

Sustaining Myanmar's Microfinance Sector during the COVID-19 Economic Crisis to Support Food Security, Resilience, and Economic Recovery

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This note discusses the significant risks facing microfinance institutions (MFI) in Myanmar in the wake of the COVID-19 health and economic crisis and the implications for poverty and food insecurity of a serious negative shock to the MFI sector. The note is based on a desk review of the early policy responses in Myanmar, of best practices identified by international and local experts, and online discussions with leaders of MFIs operating in Myanmar. The objective is to make policymakers aware of the crucial role MFIs play in a wide range of economic activities in Myanmar, including food production, processing, trade, and marketing. A serious disruption to the MFI sector has the potential to:

- Exacerbate food insecurity through damaging economic resilience in the short-to-medium term,
- Lower agricultural output in the critical upcoming monsoon production season, and
- Harm the potential for microfinance to contribute to economic recovery.

Background: The Microfinance Sector in Myanmar

The microfinance sector in Myanmar has experienced rapid growth since 2012/13 when a modern regulatory system came online, a number of new microfinance institutions (MFI) were launched, and donor support to the sector expanded. Myanmar currently has 193 licensed MFIs operating across 15 states and regions in 252 of 330 townships.¹ As of mid-2019, the sector served 3.4 million members, likely representing around 15 million individuals. The sector boasts a 99 percent repayment rate,² and extended more than USD 1.2 billion in loans in 2019 (Slover 2020). As of 2017, the top 18 MFIs represented 81 percent of total MFI assets.³ While many MFIs were launched largely with equity financing, the growth of sector in the last two to three years has largely been supported with international and domestic debt financing. In 2019, the government mandated a reduction in the

¹ According to the Financial Regulatory Department of the Ministry of Planning, Finance, and Industry (FRD-MoPFI), which regulates non-bank financial institutions.

² <https://www.mmtimes.com/news/growth-potential-seen-microfinance-sector.html>

³ <https://www.myanmarfma.com/en/financial-inclusion-myanmar>

maximum microfinance interest rate from 30 percent to 28 percent, which is considered to provide a relatively tight margin for MFIs, especially for those involved in rural microfinance.

Beyond the MFIs, the Myanmar Agricultural Development Bank (MADB) has the largest client base in rural areas and serves a similar market segment (loans under USD 1,000).⁴ MADB has branches in about 60 percent of townships, with the majority in rice-producing regions in south and central Myanmar.⁵ Some farmers borrow from MADB and then seek additional loan financing from MFIs – in some cases to address temporary delays in MADB loan disbursements.

Current Situation

Myanmar was one of the first countries after China to feel the economic effects of COVID-19 through slowing tourist arrivals from its neighbor (Aung Hein and Minoletti 2020). Myanmar's first official case was confirmed on March 23. The restrictions on movement which followed brought rapid disruptions across the economy, including in the microfinance sector:

- MFIs began to voluntarily suspend loan repayments in late March and to rapidly implement response plans, including social distancing procedures, suspension of group meetings, and COVID-19 information campaigns. Following loan suspensions by two regional authorities, the central Financial Regulatory Department of the Ministry of Planning, Finance, and Industry (FRD-MoPFI) officially suspended loan repayments (other than voluntary), the taking on of new clients, and the acceptance of savings balances for the period from April 6 to 30.⁶
- MFIs had been building reserves for the upcoming monsoon lending season (April to June). However the repayment suspension, combined with ongoing operating costs (staff salaries, rents, utilities, etc.), expected withdrawals of members' savings balances, and financing obligations (e.g., domestic and international loans and other obligations to investors) imply that MFIs will have to severely cut back their monsoon lending in the absence of major injections of outside capital. Even if normal operations are restarted, allowing MFIs to recover some capital, it is expected that many, if not most, borrowers will be unable to repay loans in the short run. For example, agricultural producers of melons and onions may find that they cannot sell their current crops, so then will be unable to service their loans.
- The Government of Myanmar announced a financial support package on March 18 with a value of 0.1 percent of GDP. This includes loan support for small and medium-size enterprises, with a likely much larger COVID-19 Comprehensive Response Plan on the way. Domestic banks announced loan repayment suspensions of up to 6 months, which may benefit MFIs with bank loans. The Central Bank of Myanmar cut interest rates by 1.5 percent, which has the unfortunate unintended consequence of lowering access to international debt financing for MFIs (Slover 2020). The country's largest donor consortium, LIFT, is facilitating access to USD 60 million in additional loan capital, while simultaneously advocating for other regulatory adjustments that could result in making double this amount of loan funds available to LIFT-supported MFIs. These MFIs together serve over 2.8 million borrowers and represent two-thirds of assets in the sector (Slover 2020). These regulatory adjustments would also increase access to finance for other MFIs.

