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A Review of Access to Finance by Micro, Small and Medium Enterprises and Digital Financial Services in Selected Asia-Pacific Least Developed Countries

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by

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Abstract

Micro, Small and Medium Enterprises (MSMEs) are key to the economies of various countries. Their numbers and contribution towards employment is well documented and there is acceptance amongst policy makers that these enterprises are critical for economic development. Increasingly, access to finance has been recognised as a major hurdle in their development or growth.

Amongst, the countries reviewed in this paper - Bangladesh, Bhutan, Cambodia, Lao People's Democratic Republic, and Nepal – Bhutan is the only target country where the supply of finance to MSMEs is favourable with nearly 68% of the demand being met. Cambodia has the highest finance gap followed closely by Lao Peoples Democratic Republic and Nepal. While examining the finance gap of microenterprises and SMEs, the gap revealed in Bhutan, Cambodia, Lao People's Democratic Republic and Nepal are not substantial. However, in Bangladesh the differences are much larger between microenterprises and SMEs with only 14% of microenterprise demand being met.

The review also explores the number of women owned MSMEs (WMSMEs) in the countries and the access to finance for such enterprises. It shows that the finance gap is amongst the lowest in Bangladesh (6%), Bhutan (19%) and Nepal (9%). In Cambodia and Lao People's Democratic Republic, the share is higher at 32% and 42% respectively. But in both South East Asian countries women owned MSMEs also are a larger proportion of MSMEs.

There are a number of demand and supply reasons or constraining factors leading to issues in access to finance. The common factors pertain to awareness, risk, knowledge, and products and

[+] The views expressed in this working paper are those of the author(s) and should not necessarily be considered as reflecting the views or carrying the endorsement of the United Nations. Working papers describe research in progress by the author(s) and are published to elicit comments and to further debate. This publication has been issued without formal editing. For more information, please contact Hamza Ali Malik, MPFD Working Paper Series Editor and Director of the Macroeconomic Policy and Financing for Development Division (MPFD) (email: escap-mpdd@un.org).

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processes. Women owned enterprises too face these challenges, but these may be more severe as they are often entrenched in gender stereotypes, limited education opportunities and restricted mobility, perception that women cannot manage businesses or lack leadership skills, and women are also often required to perform the dual role of business women and homemakers. Most of the countries are still in the process of framing laws pertaining to contract enforcement and resolution of insolvency. Specifically, on the demand side, enterpreneurship is not viewed as a career option and risk acceptance is overall low.

While these constraints exist, there are several policy initiatives undertaken by regulators and governments in these countries to increase access to finance. These approaches involve a mix of regulatory and financial approaches, including efforts to develop the financial infrastructure, such as, secured transaction laws, creation of collateral registries, developing credit bureaus, and payment and settlement systems. Other actions include interest subsidies, dedicated funds and institutions. But these are in various stages of enactment and implementation. Cultural shifts in terms of acceptance of entrepreneurship have also been observed in many of these countries, with governments adopting policies to encourage entrepreneurship.

While Digital Finance Services (DFS) initiatives specifically linked to increasing MSME access to finance are few, and there are no specific policy initiatives (in the target countries) linking the two, development of DFS and its spread is likely to positively affect MSME access to finance. This is because DFS helps to create a digital footprint that when combined with other accumulated data can yield business intelligence to make decisions related to credit risks, for example.

In all the countries reviewed, there is a notable push in terms of policy and mobile connectivity that favour the growth of digital payments. Number of bank and non-bank agents in all the five countries has shown significant increase as has the adoption of payment services by populations. This has in part been supported by the high levels of 2G and 3G mobile service penetration.

A lot of the policy and regulatory effort by the target countries is in the right direction which requires further encouragement and a more nuanced approach towards MSMEs. Policy makers need to continue to build their own capacity on MSME access to finance. In terms of financial infrastructure, what matters is that it is effective and reliable. This should be the continued focus of policy makers and regulators in the target countries. Alternative source of finance should be encouraged, but with the understanding of the varied sources and their applicability to different stages of enterprises. It is vital that women owned MSMEs be treated as a distinct category and attempts made to use data and training to remedy the perception issues. Finally, DFS offers immense potential and efforts need to be made move beyond payments and into digital lending, savings and insurance simultaneously building up consumer protection policies related exclusively to DFS.

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***Keywords**:* MSMEs, digital finance, least developed countries, Bangladesh, Bhutan, Cambodia, Lao People’s Democratic Republic, Nepal.

1. Introduction

MSMEs are often described as the 'engine of growth' [1] for emerging economies from the perspective of employment and innovation.[2] The UN estimates that MSMEs constitute 90% of global businesses and account for 60% to 70% of global employment.[3] Research studies in recent years have helped gather more data on this 'engine.' A number of these studies have analysed access to finance issues pertaining to MSMEs, and concluded that difficulties in access to finance is the widely accepted constraint for this segment globally.[4] To make progress in this area, there is increasing recognition[5] that DFS has the potential to increase and accelerate MSME financial inclusion, when compared to traditional brick and motor models:

> 'Emerging financial technology (fintech) players around the world are reshaping how MSMEs can access working capital and cash flow finance. Having acknowledged that MSMEs lack the capacity to produce financial reports to enable financial institutions to assess their repayment capacity and default risk, they are deploying nimble and agile technologies to get an accurate understanding of their cash conversion cycle.'[6]

But the growth of DFS is facilitated by new emerging business models and along with these, new types of risks. There is an acknowledgement that regulation and regulators are crucial in the context of DFS and their increased understanding and capacity is essential for managing new risk:

> 'The regulatory perimeter needs to be reviewed and perhaps redefined, new providers licensed and supervised, cyber-security standards improved, consumer protections made more robust, and data protection and privacy and competition laws strengthened, among others. There is a growing need to better equip regulators to deal with the challenges ahead, and this is an area that is often overlooked by the development community.'[7]

Furthermore, while DFS comprises of many areas[8], it is the use of agents and mobile money that has seen the greatest increase in the target countries as well as other emerging economies. Use of agents and issuance of e-money is also considered as a key enabler for DFS as per the CGAP.[9] Given this background, the paper is divided into three sections.

Section 1 sets out the above-mentioned connection between DFS and MSME financing. It examines what this connection/relationship is likely to look like particularly in the context of MSMEs being deficient in physical collateral. The chapter also lays out a digital financial inclusion pathway in countries. The pathway has four stages with the stage for the wider set of financial products being set by payments and transfers services.

[1] International Finance Corporation (2017).
[2] International Finance Corporation (2017), Matthew (2019), Gonzales, Hommes, & Mirmulstein (2014).
[3] Cometto (2019).
[4] Shinozaki (2019).
[5] See Chatterjee (2018) and Nemoto & Yoshino (2019).
[6] Chatterjee (2018).
[7] Bull (2019).
[8] For example, Real Time Gross Settlement (RTGS), National Electronic Funds Transfer (NEFT), internet banking.
[9] Staschen & Meagher (2018).

Section 2 is divided into sub-sections that discuss the situation in five countries. The sub-sections have a uniform structure:

1. **Country introduction:** This lays out the overall financial inclusion context in each country. Financial inclusion data for MSMEs is also provided where available.
2. **Access to finance for formal[10] MSMEs:** This section establishes the finance demand and gap pertaining to the formal MSME sector. In order to do this, the data from the SME Finance Forum is primarily drawn on. This data is disaggregated by type of enterprises, gender and level of constraints faced. In term of the level, the three levels – unconstrained, partially constrained, and unconstrained are explained in Annex 1.
3. **Exploring supply and demand for finance and reasons for gaps:** The supply side mainly covers credit services. The demand side mainly draws on data related to entrepreneurship and the World Bank's Ease of Doing Business. It also reviews access issues pertaining to WMSMEs. Using, various research sources, this section sets out the challenges faced by MSMEs in accessing finance.
4. **Policy effort to increase financial inclusion of MSMEs:** Creating an enabling environment to increase the flow of funds for MSMEs is very crucial. This section examines various regulatory initiatives that each of the target countries have undertaken in an endeavour to increase the flow of credit to MSMEs. It also examines regulatory efforts made to increase access to finance for WMSMEs.
5. **DFS in each target country:** The previous sections layout the background pertaining to MSME financing in the target countries. This section examines the developments related to digital finance in each country. It reviews the general DFS environment as there is a requirement for more research connecting DFS and MSME access to finance in the target countries. Never-the-less, DFS developments will affect MSMEs particularly payment and transfer services. This section also identifies which stage of the digital financial inclusion pathway each of the countries is in.

The final section of this paper will look at policy recommendations based on the findings in the previous section.

2. On the radar: MSMEs financial inclusion and DFS

The Global Findex Database 2017[11] estimates that 1.2 billion adults globally obtained a bank account between 2011 and 2017 and 69% or 3.8 billion adults have a bank account.[12] While the increased numbers do generate optimism as it shows that more adults have an account in a financial institution or through a mobile money provider, the gender gap is still a source of concern, as is

[10] The term 'Formal' in this paper has been adopted from the MSME Finance Gap report. See International Finance Corporation, (2017). It refers to MSME enterprises that are registered private sector firms.
[11] While there are various data sources for measuring financial inclusion, the data presented throughout this paper is sourced from the Global Findex 2017 and the country FinScope surveys. Findex allows for country comparison while FinScope allows for measuring financial inclusion at a national level. Where FinScope data is available, that is the preferred data source for measuring financial inclusion. This is because compared to Findex, FinScope comprises of a larger questionnaire and sample, feeds into the national financial inclusion strategies of various central banks and is customized to the survey country.
[12] Demirgüç-Kunt, Klapper, Singer, Ansar, & Hess (2018).

the number of adults who continue to remain unbanked.[13] With DFS taking off in many countries, particularly the LDCs, this does offer the opportunity to accelerate financial inclusion. In fact, a key takeaway from the Findex report is that the most significant gains (including progress on gender equality) have been in countries where governments have focused on digital payments. Other studies too show DFS as 'one of the primary' ways to accelerate financial inclusion, as it often serves as a 'gateway' to other financial services.[14] Additionally, when digital solutions are applied to various types of financial products there can be a positive effect on financial inclusion.[15]

In relation to MSME, DFS is considered as an important if not essential means to accelerating the pace of their financial inclusion. In general, a significant portion of MSME financial inclusion research is concentrated on MSME access to credit and comparatively little research is available on non-credit financial services, research available shows, financial institutions (FIs) are often reluctant to lend to MSMEs due to challenges pertaining to lack of financial and/or credit history information and inadequate or inappropriate collateral. This challenge is very aptly described below:

> "the banks have trouble making a risk assessment cheaply enough. They lend to big organizations based on their income. For SMEs [small and medium enterprises], they revert to looking at assets as they would for consumer lending. The bank can value a house or car, but not a ton of fertilized chicken eggs."[16]

However, just as in digital consumer lending, digital solutions offer an alternate route via the possibility of accumulating data points (including alternative data) that may provide FIs with appropriate and adequate information pertaining to the finances of an MSME.[17]

> 'Accumulated digital data can complement the limited data disclosed by SMEs and reduce the cost of information asymmetries'[18]

Big data coupled with artificial intelligence is helping FIs better understand credit risks and repayment frequencies allowing for an 'accurate understanding of their (MSMEs) cash conversion cycles.'[19] For example, Ant Financial's MYbank in China has used digital payments transactions data and underwritten over US$ 70 billion in loans to 5 million MSMEs since 2015. Taken over a long term, accumulated digital loans create a financial footprint (including credit history) that then may allow MSMEs to access larger and more appropriate financial products.

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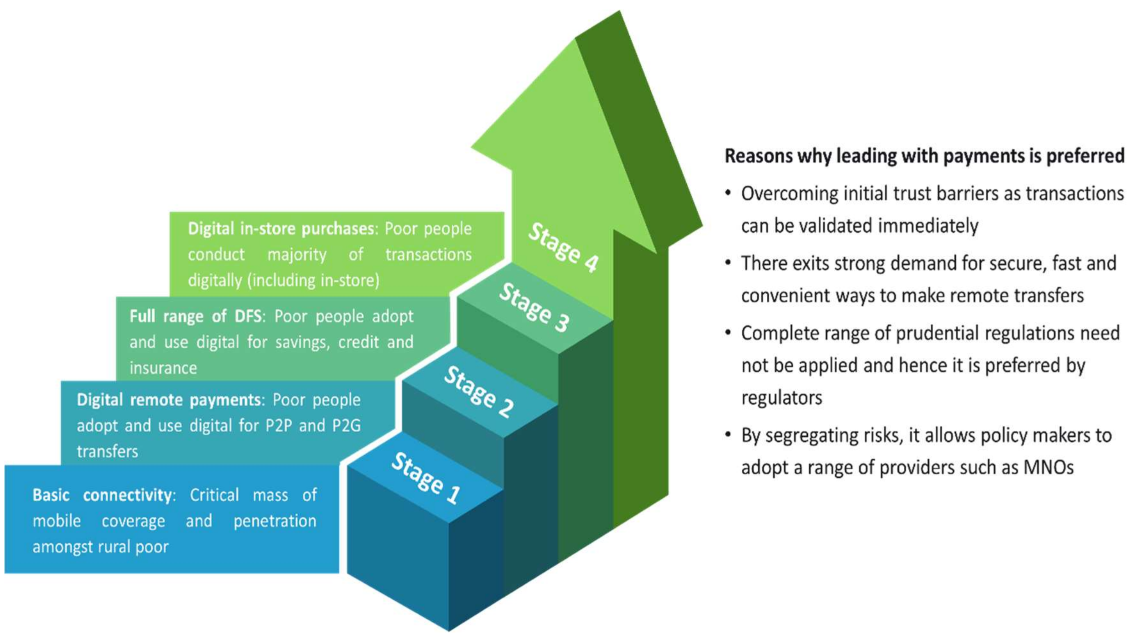
[13] Ibid. The Global Findex Database 2017 highlights the gender-based inequality in account ownership and the fact that 1.7 billion adults globally continue to remain unbanked.
[14] Better Than Cash Alliance (2018), UNSGSA FinTech Working Group and CCFA (2019), World Bank (2019a).
[15] For Example: Transfers (including international remittances) often cost less than traditional means, digital loans are often quickly disbursed and may entail lower costs for borrowers, digital savings services are usually at lower costs, higher transparency levels and offer increased liquidity, mobile phones offer a new distribution channel for insurance providers. UNSGSA FinTech Working Group and CCFA (2019).
[16] Gerald Sun, Vice President, Head of Sales for Commercial Payments Asia/Pacific MasterCard Worldwide MicroCapital Team (2016).
[17] Chatterjee (2018), UNSGSA FinTech Working Group and CCFA (2019).
[18] Nemoto & Yoshino (2019).
[19] Chatterjee (2018) Cash conversion cycle is the time MSMEs need to convert investments in inventory and resource inputs into cash through sales of goods and services that can help establish the cash generation terms of the business and thereby help to determine their repayment capacity and enhance price transparency.

