

Digital Transformation of MFIs: A Priority Agenda for Bangladesh's Microfinance Sector

In Bangladesh, many MFIs have undergone digital transformation successfully enabling them to evolve, scale, and compete more efficiently in the rapidly changing financial landscape of the country. The expectations of the customers are also changing rapidly which are increasingly being shaped by their experience with smartphone apps, fintechs, and the social media.

For the MFIs, digitising operations will no doubt emerge in the coming years as one of the most credible ways to meet the changing expectations of their customers in Bangladesh. In reality, realising the vision of a fully-integrated digital operation model needs a successful navigation by the MFIs to complete the necessary institutional transformation. Moreover, since the MFIs belong to different size categories, have different levels of institutional maturity, and are guided by their own specific mandates, a 'one-size-fits-all' menu is unlikely to be applicable to all MFIs in the country.

Moreover, each MFI faces a unique set of challenges in its operation. However, the key issue for the MFIs is to adopt the right mindset

and the most appropriate digitisation process. The 'right' level of digitisation is also likely to vary depending on a number of factors, such as adopted objectives of digital transformation, existing level of maturity of digital transformation, and similar other considerations. The MFIs should take these and related aspects into consideration to place their institutions strategically for meeting future challenges and adopt the 'right' type of digital transformation to better respond to client needs and preferences.

In reality, it is true that not all MFIs in Bangladesh are ready to digitise to the same extent or at the same speed. The need for MFIs is to prioritise the processes for digital transformation based on their current and desired level of digital maturity. Based on available best practices, a framework

may be used to deepen the understanding of digital transformation by specific MFIs, identify digital transformation objectives and maturity for adoption, and take the steps towards adopting successful digital transformation. One can identify several key issues in taking the right decisions:

Choose the right approach to digital transformation:

There exist many approaches and a growing literature of case studies and toolkits are available to help explore which would work best for a specific MFI. For Bangladesh, technology options have been explored and key pillars have been suggested for digital transformation of the MFIs. It is likely that a number of key benefits can result even from small operational improvements through adopting digital approaches. Moreover, guidance on cultural and interpersonal aspects of the digitisation process for the MFIs, case studies, market overviews, industry opinion and research focused on multiple aspects of digital financial services, including strategy, selecting the right technology, agent networks, customer acquisition and data analytics are available from different developing countries to draw informed conclusions for charting out the most appropriate process in Bangladesh. For choosing the right model for the digital journey, six different toolkits—each focused on a different business model—are also available to integrate digital channels into the service delivery approaches of MFIs.

Forge partnership between MFIs and fintechs:

Such partnerships can play an important role in enabling the access to financial services by the MFIs through offering, among others, more choices to the customers and expanding outreach to the excluded people. Such partnership also drives institution-level innovation and helps MFIs to remain efficient.

Secure the right balance between technology and human touch:

During the digitisation journey, this is the key to acquiring and retaining the customers.

Depending on the nature of the market, all MFI customers may not be prepared to involve in fully digital financial products or services due to inertia, perceived lack of trust in digital provision or discomfort in using a new technology. For success in digitising, the MFIs will have to strike a right balance between technology and human touch especially to accommodate the ‘technology-shy’ customers.

Keep pace between digital transformation and required regulatory changes:

For mitigating the digital risks, digital transformation of MFIs should keep pace with the regulatory framework governing the MFI activities. For accelerating the transformation, successful collaboration between the MFIs, digital financial service providers and fintechs is necessary.

Secure clear guidance on digitisation:

To begin with, the MFIs should seek strategic guidance from the management and the required financial and human resources to successfully navigate the fintech revolution and clearly identify the key challenges and opportunities.

Include AI in long-term strategy:

The MFIs should incorporate Artificial Intelligence (AI) as part of their long-term strategy for digital transformation. This is necessary to reduce the costs, manage the risks, and gain a competitive edge in the long run.

The MFIs operate at different stages of digital maturity, such as size category and operational diversity, adopted processes and activities, market conditions and local and industry levels, and their strategic objectives. To begin with, the MFIs should assess their present capabilities and identify the next step required to become more digital for lending and other operations. For the FSPs, three levels of digital maturity e.g. ‘early stage’, ‘base’, and ‘plus’ have been differentiated depending on several factors including which processes have been digitised and to what extent. A similar categorisation to differentiate the MFIs in terms of their ‘digital maturity’ using five key processes of their operations—member

acquisition, loan/services approval, loan/services provision and installment repayment, installment collection, and member engagement may be used to guide the digitisation journey.

