

Potential of Microfinance for Disaster Risk Reduction



All India Disaster Mitigation Institute

411 Sakar Five Near Natraj Cinema Ashram Road, Ahmedabad 380 009
Tel: +91 79 2658 3607/2658 6234 Fax: +91 79 2658 2962
E-mail: dmi@icenet.co.in www.southasiadisasters.net

Asian Ministerial Conference
7-8 November 2007, New Delhi, India

Content

- Introduction
- South Asia Experience
- Microfinance Tools for Disaster Mitigation
- Key Findings from the Tsunami Recovery
- Risk Transfer
- Key Conclusions

Key Message

“Sustainable access to microfinance helps alleviate poverty by generating income, creating jobs, allowing children to go to schools enabling families to obtain healthcare, and empowering people to make the choices that best deserve their needs.”

Kofi Annan,
Former Secretary General,
United Nations

Introduction

- India and its neighbors are global leaders in terms of microfinance activity, at the same time as the region faces many natural hazards.
- The loss of income generating assets and workplaces in any major disaster creates an increased demand for microfinance services.
- For many, access to microfinance services is the only source of economic assistance as they are not eligible for loans in regular banks.
- Microfinance activities are important elements in future disaster risk reduction, as it prepares the local communities for the next disaster by allowing the poor to make transformation from “everyday survival” to “planning for the Future”.

South Asia Experience

South Asia Experience

- Due to a combination of high exposure to natural hazards and high human vulnerability, South Asia perennially experiences significant losses to disasters.
- Relief operations and rehabilitation often depends on external aid. Support from outside is unpredictable, making recovery for the poor very difficult.
- The humanitarian acts are packed into a 'project' with a clear cut beginning and a perfect end. Humanitarian actors initially provide relief and leave to provide relief to someone else.
- The humanitarian actors know much less about what happens to victims beyond relief and rehabilitation.
- Recovery is not perceived as an opportunity to promote structural changes in development planning and governance.

A Sad Reality



The poor face disasters on a day-to-day basis.

Microfinance Tools for Disaster Mitigation

Microfinance Tools for Disaster Mitigation

Reducing vulnerability	Disaster response
Client-responsive loans	Adaptation of current lending: <ul style="list-style-type: none"> • loan restructuring • switch from group-based to individual liability • adapt current credit products to temporary recovery products • provide emergency subsistence loans • lending moratorium for MFI protection • loan forgiveness and write-offs (not recommended)
Micro credit (housing improvement loans): <ul style="list-style-type: none"> • ensure disaster-resistance and building code compliance 	Emergency reconstruction loans: <ul style="list-style-type: none"> • ensure disaster-resistance and building code compliance
Micro savings (forced/compulsory savings): <ul style="list-style-type: none"> • used to collateralise loans • usually not accessible until end of loan cycle 	Adaptation of forced savings: <ul style="list-style-type: none"> • allow access so clients can withdraw as needed
Voluntary savings	Voluntary savings: <ul style="list-style-type: none"> • clients will withdraw as needed

Microfinance Tools for Disaster Mitigation

Reducing vulnerability	Disaster response
Micro leasing (leasing for assets): <ul style="list-style-type: none"> • with option to purchase at end of cycle for residual price 	Leasing for assets: <ul style="list-style-type: none"> • likely increase in demand
Micro insurance: <ul style="list-style-type: none"> • best established before disaster 	Insurance <ul style="list-style-type: none"> • applicable pay-outs made
Money transfer services	Money transfer services <ul style="list-style-type: none"> • remittances likely to increase
Grants and donations <ul style="list-style-type: none"> • used for increasing purchasing power and building financial discipline. 	Livelihood relief (no repayment) <ul style="list-style-type: none"> • provision of income-generating items (kiosks, carts, machines, seed, stocks, etc.) • cash grants
Non-financial services: <ul style="list-style-type: none"> • training 	Non-financial services: <ul style="list-style-type: none"> • training • information dissemination • distribution of supplies

Key Findings from the Tsunami Recovery

Tsunami Evaluation Coalition

- The Tsunami Evaluation Coalition (TEC) was established after the 2004 Indian Ocean tsunami to assess sector-wide performance of the tsunami response.
- The TEC is a multi-agency learning and accountability initiative of over 40 agencies including the UN, donor governments and NGOs.
- The TEC paves the way for better disaster response and risk reduction.
- Four in-dept country studies contribute to five sector studies on Funding, Capacities, Needs, Coordination, and LRRD.