But digital applications are relevant for broader MSME financial inclusion encompassing non-credit financial services as well. For example, insurance is an area where digital solutions are increasingly being adopted wherein companies are using remote sensing technology along with crop history, sizes, yields and other data to design crop protection products for farmers.[20] Other examples include mobile wallets that provide MSMEs with a savings account and options such as payments and transfers. Digital payments can be a good starting point for various credit products such as cash flow-based loans. Small businesses can connect accounting software and avail invoice financing. This raises a pertinent question of whether there can a pathway to digital financial inclusion. A pathway is important to consider as the move from cash to digital is not likely to be 'one giant leap', but is more of a 'multi-stage process'.[21] Like Findex, as noted earlier, there is increasing evidence to show that the pathway includes early adoption of digital payments in the move towards digital financial inclusion. These findings are not specific to MSME financial inclusion, however, the same applications of mobile wallets and services such as payments and transfers can be used by MSMEs which is an established fact. As this paper will later show, in the subsequent chapters, in all the target countries, internet banking and ATMs are often the first digital applications to be launched in countries, however, it is digital payments[22] that are increasingly finding favour amongst policymakers who are keen to accelerate financial inclusion.

There are four stages in the pathway to digital financial inclusion that each country is likely to pass through (Figure 1).[23]

Figure 1: Pathway to Digital Financial Inclusion and payment preference



Source: Author's compilation. Based on Radcliffe & Voorhies (2012)

[20] Chatterjee (2018), UNSGSA FinTech Working Group and CCFA (2019).
[21] Radcliffe & Voorhies (2012).
[22] Supported by the expansion of mobile telephone due to better infrastructure and affordability of mobile phones.
[23] Radcliffe & Voorhies (2012).

- ***Stage 1:*** *Basic connectivity* - The first stage in the pathway is to ensure that a country has the necessary communication infrastructure in place and mobile penetration is high or increasing.
- ***Stage 2***: *Digital remote payments* – Once Stage 1 is in place, the next stage is connecting clients to the digital payment 'grid'. Some of the most effective ways are via migrant remittances and government to person (G2P). The advantages of leading with payments have been presented in the figure above.
- ***Stage 3***: *Full range of payments* - Stage 2 has the potential to link many poor and low-income households to digital accounts. Ideally, this should open up avenues for more financial services via the digital platform. There are various complex challenges that include overcoming pricing barriers, technological innovations and regulators identifying appropriate policy interventions that will encourage product/service innovation while balancing out incentives to 'build and maintain (those) platforms.' CGAP has identified four building blocks that help to 'create an enabling and safe regulatory framework for DFS.'[24] These are also referred to as *basic regulatory enablers* and include allowing non-bank e-money issuance, use of agents for service delivery, ensuring consumer protection, and allowing for risk-based customer due diligence.[25]
- ***Stage 4***: *Digital in-store purchases* – This final stage is to get people to make small everyday payments using the digital platform.

While the Pathway was first proposed in 2012, there is not much further work by way of research and analysis on the Pathway per se. However, work like that of the CGAP's four enablers do explore various aspects that are closely related to the Pathway. The review of DFS in all five countries suggests that their DFS journey has been initiated with the development of digital payment services coupled with robust basic connectivity. The Findex report also concludes that to ensure qualitative digital financial inclusion a well-developed payments system, good physical infrastructure, appropriate regulations and consumer protection safeguards need to be set in place.

In the case of MSMEs, the financial education of MSMEs on how to use digital tools for purposes such as accounting and storing/generating invoices will be critical. This effort and investment are mutually beneficial for FIs and MSMEs as it helps create a digital footprint based on which products can be designed and delivered. It also helps reduce costs for MSMEs. For example, a MasterCard estimate suggests that an SME spends between 3-7% of its costs on managing paper invoices. Digitising will help move invoices and money faster.[26]

As DFS and new models for banking (including with MSMEs) continue to emerge, the role of regulators has been put into the spotlight and is becoming ever more crucial in creating the enabling

[24] Staschen & Meagher (2018).
[25] While these enablers by themselves are not sufficient for DFS in a country, they are necessary to ensure that 'DFS is far more likely to grow responsibly and sustainably and achieve its full potential when all four elements are in place.' Staschen & Meagher (2018).
[26] MicroCapital Team (2016).

environment. DFS brings with it a set of challenges and risks[27] particularly on consumer protection and data governance that needs regulatory intervention.[28]

3. Country Experience

3.1 Bangladesh

Bangladesh's economy has shown tremendous progress over the past decade averaging an annual growth rate of 6.5%.[29] Along with this growth, it has also made a steady stride in increasing financial inclusion. The Global Findex database 2018[30] reveals that the number of adults with accounts in a bank, or a non-bank financial institution or a mobile money account has increased from 32% in 2011 to 50% in 2017. Those with a bank or non-bank financial institution account went up from 32% to 41% in the same period. Interestingly, mobile money accounts have increased significantly from 2.7% in 2014 to 21% in 2017.

While largely an agrarian economy, it is the MSMEs that form the 'backbone' of non-farm jobs creation. An estimated 99% of all non-farm enterprises are MSEs employing 20.3 million people.[31] Trading is the dominant activity for micro and small enterprises while medium enterprises are mostly engaged in manufacturing. These enterprises, therefore, are of economic significance and also add to the poverty reduction effort which has been of notable success in Bangladesh. Despite this, MSMEs in Bangladesh face numerous challenges particularly in terms of access to finance which ranked amongst the top three challenges.[32]

3.1.1 Access to finance for formal MSMEs

The SME Finance Forum[33] estimates that there are 7.8 million registered MSMEs in Bangladesh.[34] A large proportion is microenterprises (88%) while 12% are SMEs. In terms of ownership by gender, WMSME ownership is significantly lower at 5% across the enterprises with a marginally higher level of ownership of microenterprises (6%) compared with SMEs (4%). Informal demand for finance was 52% of formal demand or US$ 29 billion.

The estimated demand for finance amongst the MSMEs is US$ 57 billion. However, only 33% (US$ 19 billion) of this demand is currently met. The finance gap is, therefore, estimated at US$ 39 billion (67% of potential demand). The share of SMEs in this gap is significantly higher at 93%

[27] For example, fraud by mobile agents, data thefts, concerns regarding borrower over-indebtedness, low financial literacy and awareness of financial products and services.
[28] UNSGSA FinTech Working Group and CCFA (2019), Asian Development Bank (2017).
[29] World Bank (2019b).
[30] World Bank (2018a).
[31] World Bank (2019a).
[32] Political instability and electricity being the first two challenges identified. World Bank (2019a).
[33] SME Finance Forum (2018a).
[34] Number of MSMEs data sourced from Bangladesh Bureau of Statistics (Economic Unit Census) 2013 by the SME Finance Forum.

or US$ 36 billion. The finance gap share follows the ownership pattern with WMSMEs accounting for 6% (US$ 2.5 billion) of the gap compared to their male counterparts (94% or US$ 36.4 billion) Within the enterprise types, microenterprises face more of a gap with 86% (US$ 2.8 billion) need unmet. Within SMEs, this is comparatively lower, but still high at 67% (US$ 36 billion). In terms of gender and enterprises, women-owned small and medium enterprises WSME gap is higher at US$ 2.4 billion (96%). The proportion for male-owned SMEs is similar with 95% of SMEs facing a finance gap.

SMEs and microenterprises reporting that they have faced either partial or complete constraint are nearly the same for SMEs (48%) and microenterprises (56%). Over a third of enterprises SME (32%) and microenterprises (40%) reported being fully constrained in terms of access to finance. 42% of WMSMEs report being fully constrained while for 33% of male owned MSMEs report the same. Details of the level of constraint and type of enterprise are in Annex 2.

3.1.2 Exploring supply, demand and the reasons for constraints

The supply side is mainly dominated by banks (57 scheduled banks) that account for 70% of the total financial systems assets.[35] A large proportion (75%) of SME loans were accounted for by the private commercial banks. Public commercial banks accounted for 19%. Bangladesh Bank's (BB) data[36] for 2011 to 2018 on disbursement to the sector reveals that a large proportion of the credit disbursed has been to the services sector followed by trading and manufacturing.[37] Though over time, there has been an increase in percentage terms of funding to trading. Credit to women entrepreneurs has also increased during the same period, but there was a significant increase between 2017 and 2018 (165%). This could be due to the efforts of the BB as noted later. Formal banking sector lending to the MSME sector has tripled between 2010 and 2016. Around 25% of the consolidated loan book of the commercial banks are SME loans. This is a notable achievement as in many countries this ratio is in the single digits or in the tens.[38] However, the finance gap still remains significant at US$ 39 billion as explained in the previous section.

There are 724 licensed microfinance institutions (MFIs)[39] in Bangladesh whose share in SME financing is small at 3.7% of the total loans. 10 MFIs accounted for nearly 80% of the 25 million borrowers as of June 2017. 93% of these were women borrowers. Apart from these MFIs, the Grameen Bank, BRDB and Jubo Unnayan Adhidoptor are significant entities (in terms of disbursements) that cater to the same clients as MFIs.[40]

Capital markets and Venture Capital (VC) do have a presence in Bangladesh, albeit a small one in relation to MSMEs. These are currently underdeveloped as financing options (mostly equity-driven) and sources of long-term access to funding for MSMEs. Capital markets account for 20% of the financial system's assets. While VCs have been funding large enterprises (including MFIs)

[35] World Bank (2019a), Bangladesh Bank (2019a). The Bangladesh Bank annual report was released in January 2019. The data is for the period July 2017 to June 2018.
[36] Bangladesh Bank (2019a).
[37] 66% in 2011 and 52% in 2018.
[38] World Bank (2019a).
[39] Data as of June 30, 2019. The list of NGO-MFIs can be accessed from the Microcredit Regulatory Authority's (See http://mra.gov.bd/index.php?option=com_content&view=article&id=115&Itemid=95).
[40] Microcredit Regulatory Authority (2017).

the offer very limited options for SMEs; equity financing options also have had 'limited success.' This has to do with the absence of enabling financial infrastructure,[41] regulation for VC industry, and reluctance on part of enterprise owners to cede control[42] for the expansion of VCs into the MSME space.[43]

A common issue that emerges across research[44] on MSMEs access to finance in Bangladesh is that funding is skewed towards medium enterprises. Two related factors for this are the way banks segment the market (See Annex 3 for segmentation) and the reliance on collateral-based lending which medium and large enterprises are able to provide but remain challenging for micro and small enterprises. Where collateral is available, a common issue is its poor quality. Multiple studies/papers[45] suggest that there appears to be a very clear division of the segments between banks and MFIs with the former catering to large and medium firms and the latter to small and microenterprises. The current way of segmentation bolsters this argument as it leaves out many micro and small enterprises. Figure 2 captures some of the key supply and demand issues.

Figure 2: Bangladesh - Key supply and demand constraints for MSME access to finance

Source: Author's compilation. Based on Research Department, Bangladesh Bank (2018), World Bank (2019a), Singh, Asrani, & Ramaswamy (2016)

BB's study[46] reveals that 94% of MSMEs surveyed also accessed informal sources of credit. State-owned financial institutions face significant challenges in furthering the MSME financial inclusion effort. They are reported to underperform on profitability, capital adequacy, and have high non-performing loans. Added to this are issues related to governance practices, weak internal controls and inadequate risk management practices of these state-run institutions. Box 1 lists the reasons why banks reject loan applications of MSMEs.

[41] For example, credit bureau coverage and bankruptcy laws.
[42] Other challenges include the inability to conduct proper due diligence, and different perceptions of company valuations between SMEs and VC firms.
[43] World Bank (2019a).
[44] World Bank (2019a), Research Department, Bangladesh Bank (2018).
[45] Economic Research Group (2017), World Bank (2019a).
[46] Research Department, Bangladesh Bank (2018).

Box 1: Reasons for loan application rejection

- Improper paperwork particularly collateral documents, financials, sales and turnover data
- Poor credit history/no banking relationship
- Manipulation of licenses
- Fund diversion possibility
- Shortage of required stocks
- Weak product demand/market saturation
- Unwillingness to provide guarantee
- Lack of adequate business experience
- Possibility of over-indebtedness
- Adverse leverage ratio/low profitability
- Lack feasibility study/proper assessment of funds needed

Source: Author's compilation. Based on Research Department, Bangladesh Bank (2018)

Despite these constraints, there have been successes on the supply side. BRAC Bank, Industrial Development and Leasing Corporation (IDLC) and Prime Bank are examples of 'positive adaptive experiences.[47] Each modified its mission, strategy, products, organisation structure and human resources to include the MSME segment. While BRAC Bank adopted a decentralised approach that relies on agent banking, IDLC relies on technology and has centralised its credit decision function, and Prime Bank established a separate division staffed with MSME professional skills that cater exclusively to MSME clients.