Despite unprecedented growth, MFIs in Bangladesh face several internal challenges, e.g. rising dropout rates among the clients, rapidly increasing operational expenses, and risk management and related issues. There exist several other challenges as well, such as multiple borrowing and over-indebtedness among the clients, lack of access to Bangladesh's National Identity Card (NID) database and absence of credit bureau for the MFIs. In addition, the MFIs face restrictive regulations for their entry into the country's payment and remittance systems. In addition to these challenges, the financial sector itself is undergoing rapid changes. The entry of fintech firms and the government's policy towards building an inclusive digital financial ecosystem provide added compulsion for the country's microfinance sector to rapidly adopt digital transformation.

Although Bangladesh still has a long way to go to take the full advantages of digital finance, the country is moving rapidly to build the required ecosystems and remove the barriers to ensure the progression from payments to solutions 'beyond payments'. An enabling policy and regulatory environment has been created including mobile financial services, agent/branchless banking, electronic money, digital payment solutions and other new technologies. Although a large section of the population still remains excluded from the digital economy, the ecosystem has tremendous potential to expand access to affordable financial services to all populations.

For the MFIs, the adoption of the customer-centric approach will be instrumental in bridging the access-usage gap in digital technologies. The MFIs need to acknowledge that although more than 90 per cent of the MFI borrowers are women, only 18 per cent of the digital finance users are women. This shows the existence of a significant gender divide in access to digital financial services which has strong

repercussions on the uptake of digital technology by the MFI members. On the positive side, although smart phone penetration is still relatively low, it is rapidly gaining ground. Smart phones provide an important opportunity to improve user interfaces and address literacy barriers across all customers. However, the important aspect for the providers would be to develop responsive products meeting the women's needs, potentially working in partnership with the MFIs who have learned so much about serving women in large numbers.

Finally, it needs to be acknowledged that the MFIs are the most suited institutions to serve the poor more effectively through adopting the digital technologies. The MFIs, with fully developed DFS operations, can further reduce barriers of physical access and cost and, over time, would enable a much higher proportion of the population to use all basic financial services through product innovations and other developments.

For the MFIs, digital transformation also opens up new scopes for adopting innovative technologies like mobile-phone-enabled solutions, electronic money models, and digital payment platforms along with drastic reduction of costs for both the MFIs and their customers.

With rapid financial developments currently undergoing in Bangladesh, digitisation of financial services and its convergence with microfinance is inevitable in which digital credit is likely to have the key focus. The present digital revolution in Bangladesh gives the MFIs an opportunity to embrace digital transformation and enhance their capacity and knowledge to keep pace with rapid developments in technology and digital financial services through building interfaces with their microfinance operations.

Ongoing Research Projects

Study on Comprehensive Rural Finance

Under an agreement with Bangladesh Bank, InM is conducting a study on 'Comprehensive Rural Finance'. The study will undertake a comprehensive national household level field study/survey in the rural economy on the country's rural financial system (RFS) and collect sample data (both quantitative and qualitative) on financial products and services, such as savings, credit, payments, insurance, microfinance etc. from both formal and informal sectors of the rural economy.

Based on the survey outcomes, several policy papers will be produced by InM depicting future rural transformation and the role of Bangladesh Bank in ensuring inclusive rural transformation. In order to accomplish the broader goal of providing credible research support for designing rural finance policies and institutional reorganisation (as necessary) by the Bangladesh Bank and the national policy makers to support the long-term policy agenda of transforming Bangladesh to a high income country (HIC) by 2041, the study will undertake a number of specific tasks and perform several responsibilities in line with the Terms of References (ToR) of the study.

Among others, the study will provide a comprehensive review of the past and existing policies on rural finance introduced by the Government of Bangladesh and Bangladesh Bank and suggest new policies and amendments of existing policies, as needed. Further, the study will identify sector- and region-level potentials and occupational dynamics at the grassroots level of the rural economy and suggest

policies to transform Bangladesh to a HIC by 2041. It will explore the financial-rural sector nexus in the rural economy and identify dominant rural growth drivers in support of inclusive rural transformation. It will also examine the extent, channels and other dimensions of net resource transfer from the rural to the urban areas through the financial sector institutions and assess their implications for rural growth and development.

