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CASE STUDY 2.

Microfinance for Disaster Risk Management in Bangladesh

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Microfinance programs are discussed frequently in the context of income generation, productive investment and poverty alleviation. It has become a very important institutional channel of providing financial services to the poor, who lack access to traditional financial institutions. Beginning with non-collateral credit, the ambit of microfinance programs has expanded to include savings and insurance as well. Many of these programs use social mechanisms, such as group-based lending, to reach the poor and other groups, especially women.

While the jury is still divided on the impact of microfinance on poverty alleviation, its role in risk management and vulnerability reduction has been acknowledged more conclusively. Zeller (2001) identifies two principal pathways through which access to financial services can help the poor to manage their risks and smooth their income and consumption. Pathway 1 leads to income smoothing through *ex ante* measures. It involves the provision of credit and savings services through which households can raise finance to enhance the level of the household's productive capital and smooth income. Pathway 2 leads to consumption smoothing through provision of consumption credit, withdrawal of savings, and insurance claims. Consumption smoothing has been shown to be the main objective of household participation in microfinance program in a survey of 1800 beneficiaries conducted in Bangladesh (Pitt and Khandker, 1998; Morduch, 1999).

Applicability of Microfinance for Risk Management

The attributes of microfinance, which are applied in reducing household-level risks, are relevant for reducing disaster risks too (Pitt, 2000). Microfinance instruments help poor households diversify their income by source and season. They also diversify income by earner as it provides opportunities to women to earn. Multiplicity of income-earning opportunities and asset building through microfinance help poor households in dealing



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with disasters better. Microfinance also provides explicit and implicit insurance to the households, though in practice these mechanisms work imperfectly. Some of the other attributes of microfinance which are very helpful in dealing with large-scale disasters are loan forgiveness / rescheduling in the areas affected by disasters, better targeting of relief programs through microfinance networks, better flow of information among the clientele of microfinance organizations, and empowerment of women. An important feature of microfinance is its capacity to build social capital as expressed in specific mitigation measures.

At the institutional level, microfinance institutions (MFIs) offer a number of services, which can help clients in coping with the impact of natural disasters. These services include provision of temporary loans, re-scheduling of loan payment, asset replacement and housing loans, and loans for starting new activities. MFIs provide these services at different stages of post-disaster rehabilitation: relief, recovery and reconstruction. The flexibility inherent in microfinance enables it to serve a wide range of rehabilitation needs after a disaster (Nagarajan, 1998).

Microfinance Institutions' Response to Bangladesh Floods, 1998

The role of microfinance services in responding to disaster risks was demonstrated first in Bangladesh during the 1998 floods. Bangladesh experienced the worst floods in its history from July to September 1998. About 100,000 square kilometer, which is 70 percent of the country's landmass, was inundated for about two and half months. About 30 million people were affected in 52 out of 64 districts. The damages to standing crops, livestock and houses were overwhelming. The income generating activities of rural landless people were almost suspended.

All the MFIs in Bangladesh responded to the unprecedented situation of floods. During the floods MFI workers even went on boats to ensure that weekly contacts with all members were maintained. Workers carried money with them and provided immediate interest-free consumption loans so that the members would not go hungry. They provided a number of financial services as discussed below.



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Savings and Credit Products

Savings: As discussed above, in response to the floods, the MFIs allowed the members to withdraw their savings. The Grameen, the BRAC and many other small MFIs despite a very serious financial consequence for their liquidity, opened access to compulsory savings account in an attempt to reduce the precipitous decline many households experienced in their incomes. In non-disaster times, members of these institutions did not have access to these funds unless they had fully repaid any outstanding loans and decided to leave the program. The BRAC also operated disaster-related deposits, which allowed members to keep their assets safe from loss or damage due to the floods. A number of MFIs such as BURO Tangail, the Association for Social Advancement, SafeSave and others provided voluntary savings facilities to their members. These facilities provided the members more assistance in disasters than compulsory or disaster-related savings with less negative financial consequences for the MFI (Brown and Nagarajan, 2000).

Credit: The MFIs extended credit facilities in several ways. Most of them rescheduled loan repayments, permitting members to delay several repayments on their existing loans. The MFIs carried out the re-scheduling on a case-by-case basis rather than using a “blanket” approach for all affected households in a community. In addition to rescheduling their loans, the MFIs provided quick disbursal loans, often small in size, to help the members address their immediate relief and consumption needs. A number of MFIs also provided loans for economic recovery and reconstruction of houses. However, advancing these loans was problematic for all the MFIs, partly because of their resource constraints, and partly because of the members’ incapacity to take on more debt (Brown and Nagarajan, 2000).

None of the MFIs provided any insurance to their members against disaster-related losses.



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Individual MFIs' Participation in Flood Relief and Mitigation

The Grameen Bank set up a Disaster Mitigation Task Force at the central level. It prepared and implemented a rehabilitation program, which included new loan products, and loan assistance for housing rehabilitation and agricultural production. The Bank gave fresh loans to members who had 5 to 10 installments remaining in the repayment schedule. The borrowers who had already paid half or more of their loans were eligible to take new loans for the amount that they repaid. The first time borrowers who had paid 16 installments were given seasonal loans to start their activities again.

The Grameen Bank members who received housing loan before were given 5,000 Tk again, if their houses suffered damages. Those members who did not get housing loans before were given 2,500 Tk towards the same. Other members whose houses were destroyed but were considered for the housing loan were given a fresh loan to reconstruct their houses (Barua, 1998).

