

Finance as a “service” industry

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Introduction

Good morning, President Dr. Aiken, Rotarians, guests. I want to first thank you for this opportunity to speak to this most prestigious group. In fact this is a special occasion for me, since during my high school years I participated in the Interact club, I didn't however join Roteract at UWI, but it feels as if I'm come back home.

Today, the talk is entitled *Finance as a “Service Industry”*. When it comes to service, the Rotary Club exemplifies a mission of ‘Service above Self’. So I must note, the significant contribution not only of Rotary club, but all service clubs across Jamaica, for the needed contribution towards nation building and the strengthening of our social fabric.

As it relates to the banking industry, the fact of the matter is that banks are not being seen in the best light by the general public, neither locally nor internationally. We hear about bank fees, costs and charges, dormant accounts, and record profits. But my chat with you this morning, is not not intended to argue for or against, nor to debate the issues, but it is simply meant to describe an economic framework by

which we can conceptualize the fundamental roles that banks can play in providing service to the economy.

Muhammad Yunus: Microfinance

Let me attempt to make this concept a little bit more real by reminding us of the story of the Nobel Laureate, Muhammad Yunus and how he utilized finance to help reshape the economy of Bangladesh.

Most of us will identify Bangladesh with that cricket team that the West Indies could bowl for ducks. But unfortunately, for West Indies cricket team and its fans, times have changed. But imagine with me for a second, Bangladesh, a country with **population of 157 million, more than 50 times the size of Jamaica. Bangladesh has an agricultural economy with GDP per capita of US\$3,900 and has 31.5% of the population living below poverty line. The income and welfare side sounds a little like Jamaica right? Actually not, Jamaica's GDP per capita is estimated at about US\$8,900 (\$1.1 million at the old exchange 128 exchange rate) and 16.5% of Jamaica's population is living below poverty line (\$1700 JA per week).**^{i ii}

So we are imagining the conditions for some in Bangladesh. In 1983, Muhammad Yunus formed Grameen Bank, he did so to operationalize his vision of a “*Bank of the poor*”. From this he became the pioneer of the microfinance/microcredit concept. The term microfinance entails the provision of small loans to the poor to allow them

to establish small income generating activities.ⁱⁱⁱ Yunus operated under a specific philosophical believe that loans are better than charity to interrupt poverty.

“Give a man a fish you feed him for a day, teach him how to fish you feed him for life”.

With this basic business model, **between 1985 and 1994, annual membership of Grameen Bank grew on average by 29.5 per cent. Surprising naysayers, Grameen Bank recorded loan recovery rates above 90%.**^{iv} It cannot be overstated, the impact this bank’s philosophical view had on poverty reduction in rural Bangladesh.

Roles and functions of financial institutions

Now the story of Muhammad Yunus and Grameen Bank is just one special example of how banking can be used to change the life of communities and nations. I want to take the next few minutes to outline how traditional banks provide much needed service to nation building and economic development. I’ll just discuss three main ones. These are the pooling of capital, the deployment of capital, and in the process, capital transformation. Each role is separate and distinct, but intertwines and are self-reinforcing.

Allow me to step into a bit of economic theory. Let me first provide an economic classification of a “service industry”. By definition, this describes business activity

which takes the form of primarily providing service rather than a material commodity.^v In addition, the financial industry as we know, consists of firms and individuals that interact, typically in a complex manner, for the purpose of mobilizing funds for savings and investment.^{vi} This ladies and gentlemen encapsulates the main services as I will describe them.

Service # 1 the pooling of capital- When economists refer to the pooling of capital, we describe the process by which banks facilitate a collective combination of savings (bank deposits). Imagine, without this collective savings, each borrower, each business, would have significant search costs when seeking capital. However instead, one can tap the pooled capital held by banks. **As at June this collected savings held in the form of deposits in commercial Banks stood at J\$ 839 billion, 47% GDP.** This collective savings is then used to provide economies of scale in Jamaica through productive lending and investment.

Service #2 the deployment of capital and reduction in information asymmetries- The deployment of capital by the granting of credit and investment is the course by which our financial sector can help to fuel and drive economic activity. Could we imagine if each individual saver had to seek some return on his or her individual savings and information? It would be costly, burdensome and inefficient. Through experience,

through market intelligence, through specialization, banks are able to enhance the information set and expand the accessible supply of capital for deployment.