On the demand side, based on the Global Entrepreneurial Index, Bangladesh is ranked amongst the lowest (134 out of 137 countries) in terms of its ability to create and foster entrepreneurs and regionally it is the lowest ranked. On the access to finance or 'risk capital'[48] Bangladesh gets a low score of 7%. The country ranks low on other components of entrepreneurship such as start-up skills, risk acceptance, product innovation, and internationalisation. These factors impact the ability to attract capital for an enterprise.[49]

On the World Bank's Ease of Doing Business (Annex 5) Bangladesh's rank is amongst the lowest globally at 168 out of 190 indicating that there needs to be a significant regulatory effort in creating an enabling environment.[50] The data reveals that both financial and physical infrastructure is weak in the country, including:

- Strengthening borrower and lender rights related to collateral and bankruptcy laws, increasing credit bureau coverage
- Reducing time and costs for enforcement of contracts via the judiciary
- Strengthening the insolvency framework including the time taken to resolve cases and recovery rate

[47] World Bank (2019a).
[48] 'Risk Capital' measures whether capital is available from both individual and institutional investors.
[49] Acs, Szerb, & Lloyd (2017).
[50] World Bank (2019c).

While effort is needed, Bangladesh's overall rank has improved from 176 in 2019 to 168 in 2020. This is mainly due to the expanded coverage of the credit bureau. As a result, the country has significantly improved its rank from 161 in 2019 to 119 in 2020 on the Getting Credit indicator.[51] It is estimated that women's economic participation in Bangladesh lags across all types of firms and is less than half that of other low-income countries.[52] Formal ownership of enterprises is low amongst women as the SME Finance Forum's data reveals. A 2016 International Finance Corporation[53] (IFC) study on WSMEs in Bangladesh finds that only 31% were able to finance their business requirements. Demand-supply challenges faced include lack of awareness of products and schemes, gender-related perception issues, perceived high risk of lending to women, inability to provide collateral and low levels of financial literacy. Critically, over a third (36%) of WSME interviewed as part of the IFC study report that they had to involve males in dealing with FIs dues to institutional biases related to a women's 'entrepreneurial capabilities and their perceived role as primary care givers.'[54] These challenges are elaborated in Annex 4.

3.1.3 Policy effort to increase financial inclusion of MSMEs

The BB has adopted a deliberate strategy over the past few years to accelerate MSME financial inclusion and as noted in the earlier section, the flow of credit to the sector has increased. The BB's strategy has included a mix of financial and regulatory policies including targeting, establishing dedicated government units/departments, refinancing schemes, and easing provisioning requirements.[55]

There have been various dedicated institutions that have been set-up by the government and the BB.[56] The most recent being the SME and Special Programs Department that is aimed at increasing MSME financial inclusion and oversight of policy implementation.[57] Currently, as reported in BB's Annual Report 2019, there are six MSME related refinance schemes for banks and Non-Bank Financial Institutions (NBFI) being implemented. These cover specific sectors, cross-sectoral SMEs, creation of medium to long terms funding options for SMEs, and start-up capital. Recognising the need to develop entrepreneurship, the BB along with donor funding has been engaged in training and upskilling of youth who can then also have the option of accessing start-up capital from dedicated funds.[58] Some notable policy initiatives include easing of provisioning norms and risk weights of unrated assets, customised finance options for specific MSME clusters, and a dedicated rating agency for MSMEs. Apart from these, BB has also adopted a targeted approach to increasing inclusion of MSMEs. This approach includes

- 20% of loans of banks and FIs dedicated to MSMEs (increase to 30% by 2021)
- 40% of disbursement target for small entrepreneurs
- Efforts to ease loan sanction procedures aimed at reducing disbursement time
- New branch licenses issued basis target achievement on MSME loans

[51] World Bank (2018b), (World Bank (2019c).
[52] World Bank (2019a).
[53] Singh, Asrani, & Ramaswamy (2016).
[54] Singh, Asrani, & Ramaswamy (2016).
[55] Bangladesh Bank (2019a), World Bank (2019a), Economic Research Group (2017).
[56] For a comprehensive list and purpose of each department refer to World Bank (2019a).
[57] Such as Bank for Small Industries and Commerce (BASIC) established in 1988 to facilitate finance for MSMEs.
[58] Bangladesh Bank (2019a).

While there is no specific scheme that is dedicated for WMSMEs, there are targets that have been set within some of the refinance schemes for outreach to this set of entrepreneurs. Box 2 provides an overview of some of the policies targeted at women entrepreneurs.

Box 2: BB initiatives targeting women entrepreneurs

- 15% of the Small Enterprise Refinance Scheme allocated to women entrepreneurs
- 'Women Entrepreneurs' Dedicated Help Desk' in banks and other FIs
- Collateral free, personal guarantee-based loans up to BDT 2.5 million/US$ 30,000
- Dedicated 'Women Entrepreneurs Development Unit' in BB head office and branches
- Interest rate cap of 9% (bank rate+4% spread) on financing to women under BB's refinance schemes

Source: Author' compilation. Based on Bangladesh Bank (2019a).

These successes are notable, but demand and supply constraints laid out in the previous section warrant further regulatory action. A core area of work is related to the financial infrastructure as seen from the Ease of Doing Business data in the earlier section. The credit bureau coverage remains high excluding a number of MSME loans. A Secured Transaction Law has been drafted and is undergoing the due process for its likely final enactment in 2020.[59] Further work is needed to improve the resolution of insolvencies in a timely and cost-effective manner with changes to relevant laws and establishment of alternative dispute resolution mechanisms.

Another challenge identified is that MSME policy setting is under the ambit of various ministries. While the BB is responsible for framing financing policy, it cannot act in a vacuum, but 'there is very little institutional coordination and no strategic vision or overarching policy framework to support MSMEs.'[60]

3.1.4 Digital Finance in Bangladesh

The Government's vision 2021 plan envisages a 'Digital Bangladesh' wherein digital solutions will be used to 'bring socioeconomic transformation through information and communication technology (ICT).'61 The 2010-2021 Perspective Plan lays out the roadmap as to how this is to happen. Mobile technology is one of the key enablers of this plan and DFS has been identified by the BB as an area that can accelerate the pace and scope (non-credit financial services) of financial inclusion, including MSME financial inclusion.

The country has made substantial progress in terms of the development of its digital infrastructure. Global System for Mobile Communications (GSMA) data62 reveals a high level of penetration of smartphone devices and mobile connections. 93% of the country has a mobile connection with

[59] AKM (2019).
[60] World Bank (2019a).
[61] GSMA (2018).
[62] GSMA (2019a).

unique subscribers being 52.6% of the population. 99.5% of the population is covered by 2G and an equally large number (94.2%) are covered by 3G.

There is a proliferation of Mobile Financial Services (MFS)[63] and agents. The data clearly shows that MFS and agent banking have established a strong foothold in Bangladesh's financial inclusion landscape.

MFS began in Bangladesh in 2011 and has witnessed substantial growth since then. The number of active MFS account has risen 154% (3.3 million in 2019) and there has been a 69% increase in the number of agents (951,115 agents in 2019) between 2015 and 2019.

In 2013, Agent Banking services were started for remote customers. As of December 2017,[64] there were 13 banks offering these services through 2,224 outlets to 0.87 million account holders.[65]

On the mobile payments front too, Bangladesh shows promise. In terms of amount, inward remittances, and cash in/out have increased well over 100% since 2015. The largest jumps have been in utility payments (315%), salary disbursements (659%), and P2P transactions (265%). This implies a healthy trend in the adoption of mobile wallets. See Annex 6 for details of DFS in Bangladesh.

MFIs have been slower in adopting digital solutions. Many of them have in the past two years started their journey on digitising their own operations (e.g. use of tablets for loan applications). A United Nations Capital Development Fund (UNCDF) study[66] found only 30% of the MFIs showed interest in digital credit and most lacked awareness of the concept. 77% of the MFIs had no plans to adopt technologies such as artificial intelligence, but most of the large MFIs have been exploring big data and analytics.

A 2017 BB study[67] found that MSME's have also adopted MFS. They mostly use MFS for revenue collection and payment to suppliers. A large number use mobile banking for transferring money. Convenience was a key reason why most enterprises adopted mobile banking.

There has been significant work undertaken by the Government of Bangladesh and the BB to develop the country's digital infrastructure. More recently, this effort includes programs to foster innovation (Digital Financial Services Lab), scaling up the National ID effort (Smart National Identity), setting out enabling regulation and guidelines for MFS, payment systems and agent banking models. There is still scope for further regulatory action with respect to digital applications. The challenges[68] that pertain the regulatory framework include:

- The payment system is limited in application in that it only applies to Banks and MFIs are out of its ambit. E-money is treated as a deposit account and hence the restriction. This is restrictive in terms of DFS benefits to MSMEs as MFIs are unable to offer the micro and small segments the benefits of MFS (unless they become agents of banks).

[63] DFS is commonly referred to as Mobile Financial Services in Bangladesh implying that DFS will be mobile phone driven and mostly used for money transfer, mobile banking and mobile payments. Bank of Bangladesh & University of Dhaka (2017).
[64] In 2016, there were 1,281 outlets and 0.26 account holders.
[65] Kwok & Ashraf (2018).
[66] Srivastava, Kant, & Sharma (2019).
[67] Bank of Bangladesh & University of Dhaka (2017).
[68] World Bank, (2019a), Srivastava, Kant, & Sharma (2019).

- MFIs do not have access to the National ID database. This effects costs and time-related to due diligence
- Cash withdrawal limits on mobile accounts restrict transactions particularly those related to payments

3.2 Bhutan

Data on financial inclusion (Finscope and Findex)[69] in Bhutan is very scarce, but financial inclusion is a national priority issue for Bhutan and for the Royal Monetary Authority (RMA), the use of DFS (mostly payments) is of particular import. While there is a paucity of international sources of data on financial inclusion in Bhutan, the RMA's National Financial Inclusion Strategy (NFIS) reveals that financial inclusion is mostly lead by savings. 64% of Bhutan's adults have access to a bank savings account. Life insurance covers 18% of the population followed closely by access to credit at 16% coverage of the adult population. In term of gender, across the three services, males have more access than females. 64% of males have access to credit, while nearly half of that (36%) of women report access to credit. In terms of savings and insurance, 56% and 59% of males report access to a savings account and have insurance while in the case of females, it is 44% and 41% respectively. Data on MSME access to saving and credit is unavailable.

Cottage and Small Industries (CSI)[70] are the 'jewels'[71] of the Royal Government of Bhutan. They are an estimated 22,000 CSIs that employ over 99,000 Bhutanese.[72] The RMA has made access to credit to CSIs a priority area for the next five years.

3.2.1 Access to finance for formal MSMEs

The SME Finance Forum data reveals that there were 19,000 licensed MSMEs in Bhutan.[73] Of these, there are 11,000 microenterprises[74] and 8,000 SMEs. Male owned enterprises accounted for 62% while WMSMEs were at 38% of the total number of enterprises. Within the types of enterprises, male ownership of microenterprises and SMEs was higher at 57% and 70% respectively of the total enterprises in each type.

The estimated finance gap to these enterprises is US$ 91 million or 32% of the total demand estimated at US$ 284 million. In terms of the level of constraint, a high proportion (74%) faced no constraints. This is nearly the same for microenterprises (72%) and SMEs (76%). Disaggregating this data by gender reveals that a much larger proportion (83%) of WMSMEs faced no constraints while in the case of male-owned enterprises, this was 69%. Annex 2 provides details on the level

[69] Findex 2011 and 2017 do not cover Bhutan. The country is covered in the 2014 Findex survey. This data is used in the NFIS for Bhutan.
[70] MSME category firms in Bhutan are referred to as CSI.
[71] Royal Monetary Authority of Bhutan (2018a).
[72] Department of Cottage and Small Industry (2019).
[73] SME Finance Forum (2018a) This estimate is based on the 2017 Annual Report of the Department of Cottage and Small Industries under the Ministry of Economic Affairs.
[74] Based on definitions, it should cover micro and cottage enterprises.

of constraint by enterprise type and gender. The informal demand for finance is estimated to be at 38% (US$ 109 million) of the formal sector's demand.

3.2.2 Exploring supply, demand and reasons for constraints

The financial sector in Bhutan is relatively small in terms of the number of institutions in comparison to other target countries. There are five banks, three MFIs, three insurance companies. 68% of the financial sectors asset base comprises of loans and advances with banks comprising 89% of this as of June 2019.[75]

Microfinance appears to be in a nascent state. The group lending methodology often used by MFIs is 'under-represented.' Cooperatively owned savings and credit groups are few and small.[76] As of June 2019, there were 6,657 loan accounts and the average NPL was 12.22%.[77]

The share of loans by enterprise type reveals that medium enterprises have the largest share of credit at 24%. While the CSI sector has the potential to generate jobs, its share of credit is very low. Micro and Cottage industry shares are at 2% and 3% respectively. The small enterprises share is at 10% of total loans. Observation of trends in loan growth by enterprise type reveals that loan to medium enterprises has increased between June 2018 and June 2019. This is mainly on account of increased loans to tourism and trade/commerce sectors. However, loans to cottage industries has declined mainly due to a decrease in lending to the agriculture sector.[78] 45% of the loans are for non-enterprise purposes – mostly housing.[79] This has put the financial sector at risk as corporate short-term deposits are used to finance long term housing projects.[80]

The geographic concentration of financial services and credit is an area of concern for policymakers. RMA data reveals that 54% of financial services network is concentrated in just five of the 20 districts and 53% of the credit is concentrated in four districts.[81] A large proportion of the priority sector lending is concentrated in two districts – Thimphu (43%) and Chhukha (18%).[82]

Demand and supply issues leading to access to finance constraints for the CSI segment needs more detailed research. However, observations reveal that credit risk is a 'key constraint' for suppliers.83 Some observations on the constraints faced are noted in Box 3.

[75] Department of Financial Regulation and Supervision (2019).
[76] Rhyne (2017).
[77] Department of Financial Regulation and Supervision (2019).
[78] Ibid.
[79] Ibid.
[80] Dorji, (2017).
[81] Ibid.
[82] Royal Monetary Authority of Bhutan (2019).
[83] Balakrishnan (2019).

