The Microfinance Association

MICROFINANCE, THE WAY FORWARD- POST COVID 19

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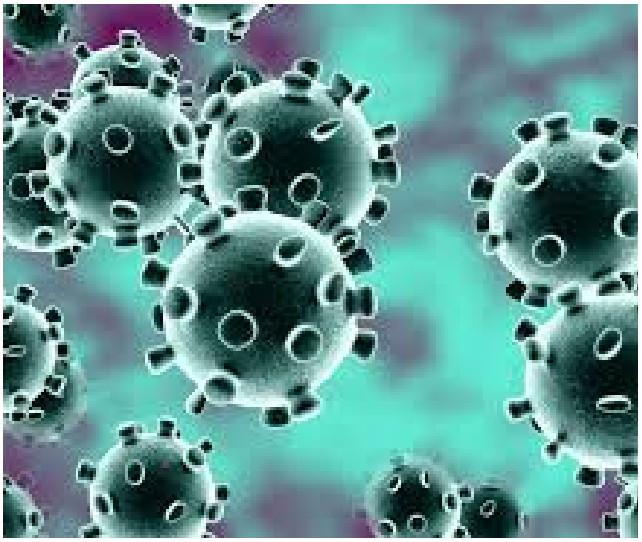
INTRODUCTION

The twin global crises of a virus pandemic COVID 19 accompanied by global economic crises are severely harming the livelihoods of various market segments especially the daily wagers, low-income households, small scale businesses and start-ups across the globe.

As the early reports of the Corona virus spread across China, at the end of December 2019, no one could have imagined how vast the devastating impact of this outbreak was going to be. The situation has been utterly unprecedented and took the world by surprise. Unfortunately it continues to fluctuate every day affecting more and more people across the globe.



With Social distancing being the only preventive option at the moment, organizations are focusing on finding solutions to this complex scenario in front of us and treating this as an opportunity to reposition the business for the changes that are afoot all over the world.

Similarly, the MFIs across the globe need to focus on revamping their existing models adapting to the new norms. This paper presents the innovative model of MFIs post COVID 19.

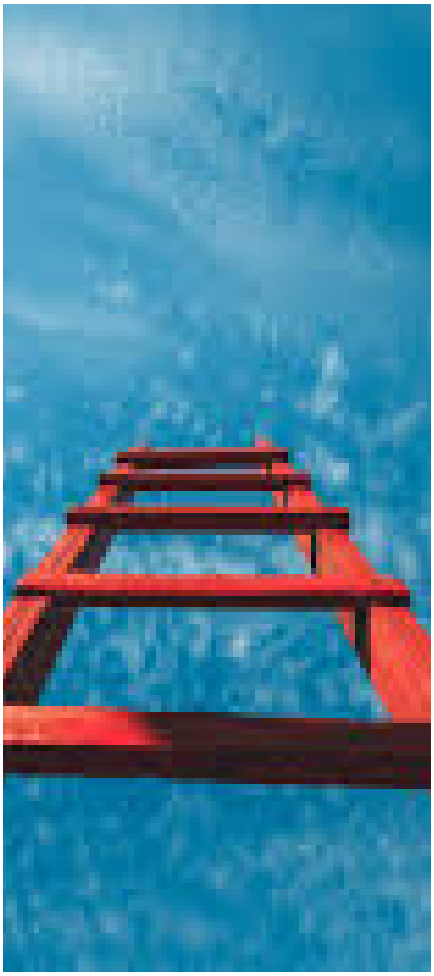
THE PENDULUM SHIFT

The Way Microfinance has evolved over the years can be classified as a theory of "THE PENDULUM SHIFT".

Microfinance initially had a limited definition - the provision of microloans to poor entrepreneurs and small businesses lacking access to credit. The two main mechanisms for the delivery of financial services to such clients were: (1) relationship-based banking for individual entrepreneurs and small businesses; and (2) group-based models, where several entrepreneurs come together to apply for loans and other services as a group. Over time, there has been a Pendulum Shift and microfinance has emerged as a larger movement whose object is "a world in which everyone, especially the poor and socially marginalized people and households have access to a wide range of affordable, high quality financial products and services, including not just credit but also savings, insurance, payment services, and fund transfers.

Moreover, with the Digital Revolution the world has witnessed exceptional uptake in the use of digital financial services across the globe. Funds transfers, loan disbursements and collections, airtime purchases and a host of other transactions including cashless payments at physical or online stores have shown tremendous growth in recent years. Thus, resulting in a major Pendulum Shift of doing Microfinance.

CURRENT CHALLENGES



The challenges that the industry faces are diverse and volatile. The biggest issue is uncertainty. The lock downs across the globe to reduce contagion and spread of COVID 19 have hit the low income household communities the hardest placing an undue burden on the marginalized segments of the society given their economic vulnerability. A majority of such households are struggling to feed themselves and lack the cash to purchase food which is their top priority. There is no doubt that poverty levels among individuals in informal employment are twice as high as that of individuals in formal employment since most lack social safety nets, and will therefore be the hardest hit by the pandemic.

From the perspective of low-income households, there needs to be a multi pronged economic rehabilitation programme. The most immediate need of such households is managing their day-to-day cash flows, so social security nets and government-led cash payouts would need to be continued and properly targeted post COVID-19. However, these would be inadequate if not supported by more effective and medium-term approaches, including access to finance through specialised lending programmes, which should enable low-income entrepreneurs to kick-start their businesses.Many microfinance providers are facing existential challenges as, post lockdown, business has come to a halt since financial services are provided at the doorstep of customers. There is a need for the Central Banks to establish a risk mitigation fund in collaboration with other stakeholders that can stem the current liquidity crisis being faced by the microfinance industry. This should essentially have a two-track approach, at one level to bolster and sustain microfinance providers through the liquidity crisis and at the second level to help low-income households restart their livelihoods post crisis.

