A Covid Microfinance Liquidity Tour of Asia[1]

The cacophony of the pandemic

October 2020

This **synthesis document** brings together selected aspects of the **Covid-19 Microfinance Liquidity Tour of Asia** undertaken by M-CRIL over the past few months. In this document, we have compiled cross country data emerging from the M-CRIL Advisory Notes covering different types of MFSPs (listed in the box below) and provided some reflections on the analysis.[2]

Reverse migration during lockdown, image from Rajesh Bhalouria, Pixabay[3]

The data used for this document covers
Cambodia's large microfinance service providers (MFSPs) –
9 MFSPs that are banks or microfinance deposit taking institutions (MDIs)
India's Small Finance Banks engaged in microlending (8),
India's largest **MFIs** (10)
Myanmar's large MFIs (10)
Nepal's Laghubitta Bittiya Sanstha (LBS, 8 largest deposit taking MFIs)
Pakistan's Microfinance Banks (MFBs, 10)

It is apparent from this summary that inter-country comparisons of M-CRIL's liquidity calculations are not always appropriate due to the differences in the severity of lockdown in the countries covered and due to the related variations in measures mandated by regulators across countries. Nevertheless, the data for MFSPs in the individual countries yields interesting conclusions that are set out in the separate country notes and synthesised here.

The following boxes summarise first the variations in lockdown conditions and then the variations in regulatory measures.

[1] With apologies to The Beatles and their 1967 double EP record titled "Magical Mystery Tour". If this reference from long ago dates the author, so be it! My thanks to Daniel Rozas for the idea.
[2] The original Advisory Notes are available on www.m-cril.com/publication and the author's LinkedIn page.
[3] https://pixabay.com/users/balouriarajesh-6205857/?utm_source=link-attribution&utm_medium=referral&amp

Asian Liquidity Tour: Lockdown drums

Cambodia: No lockdown – public asked to exercise caution while continuing their daily business. Two main industries – garments and tourism – severely affected by the collapse of international orders and tourist arrivals respectively.

India: Severe lockdown from 24 March until the end of May followed by continuing lockdowns in extensive "containment zones" and relaxations from early July.

Myanmar: Complete closure of all economic activities in the country during 6 April to 30 April 2020. Stay at home restrictions were largely removed at the end of the period. In practice, most MFIs were only able to resume operations gradually and normal operations from mid-May. There are currently further restrictions beginning 20 September.

Nepal: Nation-wide lockdown during 23 March to 21 July 2020 but impact limited outside Kathmandu and a few major towns.

Pakistan: Lockdown from late March (various dates in different regions/provinces) to a gradual easing beginning early May; strictly enforced in early weeks, then eased gradually.

Asian Liquidity Tour: Regulatory cymbals

Cambodia: The National Bank of Cambodia (NBC), issued a directive to all financial institutions (including MFIs) to restructure credit for loans in four priority sectors:[4] tourism (including food and beverage, other support services), garments (including employees), construction and transport, logistics. NBC has been encouraging MFSPs to offer re-scheduling and loan deferment on a case-by-case basis to ensure the sector's sustainability.

India imposed the severest lockdown of all the five countries and announced a virtually mandatory moratorium of 3 months on loans for all borrowers wanting it. This was followed by another optional moratorium of a further 3 months ending on 30 September 2020. The moratorium was later extended up the lending value chain to cover MFIs' and SFBs' borrowing from banks and DFIs.

Myanmar: Central Bank of Myanmar has slashed unsecured lending rates from 16% to 14.5%. The microfinance regulator, FRD, has relaxed key ratio requirements like the debt to equity ratio to ease the pressure on MFIs. The country's largest donor consortium, LIFT, is also facilitating access to US$60 million of additional loan capital and advocating for other regulatory adjustments that could result in doubling the amount of loan funds available to LIFT-supported MFIs.[5]

Nepal: NRB directed banks to increase their loans to priority sectors, such as agriculture, energy, tourism, and micro, small and mid-size enterprises to 40% from 25% by 2024. NRB also lowered the policy rate from 3.5% to 3% and announced that additional liquidity support would be made available through the long-term repo facility. This has eased the flow of funds from commercial banks to the microlending LBS.