Box 3: Access to finance constraints faced by CSIs in Bhutan

- Collateral requirements are very strict
- Few CSI own land
- Lengthy loan procedures
- Weak bank staff skills in due diligence of enterprises
- Unsuitable product design – mostly fixed asset purchase loans
- CSI fear of loan rejection
- Inability to convince FIs of start-up potential
- Poor credit discipline

Sources: Author compilation. Based on Balakrishnan (2019), Tshering, (2019), Rinzin (2019), Saal (2019), Department of Cottage and Small Industry (2019), and (Royal Monetary Authority of Bhutan, (2018a).

Despite, a credit bureau and a securities exchange, the RMA acknowledges that financial infrastructure and limited alternative sources of finance are constraining factors in the access to finance by CSIs.[84]

Entrepreneurship or the ‘perceived’ lack of entrepreneurial culture is a matter of concern amongst policymakers.[85] In order to help nurture this culture and support entrepreneurs, particularly during start-up phase, the RMA along with various other related government agencies have launched a platform in 2018 called Jab-Chor. This platform aims to bring together young entrepreneurs and funders to facilitate access to alternative sources (angel investors, P2P and crowd funding) of finance. The initiative is aimed at complementing the priority sector lending policy of the RMA.[86]

A review of the World Bank’s Ease of Doing Business survey[87] (Annex 5) reveals that the country ranks high (compared with target countries) at 89 out of 190 in terms of doing business. However, this is a drop from 71 in 2016.[88] In terms of getting credit, the country is ranked 94 in 2020, but this is a fall from 79 in 2016. This is mainly attributed to an increase (from 14% to 30%) in the number of firms highlighting access to credit as a key constraint in various World Bank Surveys conducted in Bhutan.[89] However, there is a credit bureau functioning that covers all FIs and all loans (excluding informal lending). In terms of resolving insolvency, there no rank assigned as the survey has not found any cases related to foreclosures, liquidation and reorganisation. On the enforcing contract indicator, Bhutan has a high score of 29 out of 190. However, primary data collected from bankers reveals that collateral seizure cannot be executed due to an inefficient judicial system that largely favours borrowers.[90]

[84] Cole & Carrington (2016).
[85] Rhyne (2017).
[86] Royal Monetary Authority of Bhutan (2019).
[87] World Bank, (2019d).
[88] World Bank, (2016).
[89] Cole & Carrington (2016).
[90] Ibid.

3.2.3 Policy effort to increase financial inclusion of MSMEs

In 2014, the Royal Government of Bhutan became a signatory to the Alliance for Finance Inclusion's Maya Declaration. Since then, there have been numerous efforts at increasing financial inclusion and strengthening the financial sector in Bhutan. One of the most concrete steps towards increasing access to finance has been the adoption of the NFIS (2018 to 2023).[91] Increasing access to finance for CSIs is one of the pillars of the NFIS. The Strategy aims to develop 'innovative credit mechanisms and alternative sources of financing' for CSIs. A key enabler of the Strategy is the development of payment infrastructure including ensuring interoperability that is critical for efficient DFS.[92] Apart from the NFIS, the RMA and the Royal government have also launched several key policy initiatives:

- Established rules and regulations for MFIs (2014), deposit-taking institutions (2016), agent banking (2016), E-money issuer (2017), and Payment and Settlement Systems (2018)
- Developed financial infrastructure (noted in the previous section)
- Set-up of the basic payment infrastructure – a payment gateway - in order to enable interoperability, internet banking, P2P, G2P, and P2G payments.
- Adopted the National Financial Literacy Strategy (2018 – 2023) that focuses on entrepreneurial development, usage and access to financial services, DFS and consumer protection, and financial management and credit responsiveness.[93]
- Set-out priority sector lending guidelines to increase the flow of finance to CSIs

One of the most recent (June 2019) policy initiatives has been to the issuance of registration certifications to six new MFIs that are currently operating in all the 20 districts of Bhutan in order to facilitate flow of priority sector lending to all CSIs across Bhutan. These initiatives clearly display a tilt in regulation towards DFS, particularly payments. Bhutan's DFS initiative and pathway are detailed in the following section.

3.2.4 Digital Finance in Bhutan

There has been a stream of DFS initiatives (both public and private sector) that are ensuring Bhutan's progress towards a cashless and digital society. These initiatives have included the launch of mobile banking applications, Point of Sale (PoS) machines, e-wallets, and more recently G2P and government to government (G2G) payment infrastructure. Box 4 presents specific examples of DFS initiatives.

[91] Royal Monetary Authority of Bhutan (2018a).
[92] The enablers are general and not specific to CSI, but they are likely to impact CSI access to finance positively.
[93] Royal Monetary Authority of Bhutan (2018b).

Box 4: Examples of recent DFS initiatives in Bhutan

- **2015**: Bank of Bhutan launched its M-BoB mobile payment services that allowed P2B transactions between bank accounts
- **2017**: PoS (Point of Sale) systems were established at fuel stations in the capital to allow for cashless transactions
- **2018**: Bank of Bhutan launched an e-wallet app called CHHARO for online purchase of goods and services
- **2019**: (July) the Royal government launched the Electronic Public Expenditure Management System (ePEMS) and the Global Interchange for Financial Transaction (GIFT) payment system. The ePEMS system enables the shifting of allows the government to do away with the system of issuing manual cheques for G2P and G2G payments. This will be facilitated by GIFT that will allow for interbank fund transfers in real time and to multiple accounts from a single account

Sources: Author compilation. Based on Dem (2019), Tshedup (2015), Lhamo & Zangmo (2017) and Zangmo (2018)

These assume significance as they reflect the progress Bhutan has made in its journey towards a cashless and digital society. Alongside these, progress related to mobile infrastructure and agent network has helped further the enabling environment.

GSMA data on mobile connective for Bhutan[94] reveals that 98% of the population is covered by 2G and 88% are covered by a 3G network. The number of mobile connections are 107% of the population while unique subscriber penetration is 53% of the population.

Access point data from the RMA reveals a substantial proliferation of Agents. 64% of all access points are Agents and 23% are PoS. Table 1 shows the growth in various types of access points between 2013 and 2017. Significantly, while bank branches have reduced and ATMs numbers have remained the same, Agents and PoS networks have been a substantial addition to the financial inclusion landscape of Bhutan. The increase in Agents may explain the reductions in banks branches.

Table 1: Access Points across Bhutan[95]

Access points	2013	2017
Adult population	474,334	494.586
Commercial bank branches/10,000 adults	4.3	3.01
Total branches	203	149
ATMs/10,000 adults	3.94	3.8

[94] GSMA (2019b).

[95] Data does not include Bank of Bhutan and MPay agents as they cannot perform cash in/out transactions. But they have 71,763 and 11,268 users respectively.

Access points	2013	2017
Total ATMs	187	188
Agents/10,000 adults		**43**
Total Agents		**2,133**
PoS/10,000 adults		15.35
Total PoS machines		759
Bank Agents/10,000 adults		**8.23**
Total Bank Agents		**407**

Source: Author. Based on Royal Monetary Authority of Bhutan (2018a)

3.3 Cambodia

Cambodia has witnessed 'better than expected growth' of 7.5% in 2018 along with reduced poverty rates over the past decade.[96] While this growth is mostly attributed to the construction, garments and a growing tourism sector, the country also has a relatively robust financial sector largely comprising of Banks, MFIs, Microfinance Deposit Taking Institutions (MDI) and a growing pool of DFS providers.

In terms of financial inclusion, Finscope data[97] reveals 71% of adults in the country have access to financial services. Of this 17% have access to banks, 42% to NBFIs and 12% to informal financial sources. 29% of adults are completely excluded from financial services. The data reveals that NBFIs are largely driving financial inclusion in Cambodia. 26% of the adult population exclusively uses NBFIs compared to only 5% that exclusively use banks. There is no significant difference in the gender gap and female financial inclusion is slightly higher. The data shows that 56% and 58% of the country's adults do not use saving or credit financial services. Informal channels are the main source of savings for 21% of the population while NBFIs are the main source of credit for 22%.

DFS has rapidly developed roots in the Cambodian financial inclusion landscape. Remittance is the most used service with 44% of adults have either sent or received money. Of this, a large proportion – 35% adults – use NBFIs to remit.

41% of Self-employed/MSMEs are included via NBFIs while 22% use banks for various financial services. In terms of access to formal credit, Finscope data reveals that only 28% of MSMEs have access to formal credit, 11% access informal sources of credit while a high proportion – 62% - are excluded.

While most MFIs, MDIs and a few large banks[98] are catering to the microenterprise segment, there is a growing interest amongst financial institutions, the National Bank of Cambodia (NBC) and policymakers in increasing access to finance for SMEs.

[96] World Bank (2019e), IPE Global & M-CRIL (2018), General Directorate of Banking Supervision (2019).
[97] Cenfri, FinMark Trust, UNCDF (2017).
[98] For example, Acleda Bank and Sathapana Bank.

3.3.1 Access to finance for formal MSMEs

There are an estimated 376,000 formal MSMEs in Cambodia.[99] Of these, a majority 97% (364,000) are microenterprises while 3% (12,000) are SMEs. The current finance gap in these institutions is estimated at a high 87% (US$ 3.70 billion) of total demand that is US$ 4.3 billion.

There is not a large gender differential in ownership of MSMEs, but women have a higher share at 52% of formal enterprises. More women own microenterprises than men, who own a significant proportion of the SMEs.

Data for the type of enterprises and gender reveals that women's share in microenterprises is higher at 53%, but it is significantly lower at 35% ownership of SMEs. A similar gender differential is observed for the finance gap data. While the differential is not much within microenterprises (52% gap for WMEs), but it is substantial in the SME segment with there being nearly an 82% finance gap for male-owned enterprises while WSMEs, are able to finance most of the demand (82%). In total, the formal finance gap for WMSMEs was 32% and for male counterparts, it was 68%. WMSME ownership was the largest in wholesale and retail trade at 65%. While in manufacturing, it is the lowest at 35%.[100] Women are also more likely to transact in cash and use mostly MFIs.[101]

In terms of the level of constraint, data reveals that 68% microenterprises and 65% of SMEs were able to meet the financing needs of their enterprises. 15% of microenterprises and 18% of SMEs were partly able to meet needs. Similarly, 69% of WMSMEs were able to fulfil the finance requirements, while for male counterparts, 65% state there were no constraints. Annex 2 presents the data on constraints by type of enterprise and gender.

The SME Finance Forum’s estimates suggest that informal demand for finance is estimated to be US$ 3.6 billion or 85% of formal demand.

3.3.2 Exploring supply, demand and reasons for constraints

The financial services landscape has a number of varied institutions including commercial banks (43), MDIs (7), MFIs (74), and payment service providers (16).[102] Add to this mix is a large number (273) of rural credit operators. In recent years, the number of e-money or payment providers such as Wing Cambodia and True Money, have increased their presence via agents in Cambodia.[103] These institutions are regulated by NBC.

Banks account for 84.2% of the financial sectors assets while MDIs account for 14%. The MFI’s while large in number have a very small share at 2.1%. Bank credit is mostly concentrated in construction, real estate and the retail sector. Credit from MFIs and MDIs is largely concentrated in agriculture and for households making them an important source of credit for the microenterprise sector.[104]

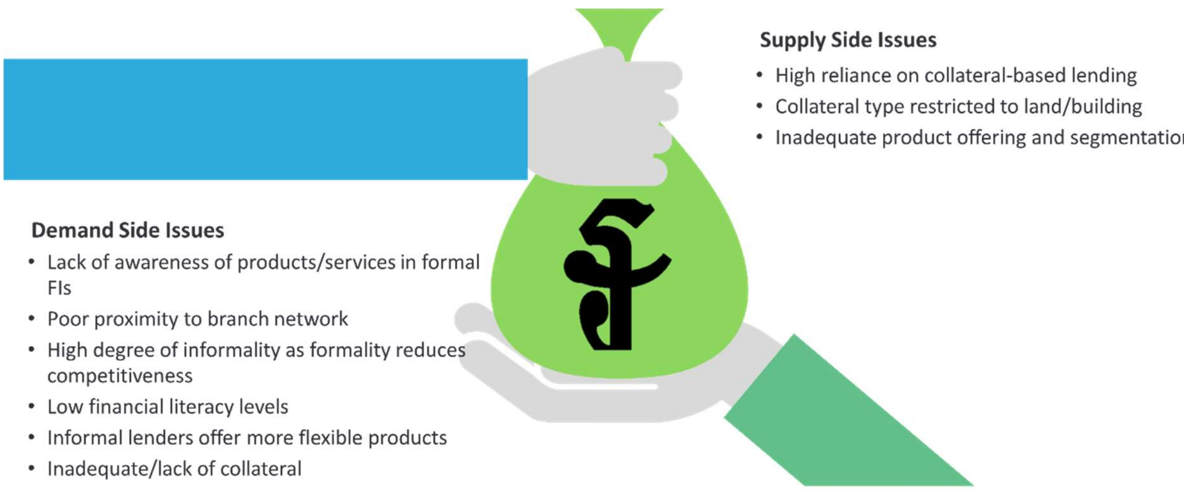
[99] SME Finance Forum (2018a).
[100] UNCDF SHIFT (2018).
[101] ESCAP (2019a).
[102] National Bank of Cambodia (2018).
[103] Wing Cambodia is reported to have 4,000 agents Asian Development Bank, (2017).
[104] National Bank of Cambodia (2018). Note: Sathapana and Acleda Banks – both former MDIs – still have a significant credit portfolio in the small loans/household segment.

Cambodia's capital market, while considered to be 'shallow and illiquid'[105] has been developing. In 2018, it's market capitalisation increased by 44% with a marginal increase in trading activity. Of note is the listing of the first Reil denominated bond by the MDI Hattha Kaksekar Ltd (HKL) in December 2018. 66% of this was allocated to the IFC. The proceeds from the sale of this bond are to be used to support MSMEs in rural areas (including farmers and women entrepreneurs).[106]

There is a growing network of VC, private equity, angel investors and venture debt companies. However, these are not explicitly specialising in or funding MSMEs. But there is a heavy reliance by MDIs on international funders and foreign banks based in Cambodia for sources of debt funds.[107] In many cases, the principal equity investors in MDIs and Banks like Sathapana and Acleda are international.