MICROFINANCE-POST COVID 19

The financial service industry forms the backbone for any economy. The global economy is in recession which is appearing to be the worst the world has seen in the last 100 years. From a risk management perspective, Microfinance Institutions will look to strengthen their balance sheets and liquidity and evaluate their business models for relevance in the new post COVID-19 world. One clear implication is that the people are going to adopt digital services at an exponential rate and every financial institution needs to have a digital strategy. Digital financial services can play a key role in mitigating the risks of the virus spreading through surfaces like paper and plastic.

As COVID-19 has halted movement and people are indoors maintaining social or what I call physical distancing, digital financial services provide almost every service that a person would need to conduct their daily financial activities remotely without the need of being physically present at a bank or public place. Speaking of various mobile banking platforms like M PESA, Easypaisa, SIM SIM with mobile apps being further upgraded to provide more customized solutions to all its users to conduct cashless transactions from the safety of their homes. With the help of mobile application, the users can enjoy a variety of different services which include but are not limited to: maintaining accounts and wallet, transferring of money and conducting payments, recharging their mobile balances, paying utility bills, availing various discounts and topping up their wallets which are also integrated with various e-commerce platforms. There are constant updates and notifications available through the digital platform, users can also make donations, conduct payments at retailers through scanning QR codes and make purchases for all essential items. As more people continue to accept that the use of these services is imperative, they are learning about the user-friendliness of the application interfaces and also about the service in general. The introduction to simpler, swifter and hassle-free transactions will undoubtedly encourage users to opt for a digital lifestyle even after the situation has returned to normal.

With social distancing here to stay, the loan disbursement methodology will change and instead of physical screening will be based on a combination of credit scoring and psychometric modelling to analyse the attitude, behavior and capacity of the borrower making use of "the BIG Data" that various countries are already making use of now through advanced data analytics. Thus household visits shall reduce substantially and the customer surveys shall be undertaken using online communication channels.

NEW BUSINESS MODEL OF MICROFINANCE

Keeping in view that social distancing or rather "physical" distancing is expected to continue it is time that Microfinance Institutions reassess and revamp their business models leveraging on digital financial solutions. In the past, two predominant business models of Microfinance have been "Group Lending Model" and "Individual Lending Model". The group-lending model of microfinance is a development intervention in which small-scale credit for income-generation activities is provided to groups of individuals based on social collateral and group guarantees whereas individual lending model is an unsecured, cash-flow based lending model catering to the needs of micro and small enterprises. In the past, Microfinance Institutions carried out household visits followed by business visits to carry out a cash flow analysis which was only an estimate of the actual keeping in view the undocumented economy in which MFIs were operating.

In my view, going forward and talking about the theory of "The Pendulum Shift", a "Digital Business Model" will need to be developed in which client screening and lending decisions will be based on Econometric Modelling and Data Analytics. To be able to grow, the adoption of artificial intelligence could help process the data to simplify the processes carried out by Microfinance Institutions making it easier to make lending decisions and follow up with the client. Instead of cash flow analysis which in an undocumented economy was always an estimate, the credit committee approval or rejection will be based on credit scoring model which will be a major risk mitigation tool and psychometric modelling which will enable the organizations to analyse the attitude and behavior of the clients. For instance, asking clients what will they do if they see a USD 100 dollar in an empty room where a certain scoring will be tied to the response of the client to determine the client's attitude and behavior. In such a model no physical household visits or business visits will be required.

Moreover, many MFIs across various countries these days have access to the "BIG Data" which can be linked to the scoring models to develop a deeper understanding of client's spending analysis and payment habits in addition to other useful information. Thanks to Data Mining Algorithms organizations can actually offer round the clock loans and savings products to the clients at the touch of a finger tip. The new alternative to manual risk control is Artificial Intelligence which takes into account over a thousand indicators including the consumption and expenditure pattern of the client.

Furthermore, not only the model the products offered by Microfinance Institutions to their clients need innovation as well. For example, product to revive the micro and small businesses and fund their liquidity gaps such as "Overnight Credit" and "Bridge Finance" will be required. Another innovative product would be a comprehensive simple and convenient business loan -a cloud based digital platform to enable MSMEs to go cashless allowing businesses to go digital by allowing e-invoicing, digital payroll, vendor payment disbursements and collecting receivables with paperless sign up process. In order to ensure a successful digital business model it is important for Microfinance institutions to to educate clients about digital financial solutions and how it can benefit their client's business. Also, on the marketing front the famous "door to door mobilization" will be changed to "Digital Marketing".

CONCLUDING REMARKS

Adjusting to the new business model of Microfinance will require a change in mindsets and the attitude towards learning new initiatives. It is time for Microfinance Institutions to work on reassessing their business strategies and future priorities. The regulators have a key role to play to ensure successful and smooth transition of Microfinance Institutions.

In many countries, there have been regular revisions of the monetary policy to accommodate all the sectors in the industry that have been impacted during these turbulent times. Banks being the main lenders have received a reduction in their Capital Conservation Buffer allowing more funds to become available for release to customers looking for credit. At the same time, initiatives are being introduced for small and medium businesses, hospital financing and payroll schemes which are aimed at easing the burden on numerous organizations.

I would like to reiterate that people should learn from what is happening around and it is imperative that we go digital in our processes as adoption of such technologies will benefit us greatly, even after the pandemic.