⁴ The MADB offers some larger mechanization loans, but the vast majority of borrowers receive seasonal or short-term crop loans.

⁵ About 90 percent of MADB clients are small-to-medium holders in the rice sector.

⁶ The FRD directive also instructed that MFIs could only disburse new loans for "emergency" or "essential" purposes. There has been some confusion about this directive, although at least some MFIs believe it means no restriction on disbursements. Some MFIs also worry about taking voluntary repayments, lest they be seen as pressuring borrowers.

Potential Negative Effects of Lending Disruptions on Food Security

The COVID-19 pandemic and resulting economic shocks will have major impacts on poor and vulnerable populations in Myanmar, including different actors in the agricultural value chains that supply the bulk of Myanmar's food (Boughton et al. 2020). MFIs play a crucial role in financing those value chains from farm producers all the way to retail markets, as well as small and medium-size enterprises that provide non-farm livelihoods for the poor. Reductions in the number or size of loans will have adverse effects on food security on three time scales:

- In the short-to-medium run, a disruption to MFIs will compound the adverse effects of the COVID-19 shock on economic resilience across Myanmar, pulling funds out of the economy and reducing food consumption, with knock-on effects for wages and employment. Breza and Kinnan (2018) present perhaps the best global evidence we have to isolate the impacts on local economies of a sharp reduction in microfinance access. Using data from India, where 20 percent of households have access to microfinance, they estimate that cutting off access to microfinance will result in a drop in rural wages for *all* workers (not just microfinance borrowers) of between 5 and 9 percent, with associated measurable drops in consumer spending, investment, and entrepreneurship. To compensate, households may seek alternative sources of financing where they can, such as through incurring debts at higher interest rates from moneylenders.
- A disruption to monsoon lending⁷ will reduce smallholder farmers' ability to invest in farm production, while further disrupting agricultural input supply chains that are reliant on microfinance-facilitated sales. This will reduce the food they produce for the late-2020 harvest, inducing higher food prices, lower dietary diversity, and reducing incomes for producers, aggregators, processors, and distributors of food.
- Sustained damage to the microfinance sector will threaten the viability of some MFIs and reduce the ability of all MFIs to serve as a pillar of economic recovery. One key lesson from a prior pandemic in West Africa is that MFIs will be most successful in enabling borrowers to replenish assets and restart economic activity in a recovery phase if they can simultaneously make new loan disbursements while restarting regular loan collections.⁸ Otherwise, there is a risk of a much slower economic recovery over many years.

Hence, a major decline in loan disbursements from MFIs poses a serious risk for maintaining food security in 2020, 2021, and beyond.

Financial Challenges for Microfinance Institutions Resulting from Effects of COVID-19

The various challenges currently facing MFIs can be analyzed through the lens of the microfinance ecosystem, depicted in Figure 1. MFIs provide a means to intermediate wholesale financing from international and domestic capital sources to borrowers in the form of generally small, retail loans.

The most urgent challenge to MFIs is a cash liquidity crisis. Incoming sources of cash – collection of loan repayments⁹ and acceptance of savings deposits – have been nearly completely frozen by the FRD directive suspending most MFI activities. At the same time, MFI customers will surely seek to withdraw savings balances from deposit-taking MFIs. Meanwhile, salaries to staff (estimated to make up more than 50 percent of the operating costs for some MFIs) and operating