TEC reports are available at: www.tsunamievaluation.org

TEC's central message

“There is a need to rethink the end goal of humanitarian assistance and move from a service delivery approach to a capacity empowering framework, or in other words to shift the emphasis from only delivery to support and facilitation.”

TEC: Key Findings on Microfinance

- The tsunami response coincided with the International year of microcredit, and there have been significant efforts to mobilize these services...
- The tsunami response again demonstrated that non-financial assistance, whether it be goods-in-kind or tied aid, is less effective and efficient than cash assistance.
- One of the most successful aspects of the response was the use of cash transfers, allowing communities a greater degree of choice than with distribution of material.
 - In Aceh, 90% of surveyed felt that cash was better than food or other relief items.
 - Similarly, in Sri Lanka 53% preferred cash to goods, which was supported by another 12% who felt that cash would enable them to buy what they want.

TEC: Key Findings on Microfinance

- Although the tsunami devastated the livelihoods of many it did not result in mass, entrenched unemployment. One of the factors that contributed heavily was the use of cash in relief and recovery efforts.
- Cash was provided in a number of locations, through cash for work and cash entitlements or grants. Use of cash grants enabled people to use their skills and abilities in their own way. It allowed victims to make appropriate use of economic resources held by the international agencies in a synergistic way.
- The private sector also made significant contribution to the tsunami recovery process. For example microfinance schemes and grants were linked to banking skill development and training. In other words, grants or loans were linked to people opening an account in a bank and starting to use it.

The Case of Sri Lanka

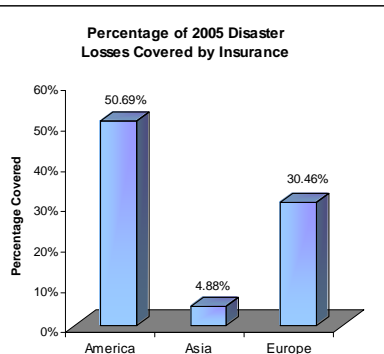
- In Sri Lanka, the 'microfinance revolution' was already experiencing serious problems in terms of poor repayment rates and over liquidity (with too many loan providers casing too few qualified clients).
- The tsunami resulted in calls to expanded lending and soften conditions for repayment, which can ruin the sustainability of the microfinance sector.
- Generous supplies of credit began to flow. In Sri Lanka 85% of the affected people applying for loans had their applications approved.
- Some have seen this as a positive sign demonstrating the usefulness of microfinance in disaster response. It is questionable, however, that a sufficiently large proportion of these people will be able to repay their loans.
- It was reported that the biggest threat to future financial services was not default due to the destruction of the tsunami, but rather a declining culture of credit due to the tsunami aid.

Risk Transfer

“Insurance Reality”

- In Asia, personal, household and small business assets are often unprotected against disasters, and their financial risks are not spread across insurance markets.
- Insurance covers many losses but is often unavailable to the poor due to high transaction cost and the subsequent high premiums.
- Insurance regulatory reforms by the Indian Government and the prioritisation of risk reduction by the UN ISDR, the ProVention Consortium, and DFID have contributed to the viability and advancement of microinsurance for the poor.
- A 2005 survey by AIDMI and the Disaster Emergency Committee identified low levels of risk transfer awareness among communities in India, Sri Lanka and Indonesia.
- HFA priority area 4 notes: “promote the development of financial risk-sharing mechanisms, particularly insurance and reinsurance against disasters”

Are we Funding Losses?



Financial losses to disasters in Asia have significantly less coverage than losses experienced in America and Europe.

Key Conclusions

- The South Asia region is attracting global attention for risk reduction: due to economic acceleration and increasing vulnerability. However, the access of the poor to vital financial services is perpetually restricted.
- It is a great struggle to sustain and run microfinance services in a commercially viable manner, even more difficult to scale up operations.
- The coordinated use of cash grants and loans provided through existing institutions has more potential to succeed than direct implementation by international and national agencies.
- Converging microfinance services and disaster risk reduction efforts can effectively reduce risks. Mitigation matters. Risks must be reduced, not merely covered.

Client is ready.



“Victims” manage the majority of disaster recovery themselves. Microinsurance can help accelerate their efforts.

Like all of you, we want the last
disaster affected poor victim recover
on his/her own two feet.
Thank you!