

# HOW TO SUPPORT MICROFINANCE INSTITUTIONS (MFIS) AND THEIR CLIENTS TO DIGITALIZE IN THE POST COVID-19 ENVIRONMENT

The COVID-19 pandemic has had a profound impact on all sectors of the economy. Governments and international organizations across the globe have been introducing recovery measures to help overcome the negative effects of the economic downturn. The pandemic has also highlighted a central role that digital technology plays in our everyday life and forced companies to react in agile and decisive ways. Businesses across all sectors, including MFIs, were forced to fundamentally rethink their traditional customer value proposition, operating and business models to fit into the new, digital reality.

The crisis has heightened the importance of MFI digitalization and served as an accelerator for adopting digital solutions. Many have moved operations online and implemented smart working methods to continue serving their clients during lockdowns and to overcome other disruptions.

MFIs seeking to emerge from the crisis in a stronger position must rethink their business models to adapt to the changing world and remain competitive. Digital transformation is not a choice, it has become a necessity. However, in a lot of cases, pre-COVID-19 barriers to digitalization such as access to infrastructure, a lack of data culture and digital awareness – internal skills gaps as well as high costs to transform – remain. This holds even stronger for microenterprises, representing the majority of MFI clients, as they lacked skills, resources and abilities for fast adaptation.

This policy paper is intended as a guide that explains what financial and non-financial support is available to the microfinance sector in Europe to adapt their business models to respond better to the post COVID-19 recovery efforts through digitalizing their operations and supporting their clients in this transition. The paper also highlights the policy recommendations and findings resulting from the conclusion of the Microfinance Centre's project "Supporting MFIs in Overcoming the COVID-19 Crisis".

The future will largely be shaped by those firms that are able to anticipate tomorrow while delivering on the priorities of today. Therefore, MFIs must support microenterprises to alleviate their short-term capacity constraints and bridge their longer-term capability gaps.

## EU Funding opportunities already available

The following section provides an overview of existing EU funding opportunities for Europe-based MFIs. It is important to understand the interconnection between microfinance and the various policy frameworks and programs for the EU for the Multiannual Financial Framework MFF 2021-2027:

**Digital Europe Programme (DIGITAL)**<sup>[1]</sup> has been set up as a central program for digital in the current multiannual financial framework with an aim to accelerate economic recovery and drive the digital transformation of Europe. From that, €580 million is reserved for digital skills, and €750



million for European Digital Innovation Hubs (EDIHs) and European Data Space.

- **EDIHs** offer services that aim to help companies become more competitive with regard to their business processes, products or services using digital technologies. They provide access to technical expertise and experimentation (“test before invest”). They also offer innovation services, such as financing advice, training and skills development that are needed for a successful digital transformation. European Digital Innovation Hubs have both local and European functions as funding is streamed to hubs that are/or going to be supported by their Member States (or regions).

The DIGITAL Programme will be implemented with close complementarity with other EU programmes namely InvestEU, Recovery and Resilience Facility, Pact for Skills and others.

**InvestEU**[2] includes a combined allocation of €13.5 bn for Small and Medium Enterprises (SMEs), research, innovation and digitisation. InvestEU will accommodate a multitude of EU financial instruments under a single umbrella including the EaSI programme incorporated to ESF+. As a financial guarantee instrument, it can mobilize multiples of additional investment – but will also have to cover a range of policy priorities through investments, promoting: (i) sustainable infrastructure; (ii) research and innovation, and digital transformation; (iii) access to finance for small and medium-sized enterprises (SMEs); and (iv) social investment and skills (including microfinance and alternative social finance: crowdfunding, philanthropic capital, impact investment).

- **ESF+** instrument creates possibilities for multi-stakeholder collaboration to support and scale up social innovation. Especially the focus will be given to testing innovative solutions before scaling them, cross-border learning transfers and new ways of collaboration between public, private and not for-profit sectors. ESF+ aims to cover grants and advisory support for microfinance. The support given to microfinance and microenterprises as well as capacity building and networking for social enterprises and social innovation are directly managed by the European Commission.

**Recovery and Resilience Facility**[3] (component of Next Generation EU instrument aiming at post covid recovery), is set to provide grants and loans equaling to €672bn (of which grants are €312.5bn and loans €360 bn) to support reforms and investments by Member States. The support can be obtained by Member States after the preparation of national plans that the Commission assesses and the Council approves. The RRF aims not only to counteract the impact of COVID-19, but also make EU Member States more resilient. Through this facility Member States can include actions aiming at specific investment targeting digitalization of SMEs (infrastructure or skills) or development of social economies, covering the Europe investment gap.