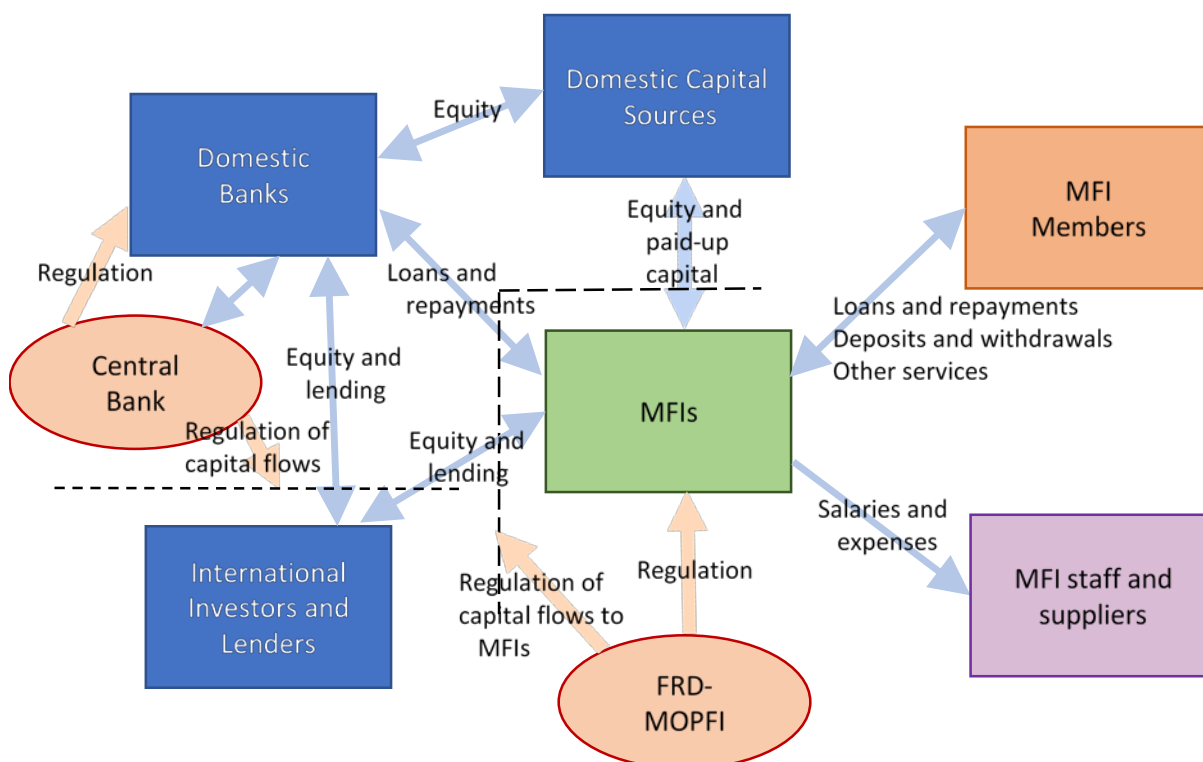
⁷ As noted earlier, MFIs also often help farmers get crops planted if MADB loans have not yet been received.

⁸ https://globaldeliveryinitiative.org/sites/default/files/case-studies/rflessonslearned_10-25-17.pdf. This MFI also found that keeping staff on board was key to a rapid recovery.

⁹ The FRD directive allows for voluntary repayments, but these are likely quite low.

expenses, such as rent and utilities, may continue to accumulate, although some operating expenses, such as field travel costs, may decline.

Figure 1. The Microfinance Ecosystem in Myanmar



Source: Author's construction.

Note: MFI = microfinance institution; FRD-MOPFI = Financial Regulatory Department of the Ministry of Planning, Finance, and Industry.

On the other side of the balance sheet, **MFIs face obligations to service their sources of capital**, as can be seen on the left-hand side of Figure 1. In terms of timing and flexibility, these obligations may take on very different forms for different MFIs. Debt financing, whether short or long-term, will have fixed principal payment obligations and interest responsibilities. Equity-type investments and ownership shares will obligate the financier to take on a greater share of downside risk, likely providing greater flexibility. The Central Bank of Myanmar regulates large international capital flows, with the Myanmar Microfinance Supervision Committee in FRD-MOPFI approving changes in MFIs' capital.

Policy Guidance: Global Best Practice in COVID-19 Response

We particularly draw upon the advice of Bull and Ogden (2020) for how the microfinance ecosystem should act in response to COVID-19 so that hundreds of millions of poor people globally can continue to rely on MFIs to borrow, save, and build their livelihoods:¹⁰

- **“Development finance institutions, multilaterals, and bilaterals** should be studying prior financial crises to consider how to structure rescue packages for MFIs, including lessons learned in buying up loan portfolios, creating regional financial support facilities, and facilitating mergers. This is the time for blended finance providers and, particularly, donor capital to step up.”

