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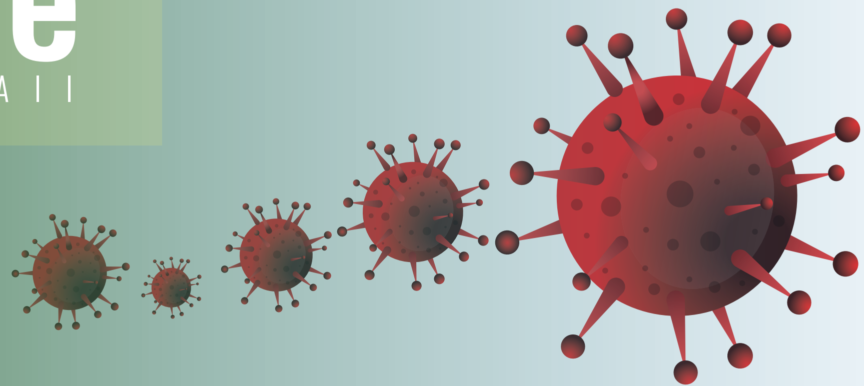

Covid-19: Innovation Drivers for MFIs

The MFIs are the major players in providing financial services to the poor and disadvantaged in Bangladesh. More than 30 million individuals are members of the microfinance network and about 2 million small businesses are lateral entrants into the MFIs' credit network. Most of these clients are parts of the 'missing middle' in the formal bank credit market. Over time, the horizon of MFIs has also expanded; micro loan products have been diversified to include both financial and non-financial products.

Moreover, the regulations of MFIs have contributed to a structural shift in the microcredit market, signifying a move towards microenterprise based higher loan size creating competition for loans between microenterprises and traditional household based activities. On the other hand, with emphasis on sustainability, the MFIs have also targeted their activities with a renewed focus on transaction costs and risk minimising approaches.

On the other hand, the coverage of the poor members under the MFI financial network has been facilitated by the availability of subsidised fund, institution of risk minimising informal microinsurance (e.g. credit life insurance, livestock insurance, health insurance) and programme-induced and targeted lending activities. The shift towards microenterprises-based lending activities has perhaps affected the loan portfolio of the extreme and moderate vulnerable poor households at least to a certain extent.

At present, there are three major targeted clientele groups of the MFIs:

1 *The vulnerable poor including extreme poor and moderate poor*

2 *Graduating microcredit members*

3 *Lateral entrants of small businesses e.g. microentrepreneurs*

This has also led the MFIs to adopt two major mechanisms to deliver financial services to the clients: (a) relationship-based lending to individual microentrepreneurs and small businesses; and (b) group-based lending under which several small borrowers come together to apply for loans and other services as a group. The group-based model represents an approach under which the poor and near-poor households can have access to an appropriate range of financial services, including not just credit but also savings, microinsurance, and fund transfers.

Considering these realities, three aspects of the financial operations of the MFIs need attention in the context of Covid-19: (i) explore innovative and sustainable measures to ease the binding financial constraints to provide financial services to the target population/business groups; (ii) develop appropriate financial products/services (including housing, business scaling-up and enterprise development, technology adoption, and emergency loan products) to meet the needs of different groups of poor households/microbusinesses; and (iii) ensure more efficient and cost effective MFI operations through adoption of digital and modern technologies and resolve the asymmetric information problem of the excluded households/enterprises.

In addition, capacity building of the MFIs needs to be prioritised to meet the demands of different segments of the targeted populations through addressing problems like lack of skilled and trained staff; inaccessibility to haor, hilly and remote areas; limited access to technology and information; inadequate information flows to the excluded households/enterprises; and limited financial education to manage financial resources in a more productive and efficient manner.

The innovation drivers of MFIs during the Covid-19 should encompass both push and pull factors. The push factors will come from external sources outside the microfinance sector that will motivate the MFIs to develop innovative financial products and services to expand outreach to currently excluded and low-income groups. Internal factors will act as the pull forces which will come from within the MFIs encouraging them to develop internal capacities for delivering better-suited and efficient services to these groups.

However, the most important push factor will be the government’s determination to rejuvenate the financial sector to overcome the deep scars of the pandemic and make the sector more inclusive. In this context, the MFIs may follow a three-pronged approach: (i) expand the capacity and enhance the confidence of the potential customers regarding efficient delivery of tailored financial products and services; (ii) provide information and education on access and use of digital financial instruments by the microfinance sector; and (iii) encourage the delivery of a variety of products and services using digital and more efficient mechanisms in line with the needs and demands of different target groups.

