Accelerating the transformation of microfinance

Digital and non-digital strategies for the small enterprise sector

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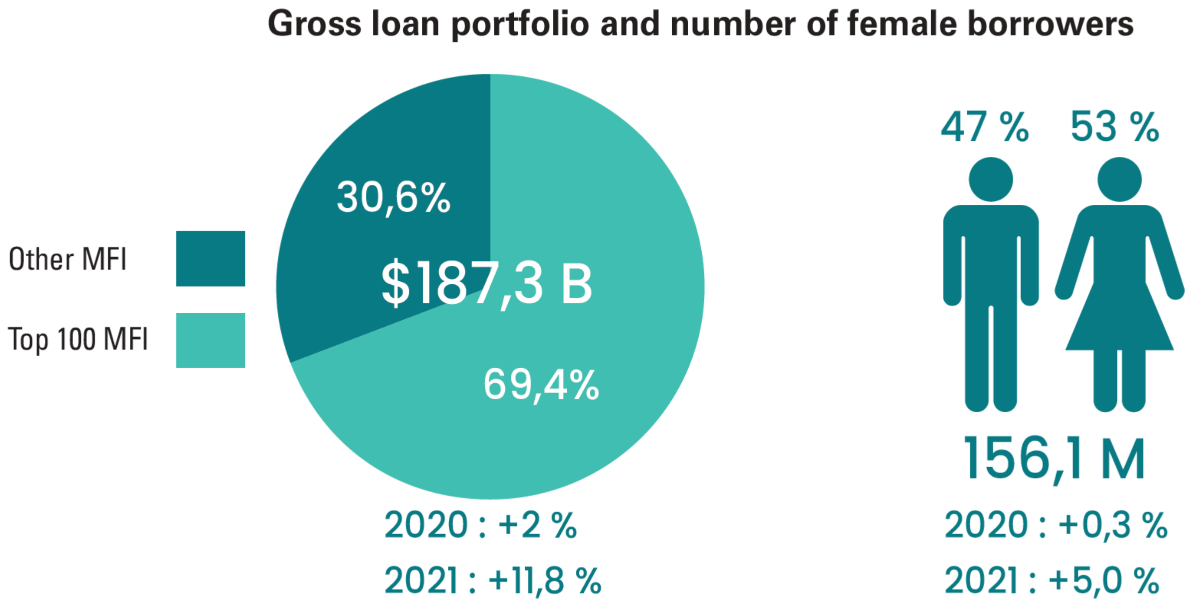
The global microfinance industry continues to play a key role