¹⁰ <https://www.cgap.org/blog/covid-19-how-does-microfinance-weather-coming-storm>

- **Investors, funders, and lenders** to MFIs “should consider temporarily suspending and rolling up returns on their outstanding loans to MFIs, pushing out repayment terms and relaxing covenants they might have on such factors as repayment rates, net asset values, and capital adequacy ratios.” March 2020 saw the largest outflow of capital from emerging markets in history, which will drive up costs of capital in emerging markets.¹¹
- **Central banking authorities** and, in Myanmar’s case, also FRD-MOPFI should undertake efforts to maintain the solvency of MFIs, including easing reserve requirements, facilitating injections of capital, especially from overseas, and directing financing from the central bank.¹²
- **MFI and digital financial services regulators** should facilitate adaptations to public health guidance during the crisis by reducing travel and face-to-face contact. This can include “allowing the use of digital signatures ... and approving credit rollovers remotely,” facilitating increased digital transactions, such as through increasing or removing limits on digital transactions, reducing or removing fees, and easing Know Your Customer (KYC) requirements.
- **MFIs themselves** will need to make a series of difficult choices about loan suspensions (principal and interest), restructuring of loans, and operational transitions (from branches to staff to digitizing processes). In the short-to-medium term, MFIs have the potential to take on a broader role in managing the crisis, for example through disseminating public health guidance and assisting in distributing social protection benefits to the vulnerable. MFIs should seek to maintain member relationships during any suspension periods, and regulators should encourage them to do so, as social capital is important for the viability of microfinance (e.g., Feigenberg et al. 2013), and can greatly facilitate recovery.¹³ MFIs may also need to adjust loan officer contract incentives.

Policy Guidance: Recommendations for Myanmar

International microfinance experts are deeply concerned about the risks facing MFIs and the potential for MFI disruptions to compound the economic shocks hitting developing country economies. Adapting this advice to the Myanmar context, we recommend the following policy responses:

- **Declare MFIs an essential service and allow MFIs to resume operations from May 1.** Doing so raises risks for health and consumer protection, which need to be managed. However, the risk of sidelining MFIs is arguably much larger. Just as banks have been deemed an “essential service”, so should MFIs be allowed to continue operations in line with the most current public health guidance (Slover 2020). MFIs can and will adapt group lending and other procedures to mitigate public health concerns, and were already moving to do so before April 6. The vast majority of borrowers are connected to MFIs with a strong record for social responsibility and a strong reputational incentive to carefully manage decisions about bringing their staff back to work; collecting, restructuring, or postponing existing loans; and channeling new financing. Misbehavior can be mitigated, such as through investigating violations and suspending the operations of individual MFIs where necessary.
- The **recent LIFT Economic Response** brief by Slover (2020) contains a series of constructive recommendations to allow the microfinance sector to rapidly contribute to economic resilience. **These should be prioritized.** In addition to the first bullet point, these are:

¹¹ <https://www.ft.com/content/8562417c-63c4-11ea-b3f3-fe4680ea68b5>

¹² In Myanmar the Central Bank does not traditionally take a large role in injecting liquidity outside of state-run banks, and especially not for MFIs. This may need reconsideration.

¹³ https://globaldeliveryinitiative.org/sites/default/files/case-studies/rflessonslearned_10-25-17.pdf

- ♦ “Increase the Debt to Equity ratio that for some MFIs will increase on-going lending to the economy;
 - ♦ “Relax the Liquidity Ratio (how much cash on hand and on deposit/total voluntary savings) from 25 percent to 20 percent – this will increase on-going lending;
 - ♦ “Clarification on asset (loan) classification for restructured loans – restructured loans because of Government directives, or MFIs decisions – does not apply if the loan is not at risk;
 - ♦ “Waiver of the 14.5 percent unsecured interest rate back to 16 percent for international loans to microfinance institutions;
 - ♦ “Fast-track process for international loans to microfinance institutions – from the current three months plus to two-weeks; [...] and.
 - ♦ “Waiver of the 365/365 interest rate convention back to the current Actual/360.”
- **Work with the sector, Central Bank, and MOPFI to enable MFIs to access capital injections, working on realistic timelines.** Direct lending from the Central Bank to MFIs is difficult. However, this process could potentially be intermediated through domestic banks. Regarding timelines, monsoon season agricultural loans are typically paid back around November. However, disruptions to food production systems may delay repayments. Hence, financial accommodations targeted at rural lending should consider a 9-month timeline.¹⁴
 - **Identify and leverage key convening forums to coordinate and communicate responses.** These forums include, for example, the FRD-MoPFI working with the Myanmar Microfinance Association (MMFA), the UNOPS/LIFT rural team, and other donor partners, keeping in mind that not all MFIs work with LIFT or are members of MMFA. These forums can also provide channels to rapidly exchange knowledge on best practice, as many MFIs in Myanmar can draw on both local and international knowledge on addressing crises. As much as possible, use clear and simple policy criteria across MFIs.
 - **Consider the approval of loan products adapted to circumstances,** such as consumption support loans and recovery loans (see Appendix for some possibilities). MFIs need approval to offer new products, but not for different modalities of existing products, e.g. changes in term, interest rate, repayment frequency, etc. The need for new loan products will vary from MFI to MFI – some MFIs would benefit from new product options, while for others these are not necessary. It would be most efficient to coordinate new product requests between MFIs, so that FRD could prioritize consideration of a small number of options.