While there are a varied set of institutions that could enable financial inclusion of MSMEs, there are several demand and supply challenges that constraint access. Figure 3 provides a summary of these constraints.

Figure 1: Cambodia - Key supply and demand constraints for MSME access to finance



Sources: Author compilation. Based on Cenfri, FinMark Trust, UNCDF (2017), ESCAP (2019a), Hout (2019), Totten, Kry, Smiddy, & Emerging Market Consulting (2019)

The issue of collateral is viewed as the more critical compared to other issues and while the NBC allows immovable and movable assets to be accepted as collateral, there remain inconsistencies between the NBCs secured transaction law and the civil code law that disallows movable assets to be taken as collateral.[108]

[105] OECD/ERIA (2018).
[106] International Finance Corporation (2019a), International Finance Corporation (2018), Hor (2018), Fleming (2018).
[107] National Bank of Cambodia (2018), ESCAP (2019a).
[108] ESCAP (2019a), Cenfri, FinMark Trust, UNCDF (2017), Hout (2019).

Research (including primary data collection) on MSME access to finance reveals that similar challenges exist for men and women-owned enterprises with regard to access to finance.[109] However, WMSMEs also have to contend with gender-based cultural and social norms. In addition, many WMSMEs report the fear of losing assets, and the having to get the business registered in a male counterpart's name results in inadequate credit history.[110]

Cambodia's Ease of Doing Business (Annex 5) ranking has been falling for four consecutive years. This is attributed to the lack of consistency in implementing regulatory reforms.[111] The country has slid six places from 138 out of 190 in 2019 to 144 in the 2020 report. The principal reason for this is that increased costs associated with the business registration procedures. Its ranking has also been affected[112] due to Cambodia being the third most expensive country in terms of contract enforcement (103% of the cost of the claim value) and a lack of judicial best practices to deal with contract disputes.[113]

But Cambodia's entrepreneurial culture is undergoing a transformation. While the GEI highlights risk acceptance as the weakest area, product innovation is the highest scored component.[114] Data collected for the Entrepreneurial Ecosystem Assessment conducted by the Mekong Business Institute shows a greater acceptance of entrepreneurship as a career option for youth in Cambodia. Several business associations/chambers of commerce that promote and support entrepreneurs have emerged. The concept of 'hubs'[115] is gaining ground amongst young entrepreneurs keen to innovate and collaborate.

3.3.3 Policy efforts to increase financial inclusion of MSMEs

Cambodia recognizes the importance of MSMEs for its economic growth.[116] SME promotion and entrepreneurship are focus areas in the government's economic development strategy and some initiatives include tax breaks, special-purpose funds and the upcoming SME Bank.[117]

While these initiatives positively affect SME financial inclusion, arguably, it is the work of the NBC and the support it has received from UNCDF Shift program and the AIF that has provided the biggest policy impetus on MSME financial inclusion including efforts to increase women's financial inclusion. The UNCDF Shift program's support has particularly been influential in helping the NBC make data-driven decisions, set financial inclusion goals, and draft Cambodia's NFIS.[118]

[109] ESCAP (2019a), International Finance Coproration (2019b).
[110] Women's World Banking (2015).
[111] Totten, Kry, Smiddy, & Emerging Market Consulting (2019).
[112] Reaksmey (2019).
[113] Enforcing contract indicator's rank remined the same at 182 between 2019 and 2020 reports. Resolving insolvency indicator dropped from 79 to 82 during this one year.
[114] Acs, Szerb, & Lloyd (2017).
[115] For example, the Impact Hub Phnom Penh (https://phnompenh.impacthub.net/).
[116] Totten, Kry, Smiddy, & Emerging Market Consulting (2019).
[117] Chea K. H. (2019).
[118] IPE Global & M-CRIL (2018).

While Cambodia's NFIS is still in a draft state, the National Financial Sector Development Strategy 2016-2025 does outline the effort in a number of systemic areas such as support to the Credit Bureau of Cambodia (CBC), development of the credit guarantees system, financial education/awareness programmes, and creation of a Trust Registry.[119] The NBC continues to work with various ministries to resolve the inconsistency between the civil code and the secured transaction law. Annex 7 sets out some of the proposed actions for development of the finance sector in Cambodia.

One of the core goals of NBC's financial inclusion strategy is promoting innovative credit products for consumers and MSMEs. The 'Key Activities' planned under this include expanding non-collateralised credit for MSMEs, improving credit reporting and credit risk assessment, and setting-up a well-functioning dispute resolution mechanism.[120]

A recent (2019) notable development has been the launch of the Commercial Credit Score by the CBC. This score will provide a firm's credit history based on data shared with the CBC by banks and NBFIs. This effort should encourage further lending to MSMEs, but efforts for increasing the formalisation of MSMEs need to continue and MFIs working with unregistered MSMEs and sharing their data with the CBC can be a value add for the segments access to formal finance.

The launch of the first Reil denominated bond on the Securities and Exchange Commission of Cambodia (detailed in the earlier section) is an important step towards widening the breadth of available formal finance options. The fact that the core goal is funding MSMEs and women entrepreneurs reflects a deliberate strategy to meet the financing requirements of these segments. Translating this effort into actual practice (for example product development, due diligence practices) needs to be carefully monitored for purposes of replication.

Financial literacy and consumer protection are areas that NBC has paid particular attention to in the past few years. The effort, while not directed specifically towards MSMEs, is relevant as it covers consumer protection and preventing over-indebtedness. The NBC is using multiple channels such as schools (in collaboration with the Ministry of Education, Youth and Sports), mobile phone applications, and financial advice via a call back on the mobile phone in response to dialing 321.[121] There are numerous consumer protection efforts made in recent years. These have included interest rate calculation methodology, transparency requirements (particularly on interest rate declarations), and establishment of a grievance redressal mechanism, including Financial Institution reporting customer complaints received periodically. However, the 2017 interest rate cap imposed by NBC has received a mixed response.

[119] Royal Government of Cambodia (2016).
[120] Chea S. (2018).
[121] Royal Government of Cambodia (2016), General Directorate of Banking Supervision (2019).

3.3.4 Digital Finance in Cambodia

"Cambodia's FinTech scene is more nascent than some other markets in ASEAN, but like many developing ecosystems, "the match has been lit."[122]

Cambodia's mobile coverage is the highest amongst the target countries. 93% of the population is covered by a 4G network, 90% have 3G and 99% have 2G. Mobile connection penetration is 153% of the population while unique mobile subscribers or ownership is 67.2% of the population.[123] These factors along with the fact that 50% of Cambodia's population is under 25 with a high rate of technology adoption creates the 'perfect storm' for DFS.[124]

The Asian Development Bank (ADB) estimates[125] that the potential impact of DFS in Cambodia is an additional US$ 2 billion in payments/transfers, US$ 1 billion in credit uptake and US$ 3 in savings mobilisation. This data focuses on women, the bottom of the pyramid and MSMEs and accounting for other segments should lead to a larger potential impact.

DFS in Cambodia is largely driven via mobile money transfer and payments. As of December 2018, there were 16 licensed Payment System Providers (PSP). NBC data[126] reveals that between 2016 and 2017, the number of mobile money agents in Cambodia grew from by 26% from 18,277 to 23,022 and the number of registered customers nearly doubled from 654,026 to over 1.3 million. As of December 2018, there were 34,449 agents [127] across Cambodia and the value of transactions amounted to US$ 22 billion.[128] Leading the PSP pack is Wing Cambodia Specialised Bank. It provides mobile money and electronic payment services all of the provinces via a network of 7,000 Wing Cash Xpress outlets. It has partnerships with more than 30,000 merchants and global financial players such as Mastercard and WorldRemit.[129] See Annex 8 for details of Cambodia's payment services performance.

The NBC, supported via various international initiatives has been proactive in the DFS space (particularly on payments) as it remains optimistic and views DFS as a 'game changer' that could have a positive impact on financial inclusion outreach and cost of this outreach.[130] Cambodia has over the past few years moved forward in terms of regulation and supporting infrastructure particularly in the payment sector.

Notable developments include the soft launch of a 'Cambodian Shared Switch' enabling clients of banks and formal financial institutions to perform inter-agency transactions and regulation on PSPs. The regulation on PSPs allows them to conduct money transfers, cash in/out, bill payments, retail payments, online payments, and cross border money transfers. A recent (2019) crucial development has been the launch of the Bakong project by the NBC. This project, based on

[122] Samuel Hall, Program Director of Startupbootcamp FinTech. Chankiriroth (2017).
[123] GSMA (2019c).
[124] Chankiriroth (2017).
[125] Asian Development Bank (2017).
[126] Chea S. (2018).
[127] 10,285 Bank and NBFI agent, and 24,164 PSP Agents.
[128] General Directorate of Banking Supervision (2019).
[129] Khmer Times (2019).
[130] Fintech News Singapore (2017).

blockchain technology, connects financial institutions and payment provides allowing for transfers across platforms and augments interoperability.

MSME access to formal finance has also received a boost with FinTechs such as Bhanji offering potential last-mile connectivity to MSMEs. Its recent (2019) collaboration with Wing is of note as it has the potential for use of alternative data, digitised financial accounts and invoices for providing credit services to MSMEs in Cambodia's remote areas. [131] Wing is providing free of charge access to Bhanji's accounts systems to 5,000 of its SME customers. Box 5 explains the work of Bhanji.

Box 1: Providing access to finance to MSMEs

Bhanji is a FinTech that provides an online accounting platform for an estimated 1,500 MSMEs in Lao PDR and Cambodia. It was launched in 2016. Apart from the accounting platform, it also offers credit assessments based on alternative data and digitization of invoices. These are used for making credit decisions on MSME credit by various FIs. Some MFIs are also using it for invoicing of their MSME clients.

Source: ESCAP (2019a) and (Totten, Kry, Smiddy, & Emerging Market Consulting, 2019).

3.4 Lao People's Democratic Republic

Lao People's Democratic Republic's economy is undergoing a transition. In the past few years, its economy has moved from dependence on the exploitation of natural resources, minerals, and hydropower to agriculture and the service sector (including banking). GDP which was over 6% does show a declining trend, but sectoral contribution shows that the services sector has bucked this in 2018.[132]

Along with the broader economy, the financial sector is also undergoing a transition exemplified by the increase in the number of private banks, NBFIs and the increasing experimentation with digital payments. However, much of the sector remains characterised by informality with a large presence of Village Funds and Savings and Credit Unions.

In terms of financial inclusion, 60% of the adult population accesses a mix of informal and formal financial services.[133] Of this, 27.3% access only informal sources, significantly more than formal sources.[134] A quarter of the adult population is completely excluded. Less than half (47%) of Lao adults use formal regulated institutions. Gender gap across the access strands[135] is minimal with near equal access to formal and informal financial institutions. Much of the financial inclusion is

[131] Khmer Times (2019).
[132] Bank of Lao PDR (2019a), Jefferis (2016), (World Bank, 2019f).
[133] Jefferis (2016), Jefferies (2015), FinMark Trust (2014).
[134] Adults served only by banks and NBFIs are 7.3% and 2.6%.
[135] Banked, non-bank formal, informal, excluded.

led by informal savings with as many as 53% of adults saving with a formal or informal institution. Interestingly, of this, 14% only save at 'home/secret place'. Credit is the least used of all the financial products in the country - 80% of adults do not borrow.[136] An equal (8%) borrow from only from formal or informal sources. 24% of Lao adults use formal remittance services.[137] A near equal number use informal sources (6%) and family/friends (5%) to remit money.

Much of policy and data are related to SMEs and less on Microenterprises which mainly access finance from the unregulated village funds (VFs).[138] the SME sector in term of employment is substantial as it accounts for 82.2% of the total private sector employment.[139] The government recognises the importance of the sector and has pushed for its development particularly since 2004. There have also been substantial inputs from international agencies such as ADB and IFC over the years.[140]

3.4.1 Access to finance for formal MSMEs

The estimated number of formal MSMEs in Lao Peoples Democratic Republic is 127,000[141] of which 46% are WMSMEs and a significant proportion (94%) are microenterprises. The finance gap pertaining to these MSMEs is at a high 85.5% (US$2.7 billion) of the demand (US$ 3.04 billion). Disaggregating the gap data by type of enterprises reveals that microenterprises accounted for a large share (55%) of the gap as compared to SMEs (45%). The finance gap within the type of enterprises is nearly equally across the micro-enterprises (85%) and SMEs (86%) segments. WMSMEs accounted for 42% of the total finance gap while male-owned enterprises accounted for the larger proportion at 58%.

Finance gap data disaggregated by type of enterprise and gender reveals that within the micro-segment, 53% of WMEs face a finance gap but in the SME segment 71% of the gap was attributed to male-owned enterprises.

In term of level of constraint, 43% of formal microenterprises and 33% of SMEs face some level of constraint in accessing finance. However, a large proportion (36%) of microenterprises are fully constraint in their access to finance. In terms of gender and levels of constraints, there is not a substantial difference between WMSMEs and their male counterparts. Annex 2 provides data on the level of constraint by enterprise type and gender.

The potential demand in the informal MSME sector is estimated to be US$ 1.2 billion or 39% of the demand from the formal sector.

[136] Estimate at the time of the Finscope survey.
[137] 17% banks and 8% other formal sources.
[138] OECD/ERIA (2018).
[139] Ibid.
[140] Not much data is available on microenterprises.
[141] SME Finance Forum (2018).

3.4.2 Exploring supply, demand and the reasons for constraints

The financial sector landscape of Lao People's Democratic Republic mainly includes banks, development finance institutions (DFI), NBFIs, saving and credit unions (SCUs) and VFs. The sector is dominated by three large state-owned banks, but private sector banking is increasing its presence as well.[142] Commercial banks assets were estimated[143] to be US$ 15.45 billion. The government-owned Nanyobay Banks – the sole DFI – is used as a channel for subsidised credit to farmers. In comparison, the NBFI sectors assets are very small at US$ 0.192 billion. Of this, the MFI sector accounted for nearly 81% (US$ 0.155 billion).[144] NBFIs largely include MFIs that provide both credit and savings products. Annex 9 provides data on the type and number of FIs as well as total asset share of various types of commercial banks.

