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Rebuilding After COVID: Financial Inclusion Across Asia

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TAKEAWAYS FROM

"Financial Inclusion During the Pandemic Crisis: More Relevant Than Ever?"

a global workshop

at the

Martindale Center for the Study of Private Enterprise, Lehigh University

Perspectives and lessons learned from Asia, by far the largest regional market for inclusive financial services, were of central interest for about two dozen leaders of microfinance organizations, impact investors, and analysts from around the world who convened recently at a workshop hosted by Lehigh University's Martindale Center to share views on how financial inclusion interacted with the socio-economic crises of the pandemic. The event built on the success of a previous similar workshop that resulted in the publication of The Future of Microfinance by Brookings Institution Press in 2020.

The COVID-19 pandemic has changed the world in so many ways. Throughout the pandemic, people, businesses, and governments were able to access various types of financial services. Lockdowns across many countries accelerated the ongoing shift towards digital payments. Households relied on financial services to stay resilient, access their savings, pay bills, conduct their business, receive social payments, and/or pay government fees. Many financial institutions across Asia responded quickly to the growing socio-economic challenges facing their clients and their own institutional survival.

Across the world, each country is rebuilding at different speeds, and one of the determining factors is access to finance for households and businesses. China, India, and Indonesia are three of the world's largest countries globally in terms of population and economy, and financial inclusion is well advanced in each country. The Pacific Islands are among the smallest in terms of population size, with varying levels of financial inclusion depending on the country. These Island nations host fewer banks and are heavily dependent on access to financial services to receive remittances from family living abroad.

Asian Responses

Clients demonstrated their agility and resiliency, as many households and small businesses were quick to adapt to the pandemic and lockdowns. However, recovery is uneven across Asia and globally. Many households face greater vulnerability, with the World Bank estimating 50 million to 200 million people falling back into poverty levels of less than $2 per day. Research by FINCA International[1] shows that 50 percent of their clients skipped meals to cope during the pandemic.

Several cross-cutting lessons can be drawn from the successful Asian financial institutions that have helped their clients weather the pandemic.

Product offerings that support clients:

- Financial service providers (FSPs) that focused on their clients and ensured fair and respectful interactions rebounded faster, even if this meant short-term institutional sacrifices. Quality FSPs managed to deepen their relationships with clients, enduring the crisis together, while tailoring solutions as needed for

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their clients. This required dynamic leadership, team cohesion, quick decisions, and clear communications throughout the institution to adapt to fast-changing client situations and environmental realities.

- FSPs offering a diverse range of relevant financial services-- especially payments, deposits, loans, and in some cases insurance—fared better.
- Lockdowns and other limitations on normal business and household activities accelerated the push towards digital financial services. Digital payments provided a lifeline for households and businesses to buy and sell essential goods and services and survive during lockdowns. In parallel, finding the right combination of physical and digital outreach enabled FSPs to engage with clients, monitor lending and liquidity closely, and manage costs.
- Despite predictions that households would deplete their savings during the initial months of the pandemic, deposit levels stabilized and even increased in some countries, while the flow of remittances and government to person payments increased in multiple countries.
- Embedded finance -- agricultural value chain lending, wholesale-retail business lending, consumer purchase lending, and other types of lending throughout the supply chain – is growing as a reliable financing option for households and businesses.

Managing funding

- Throughout the pandemic, liquidity was a critical measure of an FSP's health. Deposit taking institutions proved more resilient, with deeper liquidity. Even once recovery began, FSPs needed to carefully manage liquidity and avoid over lending. Recognizing this threat, multiple central banks and governments provided onlending and other liquidity measures to help FSPs stay solvent across Asia and the Pacific.
- International investors and lenders restructured their funding and provided new lines of credit or equity infusions to their existing financial services partners in the region, easing liquidity constraints.

Role of government

- The pandemic and resulting socio-economic tumult across the globe triggered complex challenges that required partnerships and clear communication between public and private sectors. Across the region, central banks and governments played key roles. Successful interventions across Asia's financial sector include liquidity programs for banks and their clients, expanded government to person payment programs for social welfare, consumer protection and data privacy measures, loan restructuring for businesses and households, and fraud prevention especially for the growing online lending sector.