Regulators should encourage MFIs to use digital channels, like mobile money, for loan collections and disbursements at scale immediately. Doing so will require industry-wide collaboration for interoperability. Several digital pilot programs and initiatives are underway, and these should be accelerated and expanded. Later, regulators should allow MFIs to allow other digital products, including self-account opening, digital savings, digital transfers to bank clients, and even retail payment schemes.

MFIs will also need clarification from regulators on how restructured loans are recorded in the Myanmar Microfinance Data Sharing Platform (MCIX).

In combination or in addition, some MFIs are also willing and capable to serve as a channel for cash and in-kind social protection support. This is discussed in more detail in the Appendix.

¹⁴ The government's initial response in the March 18 stimulus package seemed to suggest a 3-month time horizon, while the recent FRD directive to MFIs specified an initial 1-month time horizon.

- **Coordinate information on agricultural demand.** Risk tends to dissuade smallholder farmers from investing in inputs (e.g., Karlan et al. 2014) – they will choose not to take up agricultural microfinance loans if they do not think they can generate the returns to pay off the loans (Beaman et al. 2020). **Farmers may not take up loans, if they are on offer, or not invest the loans in agricultural production, if they take them up,** unless they believe there will be demand for their produce beyond their own household consumption needs. Restrictions on large markets serve as disincentives for farmers contemplating whether they should increase their production to supply those markets. Information on export and domestic agricultural demands should be coordinated between relevant government departments, agricultural associations, the Union of Myanmar Federation of Chambers of Commerce and Industry (UMFCCI), and farmer groups to give farmers the confidence to produce a remunerative output mix in 2020 and to reduce price volatility in agricultural markets.

Hence, it is important to combine efforts to address the liquidity and potential solvency challenges faced by MFIs with efforts to ensure that food supply chains operate as smoothly as possible and agricultural producers receive useful demand signals. The most urgent responses (e.g., addressing monsoon lending) should be timely and doable, focused on leveraging existing, at-scale platforms (e.g., MFIs, MADB) implementing existing products and modalities.

Appendix: Potential Responses for Microfinance Institutions in Terms of Loan Restructuring, New Lending, and Facilitating Social Protection

Loan offerings made by MFIs should be tailored to customer needs.¹⁵ This relies on MFIs knowing their customers and employing a set of tools to meet their needs that may include combinations of accepting loan repayments, loan postponements, loan restructuring, new productive lending, new forms of lending to enhance coping (with an expectation of repayment on perhaps a longer timeline), and facilitating social protection.

- **Some borrowers in Myanmar remain capable of normal loan repayments and taking on new productive borrowing.** For example, those operating businesses with minimal reliance on social contact, such as some food distributors, are seeing increased demand. These businesses may be willing, if not eager, to repay their existing loans so as to have the prospect of accessing new loan funding. Although voluntary repayments are technically permitted, MFIs may be concerned about misperceptions of such loan collections under the current directives.
- For **viable businesses that would have the ability to restart quickly** within six months, loans can be rescheduled for that period. However, a number of regulatory adjustments, from loan-loss ratios to records in the MCIX, may be necessary to facilitate such rescheduling of loans due to the COVID-19 crisis. Furthermore, many, if not most, farmers who are not able to repay loans now can probably repay after the upcoming monsoon season.
- For **borrowers who are no longer economically viable and others in need**, MFIs should consider working with humanitarian organizations to offer grants or other social protection, while considering forgiving existing loans without impacting the borrower's credit history and permitting future borrowing from the MFI.¹⁶

¹⁵ <https://www.centerforfinancialinclusion.org/how-should-fsps-respond-to-the-covid-19-pandemic>