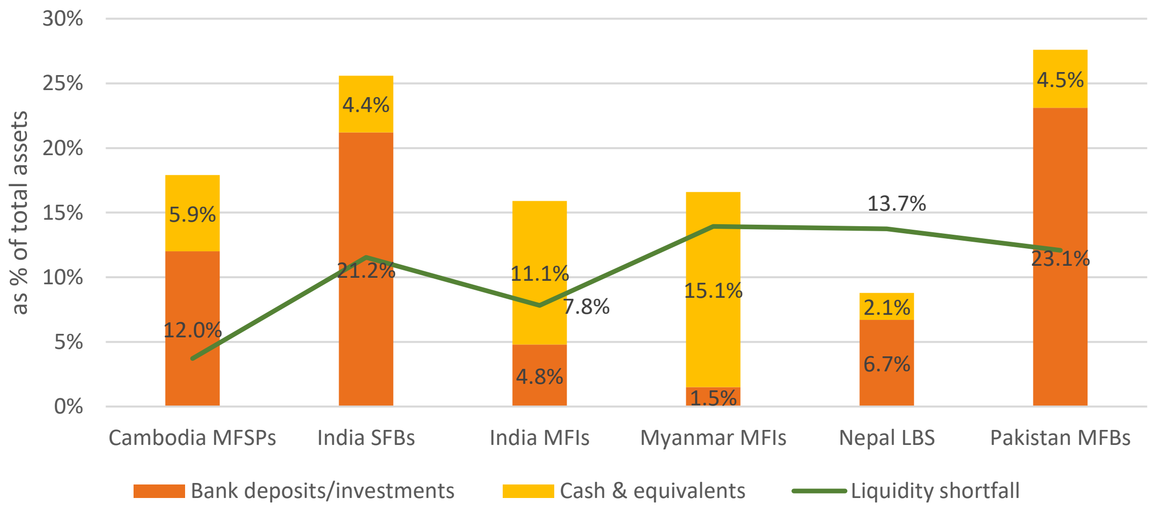
[4] https://www.phnompenhpost.com/business/refinancing-applications-drop-sharply
[5] http://ebrary.ifpri.org/utils/getfile/collection/p15738coll2/id/133695/filename/133909.pdf

Pakistan: At the beginning of the lockdown, SBP announced up to a one-year deferment of principal payments for customers who requested it. This applied to all banks, including MFBs. As the lockdown continued into April, most MFPs extended deferment of loan repayments up to six months. SBP cut the policy rate by a cumulative 525 basis points to 8% over two months with the objective of providing liquidity support to households and businesses. The policy rate cuts helped maintain credit flows, bolster the cash flow of borrowers, and support asset prices.[6]

As a result of these substantial variations both in lockdown conditions and regulatory responses, there is no consistent cross-country correlation between liquid/near-liquid assets (cash equivalents and bank deposits held by the MFSPs) and the shortfall in funds required to manage operations in the time of Covid-19. Whilst theory suggests that institutions with liquid assets should encounter smaller shortfalls in liquidity in times of crisis (and this applies fully to the intra-country inter-MFSP analyses in our country notes), it does not necessarily apply across countries under Covid conditions as shown by **Figure 1** and the associated table

- Nepal's LBS had the lowest liquidity at the start of the crisis (8.8% cash + bank deposits) and a high 13.7% cash shortfall but
- Indian SFBs with very high 25.6% liquidity still have an estimated cash shortfall of 11.5%.
- Not surprisingly the inter-country correlation coefficient between MFI liquidity and the shortfall caused by Covid is less than (minus) 4%, virtually negligible.

Figure 1 Lack of inter-country correlation between MFI liquidity and shortfall during Covid



Ratios as % of total assets						
Cash + bank deposits	17.9%	25.6%	15.9%	16.6%	8.8%	27.6%
Lqty shortfall	3.7%	11.5%	7.8%	13.9%	13.7%	12.1%
Correlation between MFSP liquidity and Covid induced shortfall						
Inter-country, R^2 = minus 4%						
Inter-MFSP	-63%	-48%	-72%	-84%	-40%	-33%

[6] CGAP/PMN, June 2020. "Pakistan: Policy, Regulatory & Supervisory Covid-19 Responses for Microfinance" CGAP Background Document.

