability and inclusion requires smart management. A microfinance strategy that focuses largely or wholly on providing credit to the unserved is almost destined to fail, potentially leaving communities worse off from excessive debt burdens. Instead, implementation strategies should ensure that the provision of credit are complemented by the necessary safeguards and financial education.

Third, successful microfinance programs are fundamentally compatible with sound commercial and management principles and practice, and normally have two things in common; an obsessive focus on operational innovations and the ability to create powerful synergies.

We have built on these premises to continuously adapt, amplify and align our approach. This year, we have embarked on an initiative, working with the Credit Guarantee Corporation in Malaysia, to develop behavioral insights that will enable microfinance providers to integrate business and technological strategies that best serve the poor. The initiative will leverage on analytics to identify drivers of borrower behavior, and expand the use of psychometric tools by financial providers to develop financial solutions that are more responsive to the needs and circumstances of micro borrowers.

A deeper understanding of borrower behaviors also provides a solid foundation for executing successful operational strategies. In fact, operational innovations – even those that represent small adjustments to existing processes – can have a far more important impact on smart design than a costly, hi-tech re-tooling of financial services.

Our experience in Malaysia suggests that simple changes in application procedures and faster processing times have encouraged a higher take-up of microfinance. Flexible repayment schedules have also enabled borrowers to better manage irregular cashflows while continuing to meet their repayment commitments. Repayment reminders, delivered in ways that are relatable to the poor (for example, “your repayment can help your friend in need”), can help keep repayments current. Working through local community groups to engage borrowers, or identifying with religious tenets to overcome weak willpower to repay, are some experiential learning that creates favorable conditions that can expand access to credit and encourage high repayment rates.

These “small nudges”, a notion popularized by behavioral scientist David Halpern, allow us to re-visualise how operating models and technology can be adapted more effectively and efficiently to deliver sustainable microfinance solutions.

Malaysia’s microfinance journey has also reflected a wider focus on developing the broad range of financial services that are needed by the unfortunate to manage and improve their financial circumstances. Credit is important, but not all important. Savings, insurance, business training and financial education are other key components of our program approach which work together to amplify the economic and social impact of microfinance.

The largest microfinance institutions in Malaysia are also among the largest mobilisers of micro savings. As a case in point, our National Savings Bank ranks among the top three financial institutions in the country with the largest number of micro-loan and savings accounts. Overall, 92% of the population have a deposit account, compared to 42% who have a loan account.

We are also currently working to expand the offering and take-up of micro insurance solutions under a multi-pronged strategy that combines tailored products offered by insurance companies and development financial institutions, and a universal product option available through low-cost mobile and other channels.

Documented studies have shown how simply introducing an affordable, safe and accessible avenue for savings resulted in increased spending towards healthcare, education and nutrition. It has empowered women with more decision-making power and enabled children to spend more on school supplies that ultimately led to better test scores. Insurance has also been shown to play an important role in encouraging micro enterprises and low income households to make productive investments without the fear of natural disasters or medical emergencies wiping away their hard-earned assets and savings.

By providing opportunities and the foundational knowledge to low income individuals and entrepreneurs to gain access to credit, increase savings and manage their exposures, this would greatly improve the probability of success in business and enhance socioeconomic mobility. This in turn will bring many important benefits to society.

These benefits might be difficult to quantify but are obvious and far reaching. This is illustrated in the story of a Malaysian micro-entrepreneur who spent 10 years selling raisins and dates from street corners in and around Kuala Lumpur. He travelled daily to and from night markets and mosques on his motorcycle; his fortunes often at the mercy of unpredictable weather. But opportunity beckoned when a micro loan was obtained in 2011, which enabled him to rent a permanent physical space and invest in a basic logistics system to stock and deliver goods to customers. With the continued support of his bank, business grew, three more stores were opened and sales increased fivefold. He secured greater financial security and independence for his family and at the same time, created jobs for 10 persons within his community. As a contribution to his community, one of the three branches was dedicated for micro-entrepreneurs in the locality to showcase their products, free of rental.

This simple and generous gesture to share resulted in positive spillovers, where some once wayward school-leavers and young adults received the opportunity to become owners of small businesses plying delicate handicraft and innovative accessories.

There are many examples such as this, that if done right, can create a virtuous cycle of expanded positive spillovers that uplift the community as a whole.

Despite what seems to be an increasingly crowded space, microfinance often ends up being relegated to government-sponsored institutions, non-profit enterprises and donor organizations, because it is perceived to be financially unsustainable if a certain scale is not achieved (usually very large) or imposing high interest rates to hedge risks or cover high operational costs. A growing body of experience shows that the reverse is necessary to deliver a lasting positive impact on the lives of the poor.

I have alluded earlier that aligning operational strategies with behaviors of micro borrowers can improve loan performance, thus reducing risks to lenders. In insurance, traditional agency-based distribution models are being disrupted to lower the costs of on-boarding and servicing micro policyholders. These are clear ways in which the trade-offs between higher perceived risks, accessibility and affordability associated with the micro segment can be managed more optimally. Sustainable microfinance programs are often successful if synergies are realized.

Between governments, policymakers, microfinance institutions and donor organisations, significant synergies can be unlocked by aligning incentives, reducing barriers and enhancing coordination.

The agent banking framework implemented in Malaysia has been a successful model where industry is able to capture opportunities for cross-sector strategic partnerships that can transform the microfinance landscape. Collaborative strategies to deliver solutions on telco and e-commerce platforms are similarly redefining new business models.

For donors, the adoption of performance-based rewards should be strongly encouraged to focus on microfinance institutions to effectively serve their mandate. The reward system should take into account outreach, financial performance and impact on wellbeing.

Another important point is that, regulators and supervisors should ensure regulatory framework should be proportionate in balancing innovation, inclusion and stability.

Conclusion

All of us have an important role to play in confronting the stark reality that the socio-economic dividends of a global wealth and growth need to be cascaded to all. The vulnerable segment cannot afford to wait for trickle-down growth.

As policymakers, we should be concerned with effective financial intermediation and sustainable growth. We are duty-bound to make sure that the fruits of economic prosperity are more equitably shared. As a community, we are morally obligated to provide opportunity and hope for the unserved to improve their livelihood.

Malaysia’s journey will not track exactly the same path as others, nor should we expect it to. But we can all learn something from the footsteps left by others as we move forward. I hope that our collective journeys, as shared in this forum and others like it, will help us harness the full potential of microfinance to build stronger, fairer and more resilient communities.