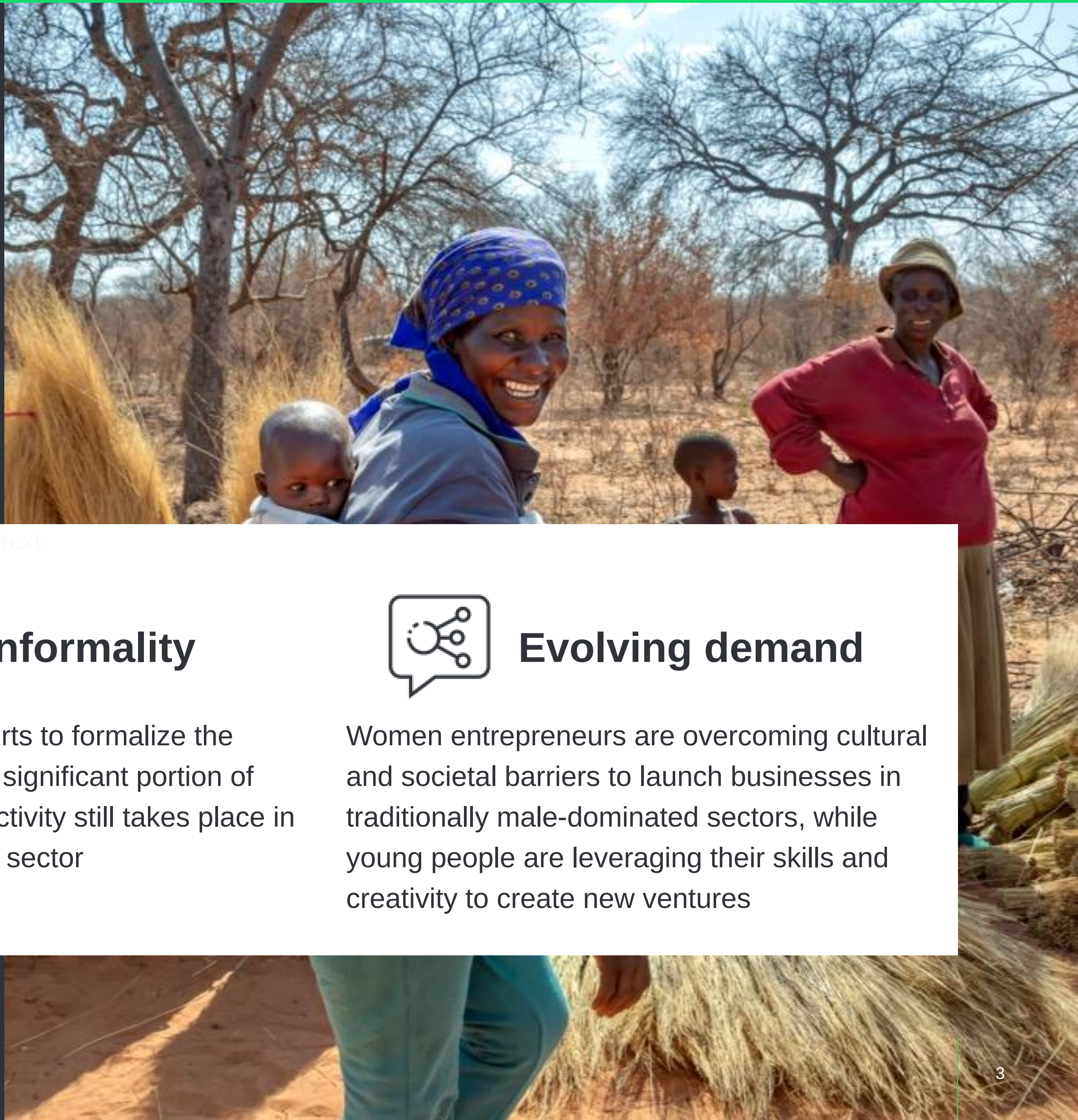


Region	% total customers	% Loan Portfolio
East and South Asia	72.5%	49.8%
Latin America	17.4%	38.8%
Sub Saharan Africa	6.5%	5.1%
Europe and Central Asia	2.4%	4.9%
Middle East and North Africa	2.8%	1.2%

Source: Global Impact Finance Barometer 2022

Entrepreneurship is evolving

Entrepreneurship is evolving rapidly, driven by a combination of factors: technological advancements, changing demographics, and growing participation of women and youth



Technology

Many entrepreneurs are leveraging technology to drive innovation and create new business opportunities. Entrepreneurs can reach new customers and markets more easily than ever before, .

Informality

Despite efforts to formalize the economy, a significant portion of economic activity still takes place in the informal sector