As expected though, the inter-institutional correlation between MFSP liquidity and the shortfall within countries is high – ranging from 33% in Pakistan to 84% in Myanmar. The lower of the inter-MFSP correlations in the table above are related to

- the availability of liberal commercial bank funding in spite of Covid lockdowns (Nepal LBS) which limits the correlation between liquid assets and the shortfall
- high, and importantly, stable deposit funding (Pakistan MFBs and Indian SFBs)
- Cambodia's lower correlation than Myanmar can be attributed both to the apparently limited severity of Covid and the significant proportion of international bank ownership of Cambodian MFSPs.

The covid liquidity paradox…

Based on the above analysis, **the key pre-existing factors that enable institutions to manage Covid conditions** are as follows

- While commercial logic dictates that a high proportion of assets should be in portfolio since that is what generates income for MFIs (and has higher interest yields than any bank deposits are likely to provide), at a time like this, **a lower proportion of assets in loan portfolio** is beneficial for managing liquidity. Pakistan's MFBs have 40-68% of their assets invested in loan portfolios so are less challenged than India's SFBs (69-80% of assets in portfolio) and Nepal's large MFIs (85-95%) but there is, nevertheless, a liquidity shortfall, even in Pakistan, for those with >65% of assets in loan portfolio.

- **A high maturity period of portfolio is also helpful** at a time like this since that reduces the need for loan rescheduling. India and Myanmar's MFIs and Pakistan's MFBs with >40% of portfolio in <180 day maturities have greater potential for a liquidity crisis than Nepal's LBS with less than 25% of portfolio maturing in that period; Cambodia's MFSPs with over two-thirds of portfolio in loans of >365 day maturity are also less affected by the crisis. This is contrary to received microfinance wisdom suggesting short maturity loans should be prioritised as these are more profitable than those with longer maturities.

- Deposit withdrawals have not been a major consequence of the pandemic. As a result, **with deposit funding at the 70-98% level** and borrowings less than 10% of liabilities, **Pakistan's MFBs are less challenged** than the higher leveraged
  - large MFIs of Nepal (30-60% borrowings),
  - India's large MFIs (70-90% borrowings) and
  - also somewhat better off than India's Small Finance Banks (50-75% deposit funding) and Cambodia's large MFSPs (55-72%).

…and reflections on the liquidity tour

Our analysis indicates the orders of magnitude for the **expected liquidity shortfalls** (needing additional finance) under likely levels of recovery of dues from clients, normal borrowing conditions and reasonable levels of disbursement under the lockdown conditions and regulatory responses necessitated by Covid. These are summarised in **Table 2** and indicate a **shortfall in the time of Covid of around $2.1 billion** in the 5 countries covered by our analysis.

Table 2 Liquidity shortfalls calculated at expected levels of various parameters (in %)

	Cambodia	India		Myanmar	Nepal	Pakistan
Expected levels of…	**MFSPs**	**SFBs**	**MFIs**	**MFIs**	**LBS**	**MFBs**
Recovery	85	65	65	80	90	65-70
Disbursement	90	65	65	85	70	75
Borrowing repaid, net%	nil	20	20	20	-30	20
Loan accounts, mn	2.2	20.2	17.6	2.4	1.9	2.8
No. of MFSPs	9	8	10	20*	20*	9
Liquidity shortfall, $ mn	320	940	400	178	137	145

* Extrapolated from analysis of 10 MFIs in Myanmar and 12 LBS in Nepal.