¹⁶ <https://www.centerforfinancialinclusion.org/how-should-fsps-respond-to-the-covid-19-pandemic>

- Working with the government of Myanmar, MFIs may also consider offering **new loan products**. To do so would require rapid approval of these products by the Myanmar Microfinance Supervision Committee.
 - ♦ **Consumption maintenance loans.** A mix of standard lending and social assistance, requiring potentially significant subsidization from government or donors, e.g., risk guarantees and/or direct subsidization. These loans would have a longer repayment horizon. For example, the first repayment would not commence for at least 3 months, with the option to defer for 6 to 12 months depending on circumstances. The loan would be designed on a potential 18 to 24-month repayment horizon and involve a highly reduced interest rate. Such loans would allow MFIs to maintain their client base and reputation. It is critical to note that all but marginal interest rate reductions would only be viable based on MFIs having access to very low-cost funding. Without such funding, any non-marginal interest rate reductions would invariably lead to losses for the MFIs.
 - ♦ **Disaster recovery loans.** World Vision provides a case study on disaster recovery loans from a typhoon in the Philippines,¹⁷ while Lane (2020) studied a microcredit product that was specifically designed to pay out a loan in response to a flood in rural Bangladesh. Both products were successful because there was a clear use case for the loan amounts to rebuild lost assets, so the loan amounts could be precisely targeted. Repayment rates were high, and the products generated significant customer satisfaction. These case studies echo recovery lending in response to an earlier pandemic in West Africa.¹⁸

Should microfinance institutions be used to channel social protection and assistance?

On the one hand, MFIs have significant outreach in rural areas with staff who are familiar and trusted in these communities. There is a history of providing this kind of support in the past in Myanmar, for example, in response to Cyclone Nargis and after the floods that began in July 2015 and affected over one million people across 12 states.¹⁹ MFIs have the legal ability to transport, handle, and manage cash, acting as a conduit for local and international capital. In other crises around the globe, MFIs that have assisted in direct humanitarian response have seen tangible benefits^{20,21} in the forms of increased trust, loyalty, and improved reputation. In these situations, MFIs have “served to quickly identify communities and members who are in need of relief assistance and assisted with distribution,”²² targeting not just their own borrowers, but the entire community.

In many communities where NGOs are not active, beyond local government officials, there are relatively few channels to individually target social protection transfers. Moreover, some NGOs are not optimized to handle large amounts of cash in the short run. Current mobile money channels have low ability to target individuals, as the vast majority of transfers are through anonymous cash-in/cash-out transactions. In the short- to medium-term, mobile money channels are better seen as a channel for wholesale financial transfers to support government and other distribution efforts.

On the other hand, using MFIs to distribute social benefits could lead to confusion around the role of MFIs and repayment obligations attached to the loans they provide. “Few [MFIs] are able to manage grant and loan initiatives simultaneously. Typically, some separation between these activities has proven to be more effective.”²³ Evidence of this was seen in the post-Nargis response in Myanmar,

¹⁷ <https://www.adb.org/sites/default/files/publication/183633/disaster-resilient-microfinance.pdf>

¹⁸ https://globaldeliveryinitiative.org/sites/default/files/case-studies/rflessonslearned_10-25-17.pdf

¹⁹ <https://www.bbc.com/news/world-asia-33844076>

²⁰ <https://gfdrr.org/sites/gfdrr/files/publication/Microfinance%20and%20Disasters-Preparing%20for%20the%20Worst.pdf>

²¹ <http://visionfundmedia.org/DisasterResilience/Disaster-Resilience-full-report.pdf>

²² <https://www.centerforfinancialinclusion.org/how-should-fsps-respond-to-the-covid-19-pandemic>

²³ Ibid.

where the highest default rates experienced by MFIs occurred in areas of the Delta that received the largest aid transfers.

Hence, effective communication would be critical to ensure that social assistance transfers facilitated by MFIs are clearly distinguished from the funds they offer with standard lending obligations. This seems feasible with sufficient preparation and effort in designing messaging. However, there will remain risks of some confusion among borrowers, and in some cases, MFIs may best play a role in assisting but not directly distributing support. It may also be more difficult for MFIs to target people beyond their existing borrower base. Transport restrictions also may prevent MFI staff from easily moving beyond the vicinity of their branches.

In sum, MFIs can be a valuable option for the provision of social protection and social assistance, but should not be seen as a panacea.

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