Evolving demand

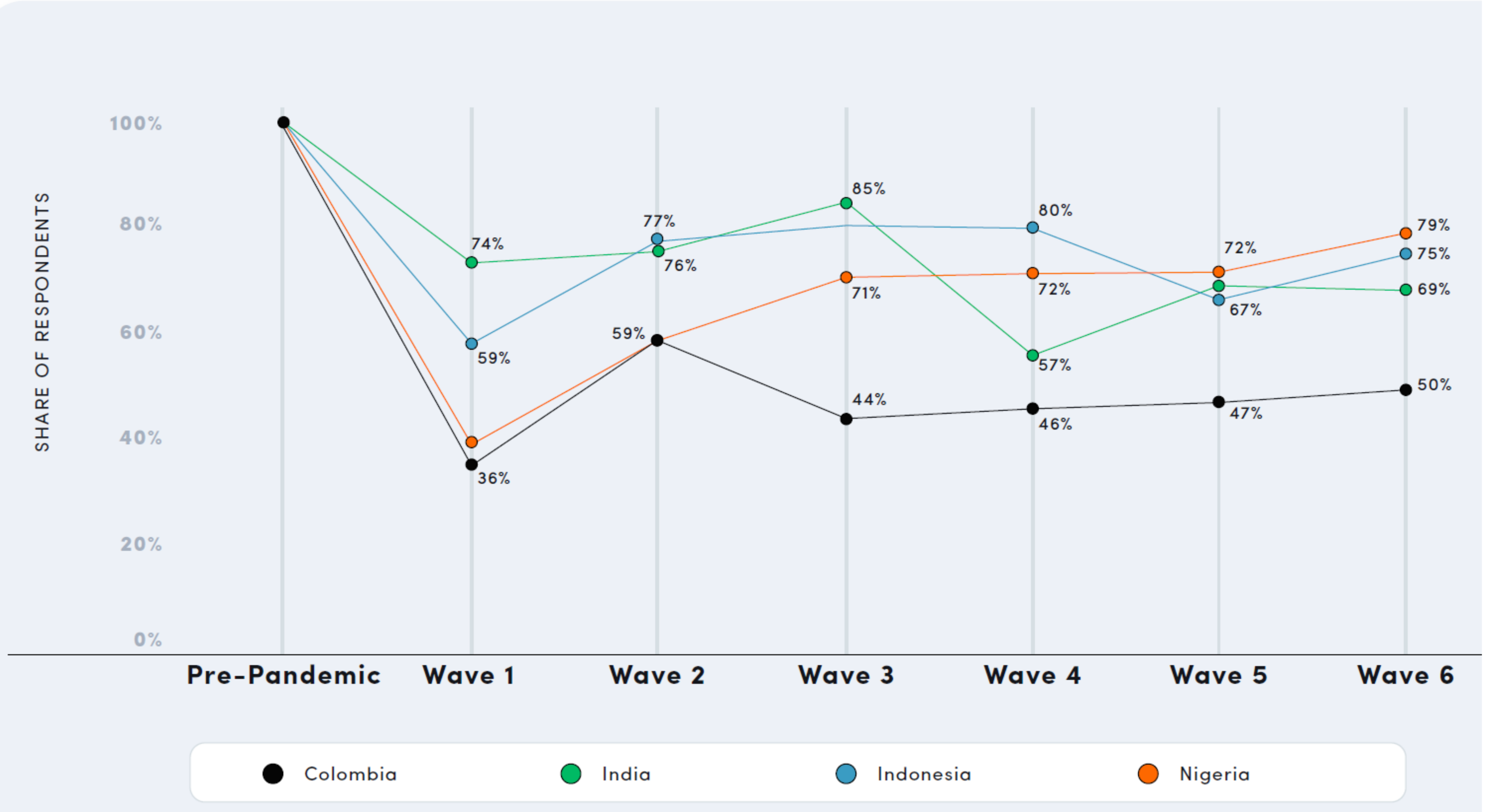
Women entrepreneurs are overcoming cultural and societal barriers to launch businesses in traditionally male-dominated sectors, while young people are leveraging their skills and creativity to create new ventures

Impact of COVID19

Lower Employment

Compared to pre-pandemic levels, employment in micro-enterprises declined as much as 50%