Perspectives from China

Micro, small, and medium-sized enterprises (MSMEs), especially those in the services sector, were hit hardest by the COVID-19 pandemic and lockdowns across the country. Many businesses went bankrupt, resulting in sector-wide job losses. During the pandemic, the Chinese government supported MSMEs mainly via tax reduction and increased loans from China's banking sector. So far there have been no direct fiscal transfers (or subsidies) to either the enterprises or their employees. Financial regulators in China directed Chinese banks through inter-bank lending and other means to increase their lending to MSMEs at basic lending rates of interest, even though the demand for new loans was weak during the lockdowns. According to the People's Bank of China (May 2022), the loan portfolio to MSMEs has been growing monthly over 20 percent year-on-year for the consecutive 24 months since April 2020 and reached RMB 20.7 trillion by April 2022.[2] The average lending rates from banks for MSME lending in April 2022 was as low as 5.24 percent p.a.

Potential challenges: Financial regulators encouraged an MSME loan expansion via Chinese banks, and this may trigger two major side effects for sustainable MSME lending in China in the next three to five years. First, this new expansion by Chinese banks might have a devastating effect on traditional non-banking lenders in MSME lending, including microcredit companies, finance companies, and others, as their costs of funding are much higher than banks. For example, the average funding costs for a well-financed and functioning microcredit company is approximately 6-7 percent per year, which is much higher than the current bank lending rate of 5.24 percent as of April 2022.[3] Given their higher cost of funds, non-bank lenders will struggle to compete with banks for lending volume during this recovery period, and they will become more vulnerable to shocks and/or close their doors. Already many small banks that typically focus on MSME lending, including urban and rural commercial banks and village banks, are struggling with rising non-performing loans, governance issues, plus stiff competition from large banks, microcredit companies, and internet service providers. Institutional reforms for struggling financial service providers, including upgrading their fintech capacity, will be crucial to maintain a competitive market for MSME financing.

Once the pandemic and recovery period come to an end, government policies on MSME lending will likely ease, and banks are expected to slash their MSME lending. In parallel, banks are already reporting increased non-performing MSME loans to credit bureaus. This looming combination of banks withdrawing and non-bank lenders being more vulnerable will lead to less supply in the market for MSME lending. To help ease this potential looming credit crunch and help MSMEs survive, fiscal subsidies could be directed towards small and micro entrepreneurs and their employees. In parallel, policy support could include extending low cost on-lending from China's central bank for agricultural and MSME financing to non-banking financial institutions including micro-credit companies.

The use of private data for consumer lending may present another challenge for the sector. Large internet services providers (a.k.a. platforms) in China, including global players that have become ubiquitous such as Ant Finance, Ali Pay, Taobao, and others, have collected massive troves of information on private citizens through consumer lending, online shopping, and payments. This has triggered an imbalance between internet service providers and other lenders including banks, as well as reports of abuse or disclosure of private client information. While the Chinese government and financial regulators have been addressing the issue by strengthening credit reporting companies, it remains to be seen whether these reporting companies will be successful in leveling the competitive field given the dominance of internet lenders.

Future opportunities: During this recovery period, China is well placed to continue impressive growth of financial inclusion given rapid and extensive development of the country's internet infrastructure, expanding use of big data, and wide-spread adoption of new credit risk models that incorporate a broader range of factors for households and businesses in lending decisions. Combining both online approach and off-line approach may be the best strategy. Online approaches include non-cash transactions, data collection and analysis with credit risk models, and instant payment using mobile phones. Off-line approaches include field visits by loan officials for selected applicants such as first-time borrowers, collecting supplementary information, and calls or visits to collect loan payments. Combining both online and offline client interaction can be a potent strategy for financial services providers to reach MSME clients, especially in remote or low-population rural areas. Further, new products such as insurance could be expanded, including life insurance, health insurance, and accidental insurance products in rural areas and for lower-income households and MSMEs. Finally, given the promising growth of the agriculture sector and consumer food value chains, new products and services in value chain financing could be explored.