Service # 3 the transformation of maturity -In the process of pooling and deploying capital, banks undertake a much valued service by what is called maturity transformation. The majority of deposits are demand or time deposits while loans and investments are typically long term. Imagine a loan environment that was limited to the average time someone demanded their funds. What kind of economy would we have with 3 months loan and investment periods? Here we see how financial institutions service the economy by absorbing the risks through the facilitation of maturity transformation.

What more can be done??

The pooling of savings, investment and transformation of maturity are all well and good, but where are we going and what more can be done? Despite the seemingly iniquitous interest rate differential on savers' deposits and bank loans, or the plethora of fees and taxes, **it still remains that based on 2014 survey data, in Jamaica only 11% of working adults borrowed money from a financial institution, while 25% used a debit card.**^{vii} As we can see from these statistics, the challenges, tasks and opportunities associated with expanding financial reach are clear. Let me just share 2 of the challenges.^{viii}

1. Low usage of electronic instruments and a high reliance on cash - Cash is still “king” for day-to-day transactions. **Only 32% of adults make electronic payments, and in this day and age 65% of wage earners still collect their pay in cash.**

2. There is limited confidence in the finance industry- About half of the Jamaican population has low confidence that the financial system will serve their needs. What compounds this issue is that most do not understand the basics of personal finance. **Statistics show that only 51% of adults report having confidence in financial institutions.**

It was Yunus who asked, *“If free enterprise has no real challenger, then why has free markets failed so many people?”* He made mention that the reason is simple: markets in their current form are not meant to solve social problems and instead may actually exacerbate poverty, corruption, crime, and inequality. The government is trying to play its part. I’ll quote two of the pillars of the Jamaica’s strategy for financial inclusion.

i. Financial Access and Usage: “The Financial Access and Usage pillar supports reforms that will facilitate increased usage of electronic payments, expansion of innovative distribution channels, digitization of government payments, and

development of financial products that channel remittance proceeds into accounts/cards.”

ii. Financing for growth: “The Financing for Growth pillar supports measures that will enable eligible households, businesses and farms to access credit and alternative financing instruments that are currently lacking in the market. “

Those described 2 of the initiatives put forward by our nation leaders on a path forwards.

In concluding, it is clear that the Rotary Club is doing a great service in aiding in the growth of the social well-being of the country. But of note, so too is the financial industry in its own form. The financial sector provides a services that assists both directly and indirectly in the growth and development of the economy. These are the pooling of capital, deployment of capital, reduction in risks through diversification and transformation of capital maturity.

However, there is still more to be done. The financial sector needs to play its vital role in helping to provide service that will reduce social problems. Yunus claimed that if you “*Lend the poor money in amounts which suit them, teach them a few basic financial principles, then they generally manage on their own*”.

Thank you

ⁱ *The World Factbook* — Central Intelligence Agency. (n.d.). Retrieved from <https://www.cia.gov/library/publications/resources/the-world-factbook/>

ⁱⁱ As at 2015, the World Bank global poverty line stood at \$1.90.

ⁱⁱⁱ Bateman, M. (2014). *The rise and fall of Muhammad Yunus and the microcredit model*. Retrieved from <https://www.microfinancegateway.org/sites/default/files/mfg-en-paper-the-rise-and-fall-of-muhammad-yunus-and-the-microcredit-model-jan-2014.pdf>

^{iv} Khandker, S. R., Khalily, B., & Khan, Z. (1995). Grameen Bank: Performance and Sustainability. *The World Bank: Discussion Papers*, (306). Retrieved from <http://documents.worldbank.org/curated/en/658601468768006874/pdf/multi-page.pdf>

^v Stigler, G. J. (1956). The Classification and Characteristics of Service Industries. In *Trends in Employment in the Service Industries* (pp. 47-60). Princeton University Press.

^{vi} International Monetary Fund Staff. (2008). Financial Soundness Indicators: Compilation Guide. International Monetary Fund. Retrieved from <https://www.imf.org/external/pubs/ft/fsi/guide/2006/pdf/chp2.pdf>

^{vii} Based on World Bank Global Findex data 2014.

^{viii} Jamaica National Financial Inclusion Strategy. March 2017. Retrieved from http://boj.org.jm/pdf/Jamaica_NFIS_Final_Draft.pdf