Post Covid-19 Period: Operational Strategies for MFIs

In the post Covid-19 world, the priority for the MFIs would be to provide their services in more efficient and sustainable ways facilitated by a better understanding of the local communities, innovative service design and delivery models, and lending techniques. Further, new innovations may also be explored in the existing MFI models.

For example, the MFIs may explore the feasibility of developing partnerships with other financial service providers (e.g. agent banking and e-money agents, local cooperative associations and other local level institutions) for performing some of their activities e.g. accepting repayment installments and micro-savings, releasing micro-loans to microcredit/microenterprise borrowers, providing microinsurance and other services through creating access points of financial services in locations where the MFI branches are not available.

The MFIs may also explore several options to enhance their activities to meet the challenges of the post-coronavirus period: (i) build a long-term relationship with the banks for supply of funds for lending; (ii) design new and digital financial products/services particularly long term housing loans and multiple loans including emergency loans and risk minimising microinsurance products; (iii) implement human resource development programmes both through training of existing staff and recruiting adequately skilled personnel especially in digital technologies; (iv) enhance security of funds especially in relatively less accessible areas; (v) ensure access to information technology for complete documentation of members and borrowers using information from the credit information bureau for the microfinance sector; (vi) use right skills and information for selecting borrowers/microenterprises and providing services; and (vii) explore options to mobilise voluntary and term deposits.

For adapting to the post Covid-19 landscape, the key option for the MFIs will be to take the digital transformation route. With rapid developments in digital transformation of the financial sector itself, this is inevitable for the MFIs as well. Digital financial services (DFS) refer to digital access to and use of financial services by the excluded and underserved populations. For the purpose, such services should be suited to the customers' needs, and delivered responsibly, at a cost both affordable to the customers and sustainable for the providers.

The DFS present a unique opportunity for the MFIs to improve service delivery, enhance transparency and accountability, increase operational efficiencies and reduce costs of operation. Delivering financial services through technological innovations, including mobile money, can be a catalyst for the provision and use of a diverse set of other financial services by the MFIs.

Those who are now excluded can enjoy expanded access to money-transfer, microsavings, and microinsurance services. For the microentrepreneurs, the adoption of DFS by the MFIs, along with providing efficient access to finance, can open up opportunities to adopt electronic payment systems, secure a varied menu of financial products and a chance to build a financial history. Innovations in electronic payment technology like mobile and prepaid services will enable the MFI members to lead more secure, empowered and included lives.

For the CMSMEs, the adoption of digital technologies by the MFIs can help to address specific challenges in the value chain—especially those that need financial services solutions, and where traditional finance has limitations to fully address the demands in the rural market. This is often due to high infrastructure costs and a lack of incentives to adapt products to the unique needs of these enterprises.

Digital finance also offers a way to expand access to the formal financial system (e.g. through a basic transaction account supervised by the regulators), taking advantage of the rapid growth of digital and mobile telephone infrastructure and the advent of agent banking. These factors have a direct link to increasing the microentrepreneurs' income and wellbeing.

InM Covid-19 Economics Survey: 93% of MFIs Experience Sharp Rises in PAR

An online survey conducted by InM on 59 MFIs (most of which are FIN-B members) during September 2020 shows that the growing portfolio at risk (PAR) is the greatest financial challenge faced by the microfinance sector during Covid-19. Nearly 93 per cent of the MFIs report sharp rises in their PAR levels during the Covid-19 period compared with their pre Covid-19 levels. Among the med-level MFIs, 59 per cent and, among the small MFIs, 55 per cent have experienced a more than doubling of their PAR; while 35 per cent of both small and medium MFIs report a doubling of PAR over their pre Covid-19 levels. Irrespective of the size category, most MFIs face similar financial difficulties due to the pandemic, such as deterioration in outstanding loan portfolio, high rates of savings withdrawal by members and difficulties in repaying MFIs' borrowed fund to the banks and/or other borrowing agencies.

To mitigate the crisis, 51 per cent of the large MFIs have revised their loan distribution policy as per the need of their clients. However, most medium and small MFIs lack the capacity of rescheduling the loan portfolio. Although 25 per cent of the MFIs have adopted mobile financial services as a business model to disburse loan and emergency grant in the pandemic situation, medium and small MFIs find it difficult to adopt it as their business model is highly dependent on personal contacts and their client-base is not very apt with digital technology.

All MFIs strongly recognise that they are probably passing through one of the most difficult times in their working history. Along with recovery strategies for putting the MFIs and their clients back on their feet quickly, the MFIs seek policies to strengthen alternative investment options and institutional behavioural changes that could reduce the likelihood of future shocks and increase their resilience when another covariate shock occurs.

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