Perspectives from India

In India, the pandemic and subsequent lockdowns and restrictions changed household and business patterns, deeply affected their financial lives, and ruined livelihoods of millions of low-income households. Evidence points to a precipitous loss of income, depletion of meagre savings, increasing indebtedness, and difficult coping strategies that may bring millions back to poverty.

The public sector led the national crisis response across India, which mitigated damage during the pandemic and is helping relaunch the economy as businesses and households are trying to stabilize and rebuild. Since 2020, both the Reserve Bank of India (RBI) and the Government of India (GOI) undertook critical actions to deal with the pandemic and its impact on microfinance clients and institutions. Examples of public interventions include RBI's swift injection of new liquidity and rules to restructure loans and ease provisioning requirements. RBI announced a moratorium in March 2020 and extended it through August 2020 on loan repayments and interest payments to help loan customers. RBI also directed lenders to maintain the account status in their reporting to credit bureau during the moratorium period to ensure that the moratorium did not negatively affect the client credit history. In parallel, the RBI issued loan resolution frameworks for individuals and small businesses allowing lenders to restructure the loans. Government of India (GOI) on its part not only supported RBI's liquidity measures through its own Partial Credit Guarantee Scheme (PCGC) but also started a nationwide program of free foodgrains to 800 million people.

As the microfinance model heavily relies on frequent physical connect with customers at their doorstep in a group format, lockdowns brought microfinance operations to a complete standstill. As a result, repayments came under pressure, creating liquidity issues particularly for NBFC-MFIs. NBFC-MFIs did not receive moratorium on their own loans from lenders, which further exacerbated the NBFC-MFI liquidity crisis. Households struggled to understand the costs and implications of the loan repayment 'moratorium' and make hard choices to repay the loan, pay for daily needs, and/or conserve cash for uncertain future. A survey amongst MFIN member NBFC-MFIs in June 2021 reported NBFC-MFIs receiving moratorium for just over a third of their repayment instalments. As a result, NBFC-MFIs came under tremendous pressure to manage their liquidity. In response, the Ministry of Finance, Prime

Minister's Office, RBI, and other GoI entities issued multiple new lines of credit, guarantee programs, and other financial support, often designed in close collaboration with the self-regulatory organizations such as MFIN and industry organization like FIDC.

In parallel, FSPs faced daunting, even existential, challenges. Managing ongoing connection with customers, continuing operations amidst restrictions, ensuring the safety of their employees, managing liquidity to cover operational costs and debt obligations, and adapting their operations to accelerate use of mobile phones and digital payments. While the loan repayment moratorium gave immediate relief, the clients were confused about how to avail of the moratorium and implications, institutions took varied approaches, and information circulated on social media, sometimes incorrectly. FSPs and MFIN took several efforts such as audio-visuals, direct calling to customers, awareness campaigns and dedicated customer mobile apps to try to raise awareness about pandemic-related measures to help clients.

In parallel, at the employee level, MFIs established additional controls to monitor repayments, avoid misinformation, misbehavior, forced collections, and/or embezzlement by field-level employees. Lenders also stepped up their client grievance redressal mechanisms to inform clients, respond to queries, and address concerns on a much larger scale. Further, many MFIs supported customers with emergency aid for health, food, and essential supplies where possible.

Future opportunities: By March 2022, as the pandemic eased out, the RBI opened a new chapter through its revised regulations for microfinance. Under the new regulations, all entities doing microfinance lending – whether a bank or NBFC-MFI -- will operate under similar regulation. This is a welcome policy shift from micro-rules to principles-based approach. Key pillars of the new regulation include a threshold of debt repayments at 50 percent of client income to verify client indebtedness, deregulation of pricing, and enhanced focus on client protection. The sector is well positioned building on the resilience demonstrated during the pandemic and enhanced efficiency from greater use of digital processes in operations. Microfinance institutions currently serve approximately 60 million people, but the estimated market is 221 million people[4] who seek financial inclusion across India. The sector now needs to expand responsibly in areas hitherto underserved due to earlier rigid price controls, launch innovative products, and demonstrate clear impact.