**Pact for Skills**[4] is a building block in the European Skills agenda which aims at reskilling and upskilling people to benefit from green and digital transition. The Pact for Skills program is on one hand an initiative to mobilize resources flowing into upskilling and reskilling the working age population, and on the other a method of stakeholder engagement (companies, social partners, local authorities workers, researchers, etc.) in the areas of skills and

education. The main components of the Pact for Skills are four broad principles: (i) Promoting a culture of lifelong learning for all; (ii) Building strong skills partnerships; (iii) Monitoring skills supply/demand and anticipating skills needs; (iv) Working against discrimination and for gender equality and equal opportunities.

### **Digital Finance Initiative**

The European Commission (EC) launched its **Digital Finance initiative** [5] as a response to the digital transformation of the financial sector. The package includes a digital finance strategy, legislative proposals on crypto-assets and digital resilience, and a renewed retail payments strategy. The EC is currently looking into revising the PSD II Directive and is seeking stakeholder feedback on open finance. The goal is to create a competitive EU financial sector that gives consumers access to innovative financial products, while ensuring consumer protection and financial stability.

### **Social Economy, Inclusive Entrepreneurship and Microfinance**

The European Commission promotes the social economy, social and inclusive entrepreneurship and microfinance as catalyzers for job creation, work integration and inclusive and sustainable growth. On 9 December 2021, the European Commission adopted a new Action Plan on the Social Economy to mobilize its full potential. The aim of the action plan is to enhance social investment, support social economy actors and social enterprises to start-up, scale-up, innovate and create jobs. Transition Pathways for Proximity and Social Economy[6] (part of EU Industrial Strategy) will support the implementation of the action plan. The European Commission is yet to announce the final shape of the initiative.

[2] [https://investeu.europa.eu/index\\_en](https://investeu.europa.eu/index_en)

[3] [https://ec.europa.eu/info/business-economy-euro/recovery-coronavirus/recovery-and-resilience-facility\\_en](https://ec.europa.eu/info/business-economy-euro/recovery-coronavirus/recovery-and-resilience-facility_en)

[4] <https://ec.europa.eu/social/main.jsp?catId=1517&langId=en>

[5] [https://ec.europa.eu/info/publications/200924-digital-finance-proposals\\_en](https://ec.europa.eu/info/publications/200924-digital-finance-proposals_en)

[6] [https://ec.europa.eu/growth/sectors/proximity-and-social-economy/transition-pathway-proximity-and-social-economy\\_en](https://ec.europa.eu/growth/sectors/proximity-and-social-economy/transition-pathway-proximity-and-social-economy_en)

**The Single Market Program (SMP)** [7] is the EU funding programme to help the single market reach its full potential and ensure Europe's recovery from the COVID-19 pandemic. With €4.2 bn over the period of 2021-2027, it provides an integrated package to support and strengthen the governance of the single market. The aim of this instrument is to establish a favorable business environment for the social economy through capacity building, exchange programs and intelligence gathering/sharing. Calls for proposals under this program will support capacity building and investment in proximity and economy for SMEs in the digital and green transition.

## RECOMMENDATIONS

The following recommendations result from the study on the evolution of the changes MFIs made to adjust their business models to the emerging pandemic[8] and the conclusions from the action research on digitalization levels of microentrepreneurs - microfinance clients in Europe.

### 1. Create conducive regulatory framework for microfinance

The regulatory environment in which MFIs operate across Europe is highly heterogeneous. While in some countries specific microcredit legislation exists in the national law (e.g. Bosnia and Herzegovina, France) or allows for loan disbursement by non-bank financial institutions (e.g. Poland, Spain), in the others it limits the lending business only to banks (e.g. Germany, Serbia).[9] Different regulatory and supervisory regimes make it particularly burdensome for the microfinance sector to accelerate much needed growth. Cross-border operations could provide access to new markets and increase MFIs outreach. Currently, however, MFIs cannot operate in other Member States than originally authorized without

going through an onerous process of registering the new entity. There is a need for a harmonized approach (i.e. an EU rulebook or EU passporting regime) towards microfinance services in order to facilitate these operations and to guarantee common standards across the EU.

Regulation can also slow down the implementation of digital financial services products. For instance, the lack of fully harmonized eSignature laws across the EU and the limiting licensing regime have hampered MFIs' ability to fully digitalize their offering. Properly implemented eSignature regulations would allow for wider use of digital contracts.

### 2. Improve access to business support and encourage innovation to incentivize digital transformation

Most MFIs across Europe are small and do not have the scale needed to justify the effort and cost of digitalization. They must resort to innovative forms of partnerships and collaboration to benefit from the economy of scale. They often lack the in-house-skills to assess their digital maturity and fully understand their needs and solutions that can allow them to fully tap into what digital transformation can offer. From establishing a strategy for change through implementation to onboarding the staff, MFIs, as important participants of the social economy, need comprehensive support to accelerate the transformation.