Private insurance in the country is under-developed in terms of product offerings (largely compulsory vehicle insurance) and the stock exchange is 'shallow and illiquid.'[145] Leasing is emerging in Lao People's Democratic Republic but mostly used for the purchase of consumer durables. There are no VC firms in Lao People's Democratic Republic 'mainly due to a lack of viable business ideas and of founders able to pitch convincingly in English.'[146] Though access to regional initiatives such as Mekong Business Initiative and or Mekong Angel Investor Network is possible.[147] Lack of a regulatory framework for VCs is also a dissuading factor for many private equity firms to set-up in the country.

Village Funds or VFs[148] are an important part of the financial inclusion landscape. The high level of social cohesion and dependence of the community may explain the presence of these VF.[149] While they are considered an important for MSME financing, 'accurate data on village banks are scarce'[150] though mixed estimates suggest their number ranges from 4,000 to 6,000[151] with a membership base of 430,000 and aggregate loan portfolio of US$ 37 million.[152] The Bank of Lao PDR (BoL) estimates there are 4,814 VFs as of 2014.[153] Similar numbers for MFIs puts their client base at 260,767 (66,157 active) and US$ 109 million in loan outstanding. [154]

On the demand side, the MSME sector is also characterised by a high degree of informality. Department of Small and Medium Enterprises Promotion (DOSMEP)'s 2016 estimates suggest that 86% of Lao People's Democratic Republic's enterprises are micro or family business and

[142] In terms of asset share.
[143] As of December 2018.
[144] Data compiled from Bank of Lao PDR and Lao Microfinance Association. Bank of Lao PDR (2019a), Bank of Lao PDR (2019b) and MFA-Lao Microfinance Asociation (2018). MFI data is of 68 members of the Association.
[145] OECD/ERIA (2018).
[146] Ibid.
[147] Roosmalen, Phodsavang, & Emerging Markets Consulting (EMC) (2019).
[148] Also called Village Banks.
[149] Jefferis (2016).
[150] OECD/ERIA (2018).
[151] Jefferis (2016).
[152] OECD/ERIA (2018). Membership and portfolio data are from 2012.
[153] Bank of Lao PDR (2019c).
[154] MFA-Lao Microfinance Asociation (2018).

operate without formal registration. The 2016 Enterprise Survey of the World Bank states that 98% of enterprises in the country fall into the SME category.[155]
While there is a lack of clarity[156] around these estimates, they agree that access to finance is a challenge for MSMEs in Lao People's Democratic Republic. The Enterprise Survey, in fact, suggests that only 20% of bank credit goes to SMEs. These estimates are a near match with that of the SME Finance Forum presented in the earlier section of this chapter.

The World Bank's Ease of Doing Business[157] (Annex 5) ranks Lao People's Democratic Republic low at 154 out of 190 countries. It has a relatively[158] higher score in terms of getting credit due to the enacted secured transaction law and establishment of a registry for movable assets as collateral. However, the enforcement is weak due to an ineffective court system and outdated Law on Bankruptcy of Enterprise.[159] Furthermore, most land is not formally registered and transfer usually is in an informal setting.[160]

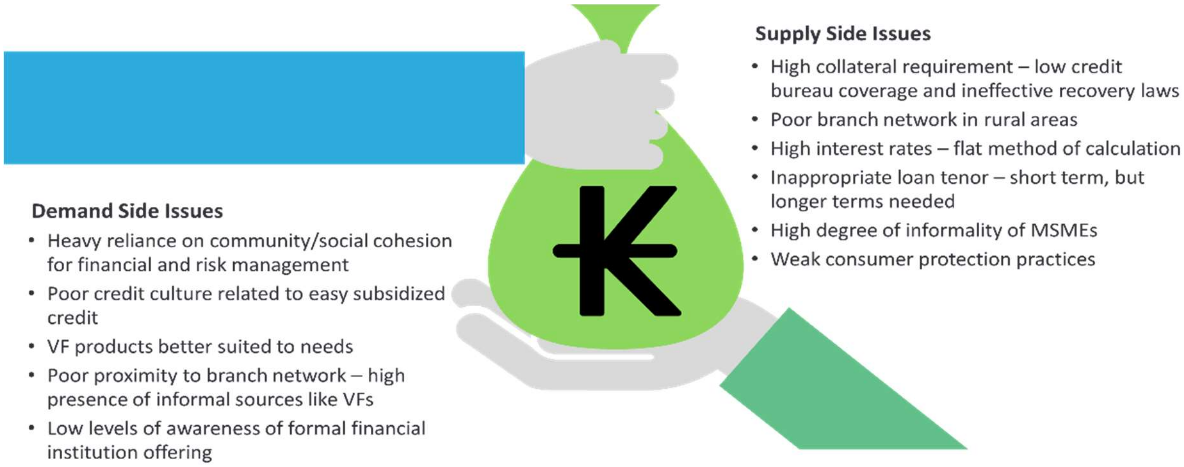
The entrepreneurial culture in Lao People's Democratic Republic is underdeveloped. This may be a result of the low-risk acceptance an area on which the country has a low GEI score.[161] Failure is culturally viewed negatively which may explain the low score. Those placed most suitably for entrepreneurship (wealthy families, urbanised) are often discouraged by elders and pushed towards jobs with institutions in the private sector and international non-government organisations.[162] The business environment is largely characterised by a 'deals-based' approach and weak enforcement mechanisms.[163] However, the country is in the process of developing entrepreneurship support programs with donor support.

In terms of the demand and supply constraints faced by MSMEs, it is important to note that Laotian SMEs are relatively more researched (albeit inadequate) subject than microenterprises. However, the principal demand and supply constraints faced by MSMEs include high collateral requirements, limited product ranges, poor branch network in rural areas and a high degree of social cohesion leading to reliance on informal sources such as VFs.

Figure 4 captures the key demand and supply constraints faced by SMEs. Some of the constraints, those evident in Lao People's Democratic Republic, are more general and may affect individuals more than businesses. However, these constraints are noted here on the assumption that most microenterprises are rural and sole proprietorship.

155 The World Bank (2017).
156 Most likely due to definitions adopted of micro, small and medium enterprises.
157 World Bank (2019g).
158 Compares to other indicators – See Annex 5.
159 On the Ease of Doing Business parameters for enforcing contracts and resolving insolvency, Lao PDR scores 135 and 151 respectively out of 190.
160 OECD/ERIA (2018), Xaythanith (2013), Noeske (2014).
161 Acs, Szerb, & Lloyd (2017) Overall GEI score for Lao is 112 out of 137. On the indicator of risk acceptance, it scores 31%.
162 Roosmalen, Phodsavang, & Emerging Markets Consulting (EMC) (2019).
163 OECD/ERIA (2018).

Figure 2: Lao People's Democratic Republic - Key supply and demand constraints for (M)SME access to finance



Source: Author compilation. Based on Jefferis (2016), OECD/ERIA (2018), The World Bank (2017), Leahy, Lunel, Grant, & Willetts (2017), Hunt (2016), and International Labour Organisation (2006)

Women's agency and participation in the country's economy have been steadily on the rise. 73% of women are part of the labour force,[164] over 40% of all enterprises in country are partially owned by women, and the majority of newly registered urban enterprises are woman-owned.[165] Most women-owned enterprises in Lao People's democratic Republic tend to be micro and small, and informal.[166] Though the Lao Business Women's Association has categorised most women-owned business as micro in scale.[167] These findings are in line with those of the SME Finance Forum.

Access to finance is a constraining factor for most women-owned micro and small enterprises (WMSEs). The main reasons for this include proximity to formal financial institutions, perception of higher risk associated with women borrowers, and lack of financial literacy. These and other factors are elaborated in Annex 10.

3.4.3 Policy effort to increase financial inclusion of MSMEs

Lao Peoples Democratic Republic has moved from a strong central planning system to acceptance of private enterprise, particularly SME, as being crucial for the development of the country. The country's policymakers have pushed for the development of the SME sector and have been supported by various international agencies such as the Asian Development Bank (ADB) International Finance Corporation (IFC)/World Bank, Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) and Kreditanstalt für Wiederaufbau (KfW) in this.

[164] Asian Development Bank and The World Bank (2012). Comparatively, 78% of men are part of the labour force.
[165] Hunt (2016).
[166] Leahy, Lunel, Grant, & Willetts (2017).
[167] Hunt (2016).

The Bank of Lao PDR is mainly responsible for financial sector regulation including access to finance and the DOSMEP under the MIC oversees policy development for the SME sector. The country's SME policy can be described as being in an 'early stage' but it does fair better than most regional counterparts.[168] Government financing schemes for SMEs are in the form of credit lines with interest rate caps. These funds, often sourced via international agencies such as the World Bank, are channelled via its specialised bank and in particular through the SME Promotion and Development Fund (SPDF).[169]

A general assessment[170] of the process of regulatory reform suggests that it is 'very slow, and laws and regulations often remain in draft form for long periods.' In addition, there are 'uneven regulatory requirements' across financial institutions and certain requirements do not facilitate a conducive environment for growth and financial inclusion.[171] Supervision is 'patchy', and with this, there are associated credibility issues. Consumer protection is considered to be weak from a regulatory perspective. Information on FI regulations, rules, guidelines and directives is not always comprehensive and interpreted in various ways. Furthermore, there are gaps in the information provided by regulators and financial institutions.

More specifically, while a significant policy effort is evident on SMEs, this is much less in the case of microenterprises that largely access finance via the VFs. While these are promoted by the government, they are informal and unregulated. Data is unavailable, but it is estimated that a large number of these VFs are unsustainable and some funds have become large. These factors in addition to the lack of VF regulation[172] poses a systemic risk related particularly to savings.[173]

An effort has been made to establish a credit bureau and the BoL is exploring reforms that may allow for private credit bureaus. A Secured Transactions Law has been enacted but there are implementation issues that have been covered in the earlier section. The country also lacks a credit guarantee system.

The BoL has recently (August 2019) adopted a Financial Inclusion Roadmap (2018-2025).[174] This largely draws on the data and proposed priority areas of the country's Finscope report.[175] Its emphasis is MSMEs and not just SMEs. Annex 11 summaries some of the key activities related to MSME under 5 priority area including increasing availability of credit, consumer protection, strengthening VFs, improving the payments ecosystem, and extending outreach of FIs.

[168] OECD/ERIA (2018). It is considered 'early stage' as it is a relatively recent policy priority. But given the technical assistance received the country has a 'a more active and better structured SME policy'.
[169] OECD/ERIA (2018). Between 2012 and 2018, this scheme provided loans worth LAK 52.7 billion to 128 SMEs. Interest rate was capped at 9% to 10%.
[170] OECD/ERIA (2018), Jefferis (2016).
[171] For example, imposition of additional capital requirements when new branches are opened.
[172] Some funds have received capacity building support that could potentially be replicated.
[173] OECD/ERIA (2018).
[174] Bank of Lao PDR (2019c).
[175] Jefferis (2016).

3.4.4 Digital Finance in Lao Peoples Democratic Republic

DFS is in its early stages in Lao Peoples Democratic Republic. There is a real time gross settlement (RTGS) in place, but it is reported to not 'widely used'. There is no clearinghouse for electronic funds transfers (ETF), no national switch and interbank transfers are settled bilaterally. However, mobile money and related agent banking 'holds promise.'[176]

Much of the DFS pathway's Stage 1 communications infrastructure is in place. GSMA data reveals a high level of mobile penetration - 84% of the population is covered via a 3G network, 98% via a 2G network, 81% penetration in terms of mobile connections,[177] and 65.5% unique mobile subscribers.[178] Finscope survey shows that one in three adults are likely to use their mobile connections to transfers, remittances, withdrawals, payments and for balance checking.[179] The survey also reveals that there is no major gender gap in mobile usage which was marginally higher amongst males (79%) than women (74%). It further adds that given the proximity of grocery stores there is potential to explore such store as mobile money agents.[180]

In terms of the pathway's Stage 2, the Findex 2018[181] data shows that 13.3% of the population made or received digital payments in 2017, 7.1% of the adult population used the internet to pay bills or make purchases while only 2.4% of adults used a debit/credit card to make a purchase. This data reflects substantial progress between the years 2014 and 2017 when in 2014, there were 'no institutions offering DFS or branchless banking – and therefore no customers.'[182]

The government and the BoL do recognise the significance of mobile money and agents (a key CGAP enabler) for improving financial inclusion. Supported by various international agencies the government has enacted the National Payment Systems Law, and the BoL has established a Payment Systems Department in 2018 for the supervision of e-money, agents and to ensure consumer protection.[183] The BoL has been encouraging commercial banks to improve mobile services with the aim of encouraging payments particularly for land tax, electricity and water bills, and road tax.

BoL's Financial Inclusion Roadmap prioritises the improvement of the payments infrastructure (Priority 4), its eco-system via mobile money and in general DFS. The four core areas of intervention under this priority are strengthening the regulatory framework, improvements to the payment infrastructure, pilots on mobile money, strengthening agent networks, and increased interoperability (Priority 4 is detailed in Annex 12).