The Bangladeshi Rural Advancement Committee (BRAC), another leading MFI, extended loans to 240,000 families for housing to supplement people's efforts in repairing and rebuilding homes. The loan amount would be mostly used to buy construction or repairing materials. The BRAC purchased 364 tons of rice in the open market and sold it at subsidized rates to group members.

The Proshika took up an emergency rehabilitation program worth 50 million Tk through which 100,000 affected families would be provided an interest-free loan of 500 Tk each. It also supported a credit program worth 30 million Tk for aman, vegetables and winter crop cultivation, to be adjusted during the following yield.

In addition to these credit operations, all the MFIs took up a number of relief and recovery activities, independent of their credit operations. For example, they set up medical centers, distributed food, drinking water, milk, and medicines. They also agreed to support a number of activities in non-farm sector, which would help the flood-affected people to resume their economic activities.



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Palli Karma-Shayak Foundation (PKSF)'s Supportive Role

Palli Karma-Shayak Foundation is the refinancing body for all the microfinance organizations in Bangladesh. The Grameen Bank, three big NGOs, namely BRAC, Proshika, and ASA, and 141 medium and small NGOs are partner organizations of the PKSF. Immediately after the floods, all the MFIs demanded additional funds to maintain their liquidity, as the participant borrowers withdrew their savings, repayment of old loans was deferred, and loans were advanced to the new and old borrowers for rehabilitation needs. The PKSF required 9200 million Tk to meet the demand of MFIs in wake of the floods.

The PKSF responded by disbursing 1000 million Tk to its partner organizations. In the month of October 1998 alone, 640 million Tk was disbursed to help the flood-affected people. The PKSF also disbursed 10 million Tk from its own fund to 138 partner organizations as grant contribution to the "Disaster Management Fund" of the partner organizations. These partner organizations will increase the volume of the disaster management fund from a portion of their income from service charges. If a partner organization failed to repay any installment of PKSF on account of its inability to collect loan installments from the borrowers due to floods, the organization could apply to the PKSF for rescheduling (Ahmed, 1998).

The PKSF also approached the government and the international donor agencies to involve the partner organizations of PKSF in the flood rehabilitation program since the network of PKSF partner organizations offer a solid institutional base to work in the remote areas of Bangladesh.

Strengths and Weakness of Microfinance Institutions and Programs

A number of factors contributed to the effective intervention of MFIs in 1998 floods. Some of these factors were capable leadership, committed staff, sound management and financial practices. MFIs with good leadership responded quickly to the situation, availed of existing disaster mitigation funds, or developed alternative strategies of fundraising to meet the demand for resources. The involvement of committed field staff who visited to assess the damage of affected people was also very important. The close monitoring of the situation was crucial to the



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rehabilitation strategy of the MFIs. It provided reasonably good information on the damage to assets and income of clients, loss of program income as a result of potential drops in savings and repayment. On the basis of the information, MFIs could project capital requirements for loans during the rehabilitation period. Good financial and institutional management including provision of cash reserve, flexibility in management and decision-making, and clarity in chain of command were also effective in responding to the crisis (Nayar and Faisal, 1999; Hassan and Nayar, 1998).

The MFIs in Bangladesh could respond to the floods and withstand its serious financial impact, because they have more than two decades of operational experience. In fact, the newly established MFIs found it difficult to operate due to the increased cost of delivery, loss of income and shortfall of cash for fresh loans. It is clear that there are several factors that limit the role MFIs can play in natural disaster response and mitigation. First, the MFIs do not have the liquidity position to respond quickly or fully in a disaster context. Second, most MFIs are not currently prepared to either weather or respond to a natural disaster situation. Third, most MFIs have not considered client needs from an emergency perspective; rather products and services are primarily geared to day-to-day business or household concerns. Fourth, demand for special services may be small, yet may require significant institutional investment. Therefore, individual MFIs are unlikely to invest in developing or maintaining these services (Parker and Nagarajan, 2000).

Microfinance as a risk management instrument may have its limitations. These limitations arise from the issues of moral hazard, inadequate monitoring of credit programs after large spatial shocks, and reduction in informal insurance arrangements provided by social networks. Many of these shortcomings can be addressed through institutional innovations in microfinance sector. Microfinance also needs to be supported in combination with other instruments of risk management, which include social funds, public works programs, cereal banks, and even public subsidy. Besides, success of microfinance programs always require supportive services and inputs in the area of education, health, irrigation, marketing, etc. (Vatsa and Krimgold, 2000; Zeller and Sharma, 1998; and Zeller et.al., 1997).



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The MFIs' intervention in the wake of 1998 floods was more in nature of the *ex post* mitigation measures. Emergency loans, permission for withdrawal of savings, small advances against savings, loan re-scheduling were some of the financial facilities extended to borrower families for coping with the disaster. However, microfinance has the potential of supporting *ex ante* mitigation measures too. Income generation, diversification of asset base and housing improvements are some of the examples of *ex ante* mitigation measures. These measures contribute to better disaster preparedness on part of the households and communities.

As there is a growing demand for these services, it is likely that the MFIs would diversify their services, and offer special products and services aimed at reducing disaster risks. However, these services require considerable investment in product development and pilot testing. In fact, there is a strong need for public investment in institutional development in microfinance. Zeller and others (1997) argue that from a policy perspective, public support for building rural financial institutions ought, in principle, not be judged on the prospect of achieving financial sustainability of the institution itself, but on the economic sustainability of the public investment. Economic sustainability of a policy implies that scarce public funds are used to maximize social returns, which may reduce vulnerability in both the short and the long run in a more effective way than some other competing policy instruments.



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