**Access to finance** MFIs would benefit from dedicated streams of funding for digital transformation, ICT advancement and internal capacity building.

**Access to information and expertise** Digital transformation requires technology skills. Central contact points for

advice, training, consulting, and funding would support the MFIs through the process of selecting, implementing, and operating new technologies. This effort could be supplemented by some forms of private-public partnerships.

**Access to off-the-shelf digital solutions** A ready-to-use solution which can be immediately adopted by MFIs without the relevant skills-in-house can speed up the adoption of new technologies and decrease the overall costs of transformation.

### 3. Encourage innovation and promote a level playing field to enhance interoperability of data

MFIs gather and store large quantities of raw data but need appropriate means to process and manage it effectively. Lacking sufficient funding, they are held back by legacy IT systems developed in the pre-digital era. Properly managed data has the potential to stimulate MFIs growth, increase operational efficiency, as well as design better fitted products for their clients. It has also a fundamental impact on the relationship with the end-customer, beyond the usual know-your-customer (KYC) processes. Without appropriate investment in infrastructure and data management skills, MFIs cannot fully reap the benefits of data economy.

The emergence of cloud computing solutions opens new opportunities for MFIs to collect, process and analyze data without needing to maintain and update their internal 'home-grown systems'. Cloud computing can provide MFIs with cheaper and less demanding options to scale and adapt products to customer needs.

[7] [https://ec.europa.eu/info/funding-tenders/find-funding/eu-funding-programmes/single-market-programme/overview\\_en](https://ec.europa.eu/info/funding-tenders/find-funding/eu-funding-programmes/single-market-programme/overview_en)

[8] Koryński P., Pytkowska J. „Microfinance Business Models During COVID-19 and Beyond” <https://mfc.org.pl/microfinance-business-models/>

[9] <https://www.european-microfinance.org/publication/microcredit-regulation-europe-overview-2022>

#### 4. Create supportive framework for ecosystem - enabled business model transition

MFIs must transform their business models to respond to the existing market pressures and digital opportunities to remain competitive but also to better serve their clients.

The ecosystem-enabled business model is designed to fit interconnected service providers and allow for multilateral relationships between the ecosystem participants to provide financial services as bundles of complementary products and offerings for microenterprises. New solutions require appropriate testing and experimentation before they can be fully implemented and scaled ("test-before-innovate"). Regulators and donors can support this approach by facilitating controlled testing ecosystems to create collaborative work environments.

#### 5. Promote capacity building of microenterprises in embracing digitalization

Microenterprises represent over 90% of European enterprises and are thus decisive for boosting jobs, growth, and investment in Europe[10]. They, however, often lag in the digitalization effort due to the lack of sufficient information and internal capacities. Microfinance is a source of financing for microentrepreneurs, especially those that otherwise would not have access to financial services. MFIs, therefore, already have existing links with microenterprises and, if resourced properly, could additionally play an important role in their awareness raising and capacity building for digital transition.

Some MFIs have piloted digital skills training and mentoring programs for microentrepreneurs. Those pilot programs revealed that to scale up the effort, there is a need for

access to a peer-to-peer learning and network as well as educational resources appropriate for microentrepreneurs (in their local language). Currently tutorials and manuals on using digital platforms are not available in all EU national languages.

#### 6. Ensure broad, trustworthy, and affordable ICT infrastructure to bridge the digital divide in Europe

Access to affordable technologies is the prerequisite to closing the digital divide and ensuring that every member of society has an equal opportunity to benefit from digital transformation. Infrastructure and especially access to connectivity is one of the elements causing microenterprises to lag in their digitalization.

This holds especially true for businesses from underserved, rural regions. The European Union and its Member States should continue to ensure joint commitments to fund and build broad, trustworthy and affordable ICT infrastructure.



Center for  
Inclusive Growth

The project was implemented as part of the partnership between Mastercard Center for Inclusive Growth and Microfinance Centre for a new international support programme for small businesses and microfinance institutions in Europe and Central Asia. The partnership will enable micro-finance institutions to pivot, adapt and embrace digitization.

The Mastercard Center for Inclusive Growth advances equitable and sustainable economic growth and financial inclusion around the world. The Center leverages the company's core assets and competencies, including data insights, expertise and technology, while administering the philanthropic Mastercard Impact Fund, to produce independent research, scale global programs and empower a community of thinkers, leaders and doers on the front lines of inclusive growth. For more information and to receive its latest insights, follow the Center on [Twitter](#), [LinkedIn](#) and [subscribe](#) to its newsletter.

[10] <https://ec.europa.eu/social/main.jsp?catId=952&intPagId=3510&langId=en>