Perspectives from Indonesia

Indonesia experienced severe impacts during the pandemic, with the millions of COVID-19 cases reported and high death rates. Economic growth declined sharply, with negative growth of approximately 5.3 percent. As in other countries, the government restricted people's mobility and partially closed factories, offices, and public spaces. This triggered millions of people to remain home, losing income and jobs. The MSME sector was hit especially hard, as both their customers and their staff were affected by lockdowns, businesses were not allowed to operate, and revenue plummeted.

The banking and financial sector also faced serious challenges. During the 1998 financial crisis in Indonesia and beyond, the corporate sector and mainstream banking were most affected. Yet during the pandemic, both mainstream banking and the microfinance sector were affected.

The range of institutions in Indonesia serving households and MSMEs is diverse and includes banks, rural banks, non-bank financial institutions (NBFI), cooperatives, and other community-based lenders. Banks and rural banks operate under national banking laws, cooperatives are governed by cooperative laws, and other types of institutions operate under specialized laws and regulations. The financial sector is distinguished by having both conventional and Islamic-based principles (sharia) for institutions and clients to follow.

The impact on financial institutions varied widely, although many smaller institutions such as rural banks, cooperatives and other NBFIs faced significant operational and financial disruption. Given increasing loan defaults, institutions lost income to cover their operational expenses while battling non-performing loans and rising costs of loan reserves. Soon, institutions were forced to manage dire shortages of cashflow and liquidity, which was further exacerbated by depositors withdrawing funds for household needs and emergency spending. Management and staff were deeply affected by these challenges, and their own safety in working and providing services to clients.

MSMEs and microfinance clients are highly dependent on the cash economy and offline business. So the lockdowns hit these businesses and households especially hard. Demand for goods and services plummeted, and households struggled to meet daily needs. In this context, many households and businesses were forced to postpone loan repayments. In the medium and long term, missing loan payments has already affected their credit scores, and instances of collateral seizures and other collection measures have increased. Women experienced greater challenges, with rising domestic responsibilities during the lockdowns, including home schooling for children, so they had even less time to focus on their business activities. Some MSMEs quickly adjusted to the situation by adopting new business models such as shifting to on-line marketing and transactions and/or adding health-related products in high demand during the pandemic. Many businesses could no longer survive, and people chose to migrate from cities back to home villages with lower costs of living. During the pandemic, the agricultural sector has been less affected, and this attracted people seeking alternative jobs.

Throughout the pandemic, FSPs struggled to manage loan collections, especially given divergent client capacity and willingness to repay loans. Many institutions managed these challenges admirably, although there were increased reports of client complaints. In some cases, clients faced surprise late payment penalties, coercive collections, improper collateral seizure, and other behavior that put clients at risk. Of particular note, during the pandemic cross-border online lending platforms increased their activity in Indonesia—despite being illegal and unregulated. These platforms provide quick loans and needed cash, but they also charge very high interest rates and fees, and many of the more serious consumer harassment cases have been tied to these cross-border online platforms. In extreme cases, some borrowers committed suicide. Although belated, the national police have started taking action to curb illegal online lenders.

In response to these challenges, the Indonesian government introduced multiple measures to help households and businesses cope. For low-income households, government programs provided safety nets through direct cash transfers, in-kind grants, and other non-monetary subsidies. Government support to FSPs included regulations on loan rescheduling and liquidity support through new or expanded programs such as the People Business Credit Program (KUR loan), Economic Recovery Program (PEN), Ultra Micro Loan Program (UMI), and the Revolving Fund for Cooperatives (LPDB). In parallel, private lenders also offered FSPs options to reschedule loans and assistance in digitalizing loan origination and disbursement.

Future opportunities: The majority of FSPs have taken prudent actions to mitigate financial and operational risks and start rebuilding. Key priorities included covering operational expenses, meeting requests for deposit withdrawals, rescheduling and restructuring loans, maintaining staff morale, and rescheduling payments to lenders while seeking additional liquidity.