Further, the study will assess the extent of availability of financial resources from different financial sources and the supply-demand gaps that exist for specific activities in both farm and nonfarm sectors in the rural economy and their development implications. The study will also examine the extent of penetration of digital (and other modern) financial services in terms of various household groups and enterprises in the rural economy and their implications for growth and development. In short, the study will provide evidence based inputs for framing effective policies by Bangladesh Bank for sustained and inclusive rural development in Bangladesh.

At present, InM has finalised all the questionnaires and FGD checklists in consultation with Bangladesh Bank and relevant experts. The field survey will start in April 2023.

Strengthening Social Resilience Programme: Development of NFIS Implementation and Action Plan and Resource Plan of Bangladesh

Financial inclusion has significant potential for improving the well-being of all citizens in society, especially for the participants in unserved and under-served financial markets who belong to the poor and marginalised groups, CMSMEs, small and marginal farm households, participants in informal sector activities, youth and women belonging to poor households, indigenous peoples, persons with disabilities, and other disadvantaged groups. The Government of Bangladesh (GOB) has adopted the National Financial Inclusion Strategy (NFIS, July 2021-June 2026) in 2021 as an effective tool to achieve the core objective to 'increase the level of financial inclusion (having at least one regulated financial service account) of all adults to 100 per cent by June 2026'. This strategy has established its linkages with the long-term Perspective Plan of Bangladesh (2021-2041), medium-term 8th Five Year Plan (2021-2025) and other relevant national strategies and policies. The government's priority to adopt the NFIS stems from a number of considerations, including the potential of financial inclusion to reduce poverty and inequality, and promote financial stability, inclusive development and shared prosperity.

Under this ADB funded project, InM has developed the updated and detailed Implementation Plan including an Action Plan (July 2021 to June 2026) of NFIS. In addition, InM has prepared a detailed year-wise Resource Plan for NFIS which indicates the amount of additional financial resources that would be required to achieve the targets of NFIS. The analysis is being carried out in close collaboration with the NFIS Administrative Unit (NAU) of Bangladesh Bank and Financial Institutions Division of the

Ministry of Finance and other relevant stakeholders. InM has submitted the Final Report in December 2022.

'WCAD-Scale Up' Programme in partnership with Water.org

InM has successfully completed the first round of "Water Credit Adaptation Programme (WCAD)" in partnership with ten MFIs with support from Water.org. InM is currently implementing the second phase of the WaterCredit Adoption (WCAD) Programme. This programme would create the scope of providing the poor households with access to small loans as a solution to affordable financing as well as access expert resources to make household water and toilet solutions a reality. In the first phase, the piloting was undertaken by InM in partnership with WCAD partner MFIs for the customers at the bottom-of-the-pyramid (BOP).

The second phase, which started in February 2023, would extend over a period of 12 months; and, at the end of the programme, around 75,000 water supply and sanitation (WSS) loans are expected to be disbursed to reach about 337,500 people with improved water and/or sanitation and increased capital mobilisation.

Completed Research Projects

Bangladesh Poverty Watch Report 2022

InM has prepared the Bangladesh Poverty Watch Report 2022 in collaboration with Center for Inclusive Development Dialogue (CIDD). The main objective of the Report is to ensure that grassroots voices of 'left behind' and extremely poor population groups are heard, and their voices are reflected in policies. The Poverty Watch Report 2022 summarises some current aspects of poverty including testimonies, reflections and 'stories' of individuals from selected 'left behind' population groups experiencing poverty in Bangladesh. As the Covid-19 pandemic is 'supercharging' existing poverty and inequalities, there are new and unequal risks for the poor and disadvantaged peoples of these groups in society. The Poverty Watch Report 2022 specifically focuses on selected plain land ethnic minority groups and transgender community.

The Report also provides poverty dimensions in Bangladesh and how poverty is defined and measured globally and in Bangladesh including social exclusion, and some statistics related to poverty and deprivation at the national and regional levels in Bangladesh.

The analysis brings out emerging priorities for policies as well as challenges faced by individuals experiencing poverty in Bangladesh. It also covers best practices for reducing poverty and social exclusion, and recommendations for policy makers emerging from testimonies, reflections, proposals and stories of persons experiencing poverty and exclusion.

The Report was launched in December 2022.

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