We emphasise that these numbers are purely indicative; we make no claims to accuracy. The methodology followed for the analysis is set out in each of the country notes. As indicated above, there are country-specific variations not only in lockdown conditions but also in related measures mandated or encouraged by regulators. These variations mean that the numbers are not strictly comparable between countries. Some of the variations include

- no lockdown in **Cambodia** further mitigated by extensive ownership of Cambodian MFSPs by regional banks which has reduced the risk for MFIs as standalone entities
- **India's** strict lockdown and associated moratorium encouraged by the Reserve Bank of India (RBI), which has created turmoil in the entire financial system and led to confusion about responsibility for interest as well as the due dates for principal collection as well as to concerns about financial performance of MFSPs that are likely to persist for years to come. The RBI has softened the effect of the liquidity crisis over the past few months by repeatedly making available, to both commercial banks and DFIs, additional loanable funds specifically earmarked for inclusive finance institutions. These amounts may be sufficient to tide over the crisis but the approach optimistically assumes frictionless fund flows which is not the case in practice – the larger institutions benefit while the smaller ones have to negotiate multiple hurdles in order to qualify
- **Myanmar**'s mandated loan rescheduling in response to a three week lockdown; extensive equity and limited loan funding make the MFIs dependent on liquidity support from investors; some are cushioned by their ownership by foreign/regional financial institutions
- relatively relaxed implementation of the lockdown in **Nepal** (outside Kathmandu and a few major towns) resulting in relatively limited disruption of the inclusive finance eco-system. This is further mitigated by a substantial liquidity overhang within the commercial banks in the country enabling significant additional funding of the LBS network without substantial additional support
- a high level of deposit funding of **Pakistan's** MFBs; since deposits have remained largely stable at this time, the liquidity shortfall is limited in spite of the deferment of repayments on around 30% of the portfolio. However, unlike India's SFBs, Pakistan's MFBs do not have scheduled bank status and are not, therefore, able to access the State Bank of Pakistan's liquidity window created to support the financial system in this time of crisis.

The object of the Microfinance Liquidity Tour of Asia (the series of Advisory Notes by M-CRIL in the context of Covid) undertaken for the five countries covered by this synthesis is to make an assessment of the additional funds from investors and local or international lenders (central banks, domestic commercial banks, foreign lenders) that some of the MFSPs have needed or will need to access **in order to grow** beyond survival and to continue to provide inclusive finance services next year and beyond.

Financial health alert: There is a view that our approach raises unjustified alarm; we believe that those making this argument are taking a short term view of the matter – short term adequacy of liquidity results from the availability of liquid reserves and the encashment of short term assets. It is enhanced by the limited repayment collections taking place at a time when disbursements are hampered by Covid-related physical restrictions. The stemming of the flow of repayment collections from clients (due to moratoriums and deferments) having reduced disbursements **now** will lead to reduced collections **limiting fund inflows over the next 12-18 months**. In the meantime, liquid assets will have been spent on meeting ongoing operational expenses. Complacency in the face of this crisis could lead to further crises in the future; **better to plan for maintaining operations and growth than to decry warnings**.

The purpose of this exercise has been to facilitate decision making in relation to the micro-lending value chain in the countries covered by the analysis. It has also been to enable understanding of the finances of MFSPs in each of the countries and to indicate the potential role of domestic as well as external investors & lenders in supporting the inclusive finance eco-system in the countries covered.

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A disclaimer for readers…

These findings provide a guide for the managements of micro-lending institutions, for wholesale lenders to them and for investors in such institutions to understand the liquidity challenges of the lockdown. As indicated in the text, this note is based on the latest available financial statements of MFSPs at the time of the analyses in the Advisory Notes prepared during June to September 2020. This document does not purport to set out rules of operation for micro-lenders in normal times, it is meant mainly as an indicator for all stakeholders in the micro-lending sector of the challenges involved and the orders of magnitude of funds of additional investment or lending to be considered. ***However, actions taken by stakeholders are at their own risk and M-CRIL will not be responsible for decisions based on the contents of this synthesis or of our earlier Advisory Notes on the subject***.

Sanjay Sinha, Managing Director

M-CRIL is a responsible development research and analytics firm with a concern for **inclusive microeconomics**. Along with its parent firm, EDA Rural Systems, M-CRIL has over 40 years of experience of international issues in microenterprise promotion and financial inclusion through a substantial record of analytics in this field including microfinance ratings, programme evaluations and focused management training and capacity building support for MFIs. Its work in support of smallholder farmers and with agricultural value chains in South and Southeast Asia emphasises its commitment to supporting the lives and livelihoods of low income families.