The country's largest mobile network operations (MNO) – BCEL – launched the country's first pilot on the mobile wallet. This pilot – BCOME (BCEL Community Money Express) - was launched with the objective of leveraging 'the potential of DFS as an alternative delivery channel

[176] Ibid.
[177] Mobile Connections: Total number of sim cards divided by population.
[178] GSMA (2019d).
[179] Jefferis (2016).
[180] 97% of adults have a grocery store less than 60 minutes away.
[181] Demirgüç-Kunt, Klapper, Singer, Ansar, & Hess (2018).
[182] PBH Development (2019).
[183] PBH Development (2019).

to offer services in the rural areas to new types of customer segments.' In phase 1, three services – OTC, cash remittances, cash to own (deposits) and cash to others (payments/transfers) – were launched. These services were provided through a network of agents that BCEL recruited and trained. Initial project reviews suggest that MSMEs are also using the agent network to pay suppliers and for domestic transfers.[184]

The network of agents as of February 2019 under this pilot was 446 agents including 54 banking agents. The pilot has been extended into Phase 2 to test interbank transfers, cash withdrawals, opening on the spot basic bank accounts with an ATM card, and payment of road tax (P2G). Other initiatives have also been given the go-ahead for mobile wallet pilots.[185]

Lao People's Democratic Republic offers a case wherein a span of five years (2014 to 2019), a country has gone from virtually no clear DFS regulation and agents to a national payment system law, significantly enhanced capacity of the regulator on DFS, providers offering mobile money services through a vast network of agents, and willing customers including businesses that are using DFS.

3.5 Nepal

Landlocked Nepal is largely an agrarian country that is prone to natural disasters. Over the past few years, it has faced political instability and a falling GDP due to earthquakes and more recently it also faced one of the 'worst flood in decades.[186]

The government recognises the importance of financial inclusion and has initiated various policy initiatives to increase access to finance. While 61% of the population have access to a formal financial institution, 21% rely on informal sources. A small minority (18%) are completely excluded. The gender gap in financial inclusion is not very large, and although more men are financial included, a majority of men and women adults have access to a bank and/or other formal FIs.

Access to formal FIs is led by savings and payments remittances.[187] 40% have access to a formal savings facility either at a bank (27%) or an NBFI (13%). 36% use banks for transactions and 21% use formal channels like banks (8%) or NBFIs (19%) for remittances. 23% of Nepali adults used an informal source for credit. Access to formal FIs for credit is low - 10% used banks and 8% NBFIs. Levels of exclusion are significant across the various products. 43% do not save, 53% are excluded from access to credit and 65% do not use payments. 28% use informal sources (moneylenders and friends/family) for credit implying a demand for credit.

Based on the main source of income, the Finscope survey[188] estimates that 32% of Nepal's population is agri-dependent and 13% have an enterprise/MSME as their main source of income.

[184] MAFIPP (2017), PBH Development (2019).
[185] Ibid.
[186] World Bank (2019h).
[187] FinMark Trust (2015).
[188] Shakya, Bhaju, Shrestha, Tuladhar, & Tuladhar (2016).

But MSMEs are better served by formal FIs compared to farmers.[189] Over 50% have access to a mix of banks, NBFIs and informal sources. Formal and informal sources access is near equal. 12% do not have access to any financial service.

MSME contribution to Nepal's economy is substantial. It accounts for 80% of employment, 70% of the total value of exports and 90% of industrial GDP. The sector is characterised by a high degree of informality to the extent that the county is often referred to as having the largest 'shadow economy'.[190]

Despite the sector's well-documented contribution and the government's acceptance that it is an important contributor to the economy, lack of access to formal finance sources poses challenges for MSMEs 'to start, sustain and grow their businesses.' [191]

3.5.1 Access to finance for formal MSMEs

The SME Finance Forum estimates there are 320,000 licensed MSMEs in Nepal.[192] A majority (65%) of enterprises are under the microenterprise category. Male-ownership amounts for 82% of all enterprises and WMSMEs accounted for only 18%. Within the type of enterprise, the ownership pattern is similar with 83% of microenterprises and 79% of SMEs being male-owned.

The estimated gap in finance for formal MSMEs is US$ 3.6 billion which amounts to 83% of the total demand (US$ 4.3 billion).[193] This is an estimated gap of 83% of the potential demand for finance which is estimated to be US$ 4.3 billion. The share of microenterprises in this gap was significantly smaller at 20% while SME accounted for 80% of the finance gap. The finance gap within microenterprises (85%) and SMEs (83%) is nearly the same. Male-owned enterprises accounted for nearly 91% of the gap.

In terms of the level of constraint and enterprise type, the Forum's data reveals that a larger proportion of both microenterprises (52%) and SMEs (61%) face some level of constraint. 66% of WMSMEs are faced with constraints while 53% of male-owned enterprises face constraints. However, a significant proportion (52%) of WMSMEs do not have any access to credit. Annex 2 presented the data on the level of constraints by enterprise type and gender. The estimate informal demand for finance is US$ 2.4 billion or 56% of the formal demand.

[189] Ibid.
[190] ESCAP (2019b) & Shakya, Bhaju, Shrestha, Tuladhar, & Tuladhar (2016). Also see FNCSI available at http://fncsi.org/index/?page_id=12. The terms 'Shadow Economy' has been defined by (Schneider, 2010) as on that 'includes all market-based legal production of goods and services that are deliberately concealed from public authorities'.
[191] ESCAP (2019b).
[192] SME Finance Forum (2018a) SME Finance Forum data on microenterprises is sourced from Government of Nepal's Department of Cottage and Small Industries and Women SME Banking Diagnostic, Berger while SME numbers are from Berger.
[193] This is similar to the ESCAP study (2019b) on MSME access to finance in Nepal that has estimated the gap to be approximately US$ 3.1 billion (exchange rate of 1 US$ = NR 113.93). The difference may be due to the number of formal MSMEs estimated. The SME Forum estimates this to be 320,000, while the ESCAP study has estimated the number at 286,229.

3.5.2 Exploring supply, demand and the reasons for constraints

The number of banking and financial institutions in Nepal as of mid-July 2018 was 151. There are 65 MFIs and 33 development banks. Commercial banks and finance companies number nearly the same at 28 and 25 institutions respectively. Apart from this, there are 14 licensed cooperatives and 24 licensed Financial Intermediary Non-Govenmental Organizations (FINGOs) offering microfinance services.[194]

Commercial Banks have the largest share of financial assets with close to 83% of the financial assets. This is followed by Development Banks with 10% share. MFIs have a significantly smaller share at 5%.[195] The Cooperatives and FINGOs are likely to become licensed MFIs or merge with existing MFIs.[196] Nepal does not have a specialised bank for MSME financing. Instead, various commercial banks have a department or a unit that does SME financing. The Government of Nepal (GoN) has created several special-purpose funds,[197] but most have had limited outreach.

The Nepal Stock Exchange is dominated by commercial banks and insurance companies[198] and has seen a decline in market capitalisation (23%), total turnover (41%) and average daily turnover (42%) over the one year period between 2016/17 and 2017/18.[199] Venture Capital funds are a recent addition to Nepal's financial inclusion landscape and still in their infancy.[200]

The GoN mandates that 10% an insurance company's portfolio has to be under microinsurance. However, primary data reveal that micro and small entrepreneurs are unaware of microinsurance schemes. There are also no clear guidelines as to how companies should promote microinsurance schemes to MSME.[201]

In terms of geographic location, most financial institutions are 'highly concentrated' in three of the large districts and mostly in urban and metropolitan cities.[202] ESCAP estimates that 74.1% of all MSMEs are concentrated in Province No 3 which also includes the capital Kathmandu.

While geographic concentration is a key constraint for access to formal finance for MSMEs in rural areas, MSMEs in both rural and urban areas do face a number of common demand and supply constraints. These demand and supply-side constraints are captured in Figure 5.

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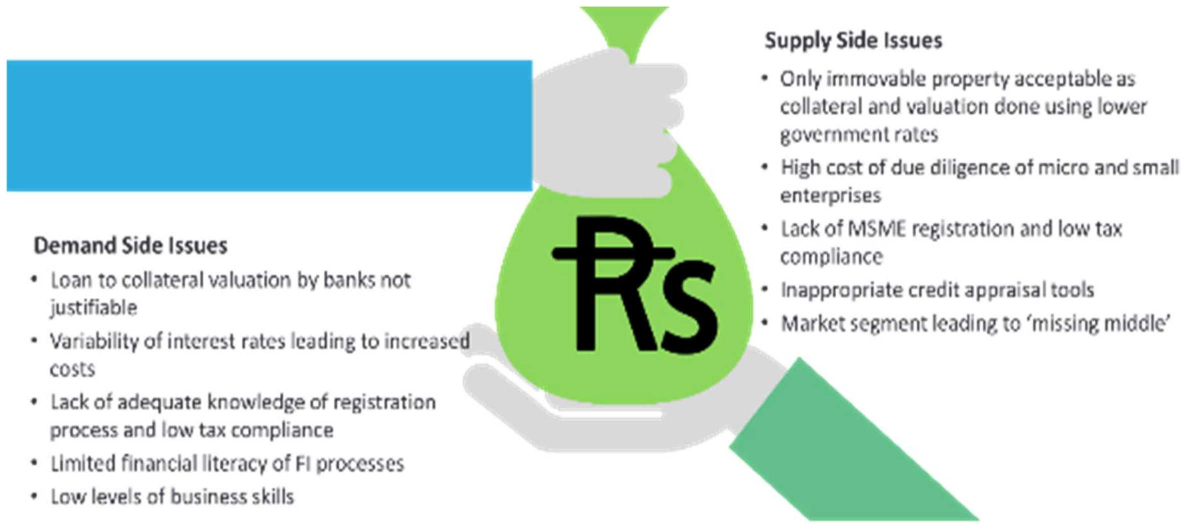
[194] Bank Supervision Department (2019).
[195] Ibid.
[196] ESCAP (2019b).
[197] For example, Women Entrepreneurship Development Fund, Youth and Small Entrepreneurship Self-employment Fund.
[198] Market capitalization of 52% and 16% respectively.
[199] Nepal Stock Exchange Ltd (2018), Bank Supervision Department (2019).
[200] ESCAP (2019b). Some funds such as Dolma Foundation, Gazaab Social Ventrue are especially designed for social/impact investing purposes.
[201] ESCAP (2019b).
[202] International Monetary Fund (2019), ESCAP (2019b), Bank Supervision Department (2019).

Figure 3: Nepal - Key supply and demand constraints for MSME access to finance



Source: Author. Based on ESCAP (2019b).

WMSMEs face similar constraints. They report low levels of knowledge and skills pertaining to 'business plan preparation, loan application, knowledge of updated policies, maintenance of books of accounts and records, preparing financial statements, (and) complying with tax requirements.[203]

Most women entrepreneurs do not have land and building in their name. The government has introduced a scheme wherein WSMEs can take a loan up to Nepalese Rupee 1.5 million from commercial banks without physical collateral. However, most women entrepreneurs are unaware of this scheme while banks report poor market demand, but also admit that they lack the skills to assess non-collateralised loans.

While entrepreneurship is not a well-researched area in Nepal,[204] in terms of the World Bank's Ease of Doing Business (Annex 5), Nepal was ranked 110 out of 190 in 2019[205] – down 5 places from 2018.[206] However, it has jumped to 94 as per the 2020 report.[207] In term of getting credit, Nepal has jumped from a rank of 99 to 37 as a result of expanding the coverage of the credit bureau which should improve access to credit information. It has also recently operationalised its secured transaction law, along with a collateral registry. The country also marginally moved up in rank on the enforcing contract indicator – from 154 (2019) to 151 (2020). This is due to the introduction of new civil codes that introduced time codes for key court events. There have been improvements related to speeding up of processes involved in the filing of claims as well. On the resolving insolvency indicator, while the country has moved up marginally from 87 to 83 (this is more due to the rank being relative to others, but no material change has been recorded).

[203] ESCAP (2019b).
[204] GEI does not cover Nepal. An online search only revealed undated papers.
[205](World Bank (2018c).
[206] Mainly due to the changes in labour market regulations that make paying taxes cumbersome.
[207] World Bank (2019i).

3.5.3 Policy effort to increase financial inclusion of MSMEs

There are various initiatives, including laws and directives, of the GoN that seek to support MSMEs. The principal responsibility for their access to finance rests with the Nepal Rastra Bank (NRB). But despite recognising the importance of MSMEs and their contributions to Nepal's economy, the country lacks a dedicated framework or policy that brings together and coordinates the various MSME related support efforts.[208]

Despite this, there are various policy efforts undertaken that may positively impact MSME access to finance. Some of these are directly related to MSMEs while others can impact the segment. These include:[209]

- **Changes proposed FI portfolio composition**: It is mandatory for all commercial banks to dedicate at least 5% of their portfolio for SME financing. Banks are maintaining this level and have expressed interest in increasing this to 10%.[210] While the MFI microenterprise portfolio is at 11.5%, NRB is encouraging them to increase it to 33%.
- **Easing collateral norms**: NRB has allowed for local value to be used for collateral valuation. It has also allowed MFIs to provide physical collateral-free loans to individual borrowers who present 'convincing business plans.' The same has also been prescribed for WMSMEs for loans up to Nepalese Rupee 1.5 million.
- **Support for various funds**: As noted in the previous section, there are several dedicated funds established. While challenges in their implementation exist, the various purposes (e.g. for women entrepreneurs, for youth) for which these funds have been established in recognition that there have to be policy interventions to account for unique constraining factors that the represented population segments face.
- **Secured transaction law**: The secured transaction law is a positive step towards strengthening the credit market particularly for SMEs who may be able to provide movable assets as collateral in the future.
- **Financial literacy**: The NRB has put in effort towards developing curricular for increasing financial literacy. Operationalisation of this is currently pending.[211]

While these are forward steps for fostering a comprehensive enabling environment for MSME access to finance. The NBR needs to consider a credit guarantee mechanism. Under the Sakchyam project, new loans to SMEs were guaranteed and the results were positive. However, post the pilot project, the implementing partner did not continue with the program. The success of the Sakchyam pilot should be studied and recognised as an opportunity for sector-wide implementation.

[208] For example, Nepal's 2010 Industrial Policy uses employment, turnover and capital to define microenterprises while for SMEs, it only applies the capital criteria. Banks on the other hand use various loan amounts to define MSMEs. ESCAP (2019b).
[209] ESCAP (2019b). Note: There are several implementation challenges that exist in achievement of this. These challenges are documented in the supply and demand constraints figure earlier in the chapter.
[210] Ibid.
[211] There are initiatives such as the Sakchyam Access to Finance project (available at https://sakchyam.com.np/) funded by the UKaid. Sakchyam is working with various MFIs to apply digital applications for financial literacy via mobile phones.