MSME Employment Levels

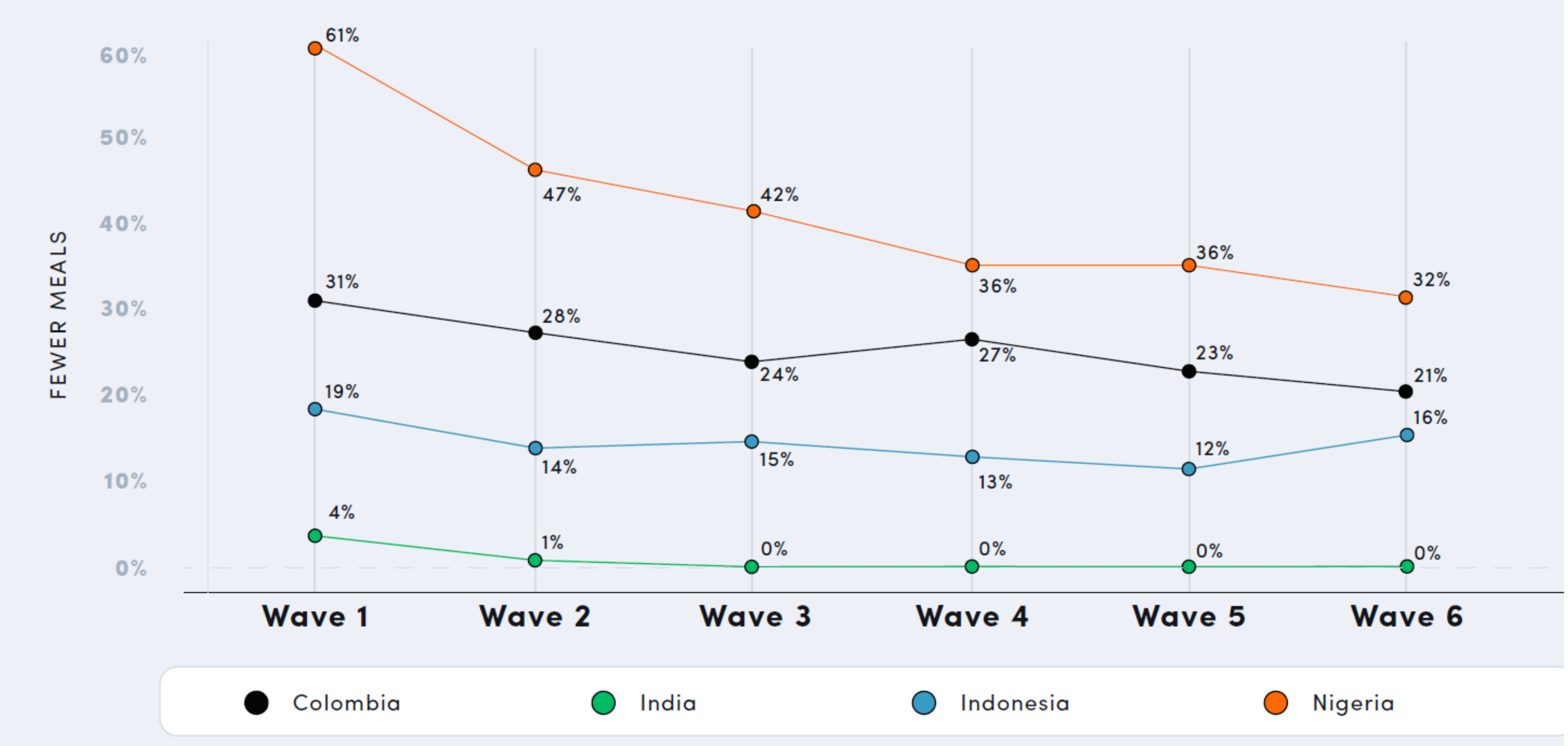


Source: Center for Financial Inclusion

Impact of COVID19

Lower livelihoods standards

The livelihoods of entrepreneurs were negatively affected. One in three MSEs in Nigeria had to forego meals