The pandemic response demonstrates the crucial role digital and responsible financial inclusion serves to address household and business development. MFIs that are further advanced in digitalizing their operations and financing infrastructure have been able to survive and grow, and they are well positioned to help shift millions of MSMEs from offline practices to online financial services, supply chains, and other services. According to the Ministry of Cooperatives and SMEs, 19.5 million MSMEs are already active online, and the government aims to have 30 million MSMEs online by 2024.[5] The benefits of responsible digital operations would improve business operational efficiency that would lead to greater client satisfaction, credit risk mitigation, and business profitability.

Perspectives from the Pacific Island Countries

Many Pacific Island countries were spared severe health effects of the COVID-19 pandemic, as cases were relatively lower compared with other countries across Asia and globally. However, socio-economic effects were dramatic given plummeting tourism and other economic activities across the region.

The Pacific region is geographically diverse, with a population of over 11 million people, including two larger countries of Papua New Guinea and Fiji and many smaller island countries such as Solomon Islands, Samoa, Vanuatu, Tonga, and others. Remittances and digital payments are critical in the Pacific given the strong reliance on overseas migrant workers to support local communities, and this became even more crucial during the pandemic.

There is no consolidated formal statistic about financial inclusion for the whole region. Based on estimates and Findex data, approximately only 30 percent of the adult population across the Pacific Island countries (excluding Fiji) have access to financial services. Governments and private sector institutions have launched several initiatives in the region, with support of development partners, to boost financial inclusion in the region in the recent years.

Core challenges to the Pacific region include bank de-risking and the high cost of remittances. De-risking was already a serious issue for many money transfer operators (MTOs) in the Pacific. Many banks had stopped offering account services to MTOs due to the concern of perceived or real concerns on anti-money laundering (AML) and know-your-customer (KYC) compliance. Multiple MTOs were forced to close operations across the Pacific given concerns from their banking correspondents and regulators. In response, the availability of remittance services declined and costs to send money home increased. Globally, the cost of remittances averages 6.38 percent, but across the Pacific region, costs are over 10 percent. This situation was exacerbated during the pandemic, as households and businesses relied on fewer licensed remittance providers and banks operating in the Pacific region.

The World Bank Group Remittance study showed that Tonga, Fiji, and Samoa are the top remittance receivers in the Pacific. In fact, Tonga is the most significant recipient of remittances in the region, with annual remittances close to 40 percent of national GDP.[6] Australia and New Zealand are the two main sources of remittances to the Pacific region, given large communities of Pacific Islanders diaspora and seasonal workers.

For several years, the World Bank and IFC have been supporting Pacific countries to develop the necessary legal and regulatory framework and improve national payment system infrastructure to enable more retail digital payments and remittances. For example, the IFC has supported Tonga Development Bank (TDB) to establish new digital remittances corridors with New Zealand and Australia, called 'Ave Pa'anga Pau (which means 'Send Money Securely' in Tongan).[7] 'Ave Pa'anga Pau enables Tongans to send money home in a quick and secure way, and at a significantly lower cost than other services. The average cost to send money home through other remittance providers exceeds 10 percent,[8] yet through 'Ave pa'anga Pau, the cost is approximately 5 percent, and this cost savings for remitters means people at home receive more money.

Since the launch of 'Ave Pa'anga Pau in 2017 between Tonga and New Zealand, the program now covers 95 percent of Tongan seasonal workers in New Zealand. The launch of 'Ave Pa'anga Pau' between Australia and Tonga in November 2020 came at a crucial time during the pandemic, as people sought online solutions while under lockdown, and program usage surged. The program also served as a financial lifeline for many people in Tonga when the Hunga Tonga-Hunga Ha'apai volcano erupted in January 2022. To date over 2,000 bank accounts have been opened in Tonga through the program. With a population of about 107,000 people, this is a significant increase in financial inclusion.

Future opportunities: Digital financial services will continue to grow in the Pacific countries, with central banks progressing in operationalizing the national electronic payment systems in Fiji, Samoa, Solomon Islands, and Vanuatu. In parallel and building on these efforts, commercial banks and telecom companies are offering new digital payment and remittance products. Households and small businesses in Pacific countries stand to benefit from national payment system reforms that will help modernize national and regional financial architecture, in turn driving inclusive economic development and making every day financial transactions easier.

Endnotes

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