Source: Center for Financial Inclusion

The pressure for efficiency continues to grow

Pressure points in microfinance come from different sources

a. Growing cost and revenue pressures

MFIs continue to face growing costs: operational costs, loan origination costs, loan loss provisions, funding costs, market and outreach, technology, etc

b. Increased regulatory scrutiny and competition

MFIs must navigate an environment characterized by heightened regulatory oversight, including for consumer protection, privacy, data security

c. Increased competition from Fintech

Fintechs are building their customer base in urban areas with high-value customers. MFIs will be left trying to serve rural and vulnerable communities. This means no cross-subsidies to lower-value customers

The role of microfinance needs to evolve

a. Digital transformation

While digital transformation has been a critical component of the evolution of microfinance, there are other transformations that are equally important

b. Climate resilience

Climate change is having a significant impact on the livelihoods of microentrepreneurs, and microfinance institutions need to adapt to help their clients build resilience to climate shocks, while also promoting sustainable practices.

c. Trust and client protection

Microfinance institutions need to see client protection not as a matter of compliance with the law, but as a value proposition that can accelerate their growth and retention of existing customers

Digital transformation in microfinance: opportunities, pitfalls

Indonesia

From legacy institution to digital front runner

Open APIs
- Focus on onboarding partners
- ISO certification for security compliance
- Credit risk reporting

Branchless agents
- Agent BRILink, a nationwide network of “branchless agents” designed to reach rural customers
- Open accounts, deposits/ withdrawals and process and disburse loans in under two minutes

E-commerce integration
Partnerships with several large e-commerce companies and hailing rides, ranging from Tokopedia, Grab, Bukalapak, Shopee, Gojek

EQUITY

From building society to a digital Equity 3.0

Kenya

Mobi Eazzy Loan

Equitel

Equitel – Mobile Virtual Network Operator

- Focus on onboarding partners
- ISO certification for security compliance
- Credit risk reporting

Omni-channel - Customer digital app

- The Eazzy Banking suite provides an array of financial services to consumers: payments, lending, savings, FX

97%

Of transactions outside the branch network

70%

Of transactions are self-initiated on mobile

Digital transformation: common use-cases in microfinance

Workflow applications

MFIs have started their digital journeys by replacing traditional paper-based processes with mobile workflow applications for customer signup and loan applications.

Cash-in Cash-out

The expansion of cash-in, cash-out (CICO) points beyond traditional branches has helped MFIs increased revenue and efficiency as small transactions move outside of branches

Credit Scoring

As credit is a primary source of revenue, many MFIs have shown interest in automating credit decisioning. Automation is often applied to follow-up loans rather than first-time borrowers

Customer apps

Customer mobile apps are increasingly common, even though uptake and use are often modest.

Business intelligence - Analytics

MFI can take different approaches to digital transformation

8The “how” to pursue digital transformation is equally, if not more important for successful implementation. A successful digital transformation plan requires careful thought about how to integrate two different operating models under one roof.

Core transformation	**A fully integrated holistic approach where all departments have collective responsibility for transformation**
Experimentation unit	**Setting up a stand-alone unit that builds, tests, learns, and launches products outside the FSP's existing business operations**
Partnership-driven	**3A partnership-based approach that relies on external fintech or technology partners for the implementation of new products**

Pitfalls and risks in digital transformation

Regulatory barriers	Neglecting demand-side needs and barriers	Excessive focus on consumer credit
Regulations can pose unexpected challenges for MFIs: • **Remote onboarding**: For AML/CFT reasons, most jurisdictions have specific rules for conducting remote customer due diligence • **Agent networks**: What can the agents do and not do? Is customer onboard allowed? Rules on agent exclusivity, proprietary agents, etc. Eligible criteria for agents • **Cloud computing**: many regulations can affect cloud computing, e.g. security, privacy, data localization, third-party outsourcing, etc.	Focusing on the technology over the needs and wants of the customer is a common pitfall. • **Capacity**: MFI customers are often unable to use the latest technologies • **Value for in-person interactions**: MFI clients value the learning and personal interaction with loan officers and agents. Digitization should not eliminate this part of MFI's value proposition • **Simplicity**: vendors often push for more complex solutions. MFI clients however often prefer simple, straightforward solutions.	Digital nano-loans provided to consumers have proven to be very popular and yet very problematic • In Kenya, 3.6 million people – 13 percent of the adult population – were negatively listed. Digital transformation has reduced credit discipline • In India, the growth of digital credit has forced the central bank to impose stricter regulations on the sector • However business models targeting entrepreneurs are growing

MFIs face many barriers when pursuing digital transformation. It is important to consider these challenges early on and ensure that risks are mitigated

Source: CGAP

Pitfalls and risks in digital transformation

Excessive focus on technology	Change management
· The adoption of new and complex technologies can be very challenging for MFIs. • **Institutional capacity**: Rushing into technology solutions, without having the institutional capability in place to commercialize them, is a common mistake MFIs make when digitizing • **Simplicity**: Using minimum viable products (MVPs) for early-stage technology innovation is the best way for most MFIs to test and iterate digital solutions, • **Risk of vendor dependence**	Change management is often the biggest barrier to successful implementation. • **Loan officers**: Loan officers are often the key stakeholder that needs digital skills to adapt to digital transformation • **Branch managers**: the role of branch managers is critical in digital transformation to act as intermediaries from headquarter technical experts and field staff • **C-suite**: Understanding and buy-in are critical for successful adoption/implementation of new technologies

Additional barriers to digital transformation

Source: CGAP

Microfinance transformation, beyond digital

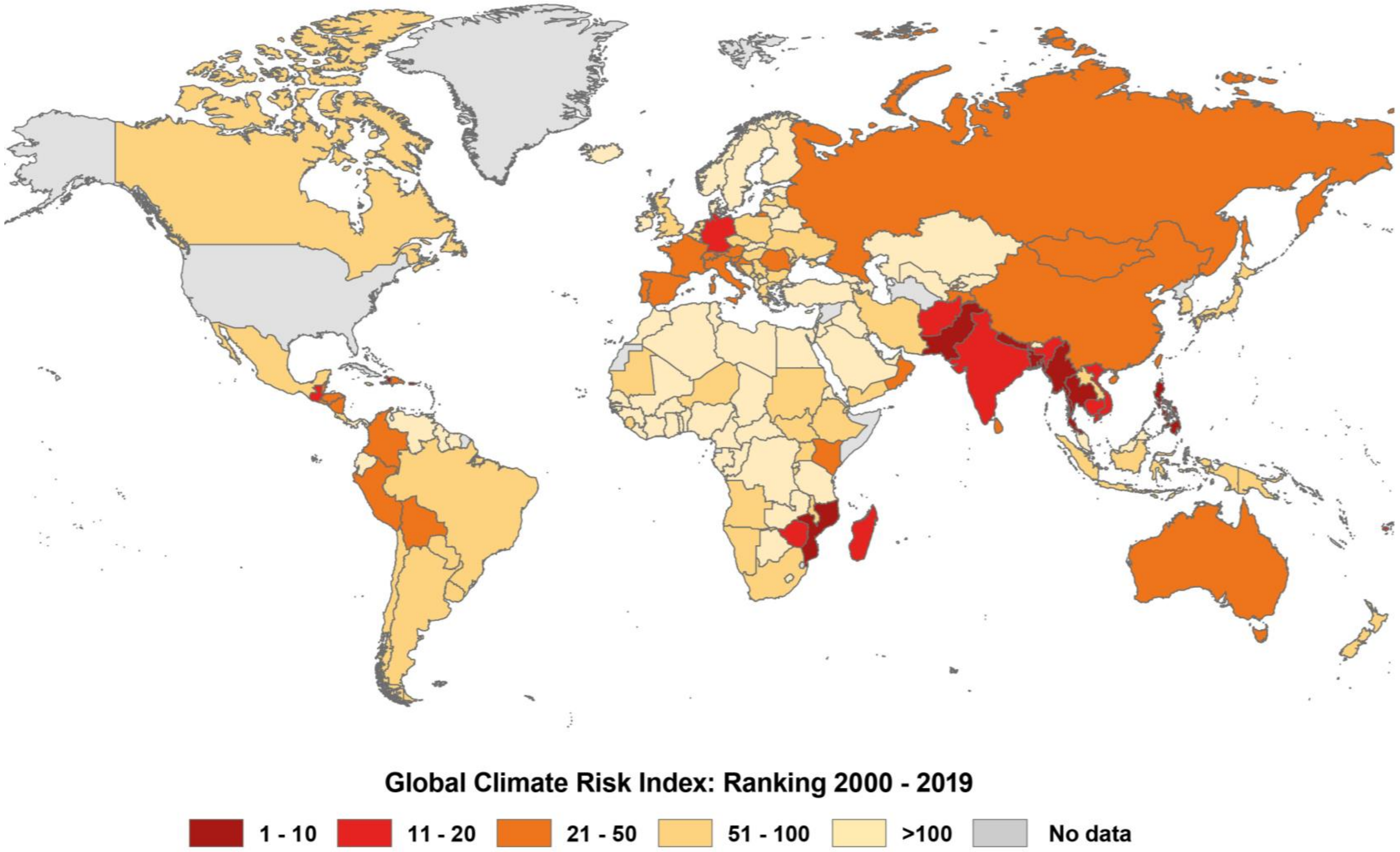
Climate change has the greatest impact on the people who have contributed the least to global emissions

Climate-related risks are increasing in **likelihood**, **unpredictability** and **extremity**

- 40% of people are expected to face climate-related shocks and stresses in the next decade

The poorest 50% of people produce half the emissions of the richest 1%

Green finance needs to work for these people too



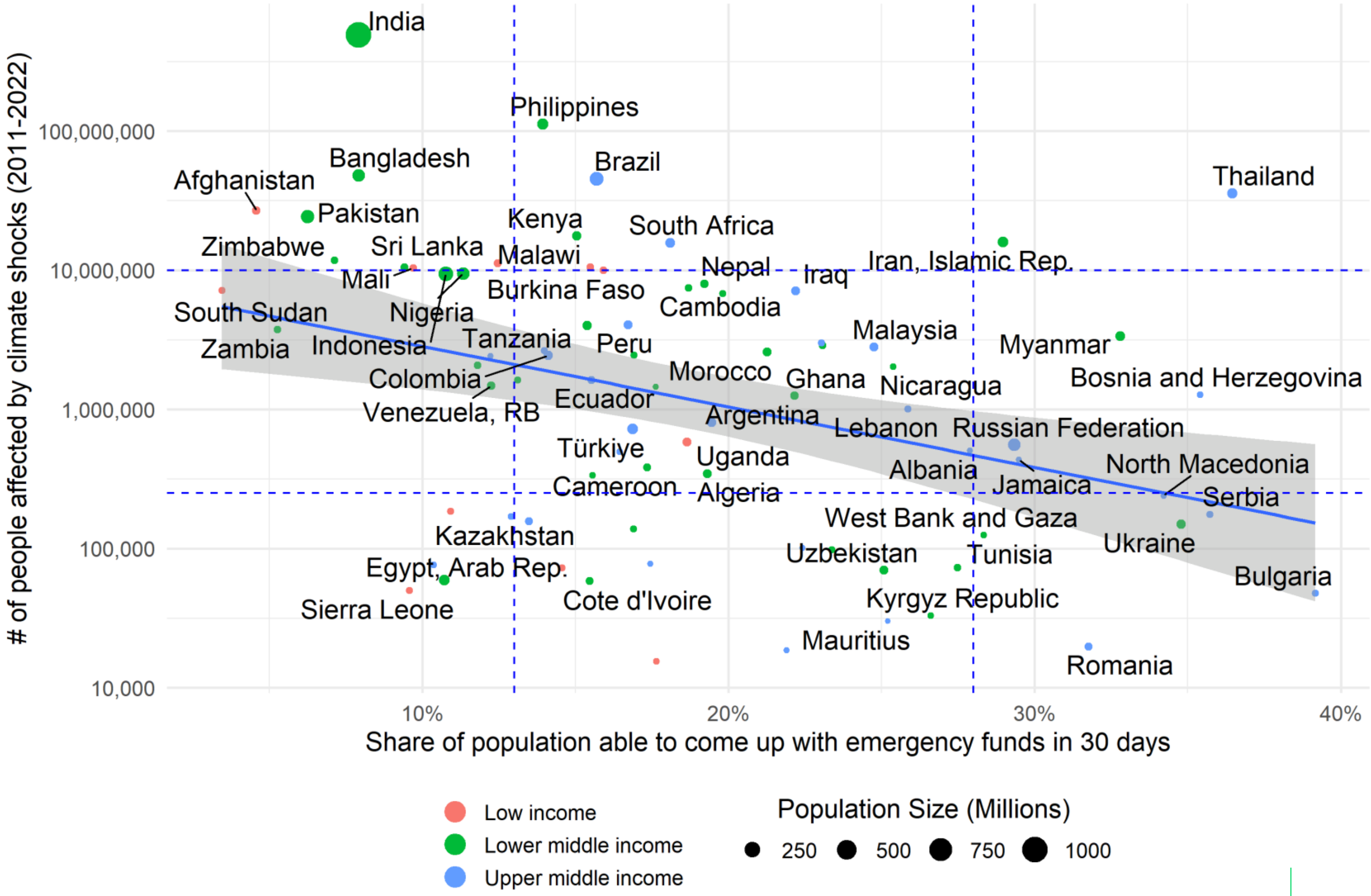
The people most vulnerable to climate shocks have the least access to the financial tools that they need

The impacts of climate change will be the hardest on those already marginalized socially, economically and financially

- Women, indigenous communities, young people are particularly vulnerable

The intersection of low-income, high vulnerability and limited access to financial tools leads to low levels of **resilience**

- 17% of people in Latin America would can come up with emergency funds within 30 days without much difficulty



Green inclusive finance

Pathway	Role of Inclusive Financial Services	Example of Inclusive Financial Solution
Mitigation	To support the adoption of green technologies and practices that can improve local environmental conditions for households and communities	↗ Installment plans to pay for solar lighting systems ↗ Financing of "clean" cookstoves (e.g., those powered by electricity or biogas)
Resilience	To support the financial resources needed to prepare for, manage through, and recover from climate-related shocks	↗ Weather/livestock index insurance ↗ Easy-access savings ↗ Social protection payments for food or wage security
Adaptation	To support necessary changes to livelihood strategies in response to longer-term climate-related events	↗ Financing to farmer producer groups for high-value crop diversification and value chain linkages ↗ Financing to support weatherproofing homes
Transition	To support shifts to new livelihood strategies in response to and in anticipation of future climatic events	↗ Financing/remittances for migration to new locations ↗ Financing to invest in vocational training for new livelihoods

Key lessons

- The demand for digital services continues to be slow in the poorest and marginalized segments of the economy. But it is growing, and MFIs must leverage their proximity to low-income consumers to understand the demand and the barriers

- Open banking is key for the digital transformation of microfinance. Indonesia is an example of a thriving digital economy that is intertwined with microfinance. Partnerships with e-commerce and social commerce platforms is a promising area of growth

- Digitization is only one component of transformation in microfinance. Neglecting the growing risks of climate change

> **“You can’t fintech your way out of climate change”**

Thank You!

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