Notably, there is a need for the GoN to set out a comprehensive MSME development policy that coordinates the various initiative of the GoN and private agencies working on MSMEs, recognises the challenges faced by MSMEs and provides for targeted solutions in a time-bound framework.

3.5.4 Digital finance in Nepal

Nepal has made steady strides in terms of DFS. Much of the DFS pathway Stage 1 communication infrastructure is in place. GSMA data[212] on the Mobile Connectivity Index reveals that 92.5% of the population is covered by 2G while 73% have 3G connectivity. The number of mobile connections is 134% of the population while unique subscribers are 53.6% of the population.

An examination of the growth of various digital banking solutions reveals a range of digital services offered and Nepal is probably in the early stages of Stage 3 along the digital financial inclusion pathway. Mobile banking and agents are a strong presence now in Nepal's financial inclusion landscape. Between July 2016 and July 2017, mobile banking clients increased 53% and between July 2017 and July 2018, this jumped by 90% to reach 4.7 million. (Annex 13 for data on various digital applications in Nepal) NRB's Financial Inclusion Dashboard[213] data reveals that as on June/July 2019 the number of mobile banking clients had increased to nearly 8 million of which 6.5 million are active users. Mobile banking services are mostly used for balance inquiry, mini statement, last transactions information, withdrawal alerts, cheque book inquiry/request, inter-bank and intra-bank fund transfer, and utility bill payments.

On uses of Agents, the NRB's data[214] shows that as of June/July 2019 there were 149,000 registered agents in Nepal. The activity rate of these agents was between 40% to 50%.[215] The data also reveals the strong presence of these agents in rural areas with an activity rate between 60% and 70% in rural municipalities.[216]

The majority of the commercial banks have opened up branchless banking (BLB) units in rural areas using a local person as an agent to manage these units. This has helped rural people and even MSME entrepreneurs to avail cash at the local level. Initially, these units were equipped with a point of sale (POS) units that could be used only for cash-in (deposit) and cash-out (withdrawal). This has been expanded to include KYC updation in real time. In terms of BLB agent scope of activity, these agents are allowed to perform cash-in/out transactions and loan processing work[217] for banks. At the MFI level, the same is being done via the use of tablets during group meetings.

There has been an expansion of mobile wallet services which has been supported by the Sakchyam and UNCDF Shift projects. For example, The Sakchyam support to IME Pay has resulted in the creation of a network of 15,000 agents and over the course of two years. These mobile wallets witnessed 40,000 transactions, many of these from rural areas.

[212] GSMA (2019e).
[213] Nepal Rastra Bank (2019a).
[214] Nepal Rastra Bank (2019b).
[215] Data estimate over a nine-month period. Activity rate is defined as total number of active BLB agents (those who conducted transactions in the past 30 days) divided by total number of registered BLB agents.
[216] Over a nine-month period.
[217] For example, help clients prepare documentation which are then sent to bank branches.

These efforts have been facilitated by NRB's National Payments System Development Strategy (2014). However, specifically related to MSMEs, there needs to be more policy focus on the two related areas of digitising enterprise identification cards, and development of the credit bureau/credit score for enterprises. Digitisation can help further use of artificial intelligence, big data and alternative data to establish the creditworthiness of MSMEs leading to systems such as risk-based due diligence.

4. Policy recommendations

Regulators in the five countries are actively seeking to create an enabling environment for increasing access to funds for MSMEs and expansion of DFS, and efforts taken have already been explained in this paper. The role of policy makers is extremely crucial as it will determine the pace and quality of access. Based on the various constraining factors and efforts already made by regulator, this section seeks to identify broad recommendations towards furthering the agenda of the policy makers. It presents recommendation in five broad areas related to peer learning/capacity building, financial infrastructure, alternative sources of finance, gender related issues, and DFS.

4.1 Peer learning and capacity development

While each of the countries have both unique and common challenges, they do offer numerous lessons for others in similar settings. For example, for countries with a low digital financial inclusion base, Lao People's Democratic Republic offers a good guide as to how in a short span, development of digital technologies can increase financial inclusion of various segments. Bhutan, on the other hand, offers a guide to small islands with geographic restrictions and sparse and scattered populations on how to increase access (not only to MSMEs). Cambodia is an example of an LDC that has used advanced technologies, such as blockchain to increase interoperability between FIs, which increases likelihood of improved quality of financial inclusion. Bangladesh's experience of FIs such as IDFC, BRAC and Prime are good examples of successful models that could be replicated.

These examples are crucial as regulators and **policy makers in LDCs can look towards their peers for possible solutions** towards increasing MSME access to finance (or indeed even broader financial inclusion) and digital financial inclusion.

It is equally, imperative that **policy makers invest in their own capacity enhancement**. An enabling policy environment is enhanced if policy makers have the necessary skills related to key areas such as financial infrastructure and alternative sources of finance. This is likely to ensure financial stability with the development of alternative sources. This is also critical as new business models and associated risks related to DFS emerge.

4.2 Financial infrastructure

Financial infrastructure includes credit bureaus, collateral registries, and payment, remittance and securities settlement. This infrastructure, if efficiently managed, aids in reduction of financial intermediation.[218]

In all the five countries, financial infrastructure is still under development. For example, secured transaction laws (including collateral registry) are either enacted or developed, but overall implementation still lags. Similarly, credit bureau coverage in most of the target countries remains low and development of a well-functioning credit bureau should address credit risk information asymmetry to an extent. This coupled with secured transaction and bankruptcy laws should encourage investor and lender confidence.[219]

Credit guarantees schemes are also an option for regulators to explore. This is of relevance for MSMEs that are unable to offer collateral. A starting point can be the World Bank's Principles for Public Credit Guarantee Scheme for SMEs.[220]

Most of the target countries have well-functioning payment and settlement systems which has been over the past few years, through regulatory effort, developing in a positive direction. On digital financial inclusions, the CGAP's four enablers offer a good guide for policy makers on what learnings there are to ensure effective and reliable systems related to payments. For example, non-bank agents are a key enabler as per CGAP. All except Bangladesh have laid stress on **expansion of the agent model through the regulation of non-bank agents**, while Bangladesh only allows for bank agents. This may need review considering the learning emerging globally.

As a priority, the target countries should **continue to build on what they already have, i.e. ensuring the effective implementation of the secured transaction laws and collateral registry. In addition, the credit bureau coverage should be further expanded to include not only more individuals, but also SMEs.**

Financial education of consumers is also a critical of qualitative access to finance. Regulators should lay stress on increasing awareness of the various schemes and programs available for MSMEs. While all the target countries have programs on financial literacy, Bhutan is the only country that has a National Financial Literacy Strategy. The same effort is warranted in other countries as well.

4.3 Alternative sources of finance

Non-bank sources of finance are considered important for development of the MSME sector.[221] These sources are currently underdeveloped in the target countries (e.g. shallow capital markets, low presence of VCs). In many ways, alternative sources of finance are also dependent on the

[218] International Finance Corporation and the World Bank (2009).
[219] Alliance for Financial Inclusion (2016), Chávez, Koch-Saldarriaga, & Quesada (2018).
[220] Alliance for Financial Inclusion (2016), World Bank (2015).
[221] ASEAN Secretariat (2017).

development of financial infrastructure and should be seen within that context.[222] These sources of finance include asset-based finance, alternative debt, hybrid instruments, and equity instruments. It is **critical to understand that and not all these are applicable for all enterprises. Applicability depending on a firm's risk-return profile, stage in the business life cycle, size, scale, management structure and financial skills**.[223]

For example, asset-based finance[224] includes a good set of financial instruments for firms that are in start-up stage, limited credit history, lack collateral, and those that are engaged in production or trading of commodities.[225] New and small firms particularly benefit from this type of financing that can be flexible and done fast.[226]

Policy makers **need to acknowledge and understand these stages and identify where the gaps in their markets are**. Targeted policy initiatives can be used to remedy the gaps.

Financial rating models that use alternative data in digital format may be an area for regulators to develop as this can help with improving the credit decision making for both bank and non-bank entities. In general, regulators also need to consider various policy dimensions related to reduced administrative burdens, tax policies, and investor protection policies.

On the demand side, it may be necessary to **consider awareness campaigns on alternative sources of funds** for MSMEs as well as skill enhancement related to applicability and management of alternative sources of finance.

4.4 Gender-related issues

WMSMEs have a similar set of challenges as their male counterparts, however, these challenges may be more severe as these are often intersectional challenges, such as gender stereotypes coupled with limited education opportunities, and restricted mobility. There is also perception that women cannot manage businesses or have the necessary leadership skills for business. These may restrict business hours, dealing with male suppliers/customers, and also government officials. Furthermore, women often perform dual roles - businesswomen and homemakers – which restricts mobility leading to poor access to networks, trainings, and often prevents expansion of the business.[227]

The share of women of WMSMEs in many of the target countries (particularly Bangladesh – 5%, and Nepal – 18%) is low, however, it is important to consider that due to the above mentioned challenges, women often have to rely on men to get businesses registered, while still being

[222] For example, credit bureau, registries, bankruptcy resolution and protection of shareholder rights boost investor and lender confidence.
[223] OECD (2018).
[224] For example, factoring, purchase order financing, warehouse receipts, and leasing.
[225] OECD (2018).
[226] Centre for International Law (2016).
[227] International Finance Coproration (2019b), Emerging Markets Consulting (2017), International Labour Organisation (2006), Roosmalen, Phodsavang, & Emerging Markets Consulting (EMC) (2019).

managed by women entrepreneurs.[228] The share of owned and managed WMSMEs is therefore likely to be larger than what is reflected in the data.

Given this, it is necessary that **WMSMEs be treated as an independent segment by policy makers and FIs**. This will require **a more data driven approach towards understanding the specific needs, preferences and challenges faced by women entrepreneurs**. While many of the target countries have made the effort to facilitate WMSME access to finance (e.g. interest rate concessions, earmarked funds), the review reveals that most of these are needed, but inadequate to ease flow of financing given the above-mentioned challenges.

A **data driven approach should also be applied to provision of DFS**. This may facilitate incentives to DFS providers for support to WMSMEs who may be able to, for example, apply alternative data for credit scoring, or selection of geographic locations reflecting poor access to WMSEs.[229]

Policy makers may also have to rely or continue to rely on **non-traditional approaches, including easing collateral requirements and reliance on instruments such as credit guarantees**. Apart from this, **non-financial services such as mentoring, networking and training** are also considered relevant for WMSMEs.

More importantly, for the longer term, these approaches will need to be **supplemented with data driven training of FI staff in order to do away with institutional biases and perceptions** related to women entrepreneurs.

4.5 Digital Financial Services

Several recommendations related to DFS have already been provided above. While the reviewed countries have made significant strides in the creation of an ecosystem for digital payments, the issue of consumer protection linked to DFS is still an area of further work. DFS poses a separate set of consumer protection risks (e.g. data theft, loss of passwords/PIN). Policy makers **need to actively engage with the issues around consumer protection specific to DFS**.

More generally, policy makers need to **start actively looking at how DFS moves beyond the realm of payments and into digital lending, savings and insurance**. This will probably require more innovative models, further development of regulator/policy maker capacity, incorporation of specialised units or working groups (e.g. data analytics, on innovation) within the regulators organisation structure, and an increased level of engagement with the broad set of stakeholders such as academics, securities exchanges and pension regulators and service providers.[230]

Countries such as Cambodia have started to make the push towards broader DFS as is evident in the latest Wing and Banji collaboration. Such models should be nurtured and critical lessons used to further DFS.

[228] Ibid.
[229] Alliance for Financial Inclusion (2019).
[230] The work of the AIF Alliance for Financial Inclusion (2020) in this regard may be of interest and relevance.

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Annexes

Annex 1: Definitions of level of constraints

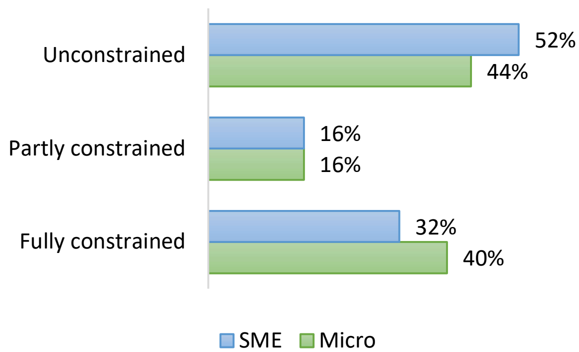
The following definitions are from the IFC's SME Finance Forum's work on estimating the MSME Finance gap.

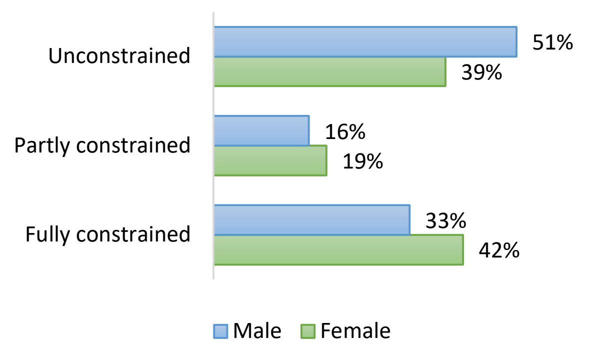
DEFINITIONS	
Fully credit-constrained (FCC)	Fully credit-constrained (FCC) firms are defined as those that find it challenging to obtain credit. These are firms that have no source of external financing. They typically fall into two categories: those that applied for a loan and were rejected; and those that were discouraged from applying either because of unfavourable terms and conditions or because they did not think the application would be approved. The terms and conditions that discourage firms include complex application procedures, unfavourable interest rates, high collateral requirements, and insufficient loan size and maturity.
Partially credit-constrained (PCC)	Partially credit-constrained (PCC) firms are defined as those that have been somewhat successful in obtaining external financing. PCC firms include those that have external financing but were discouraged from applying for a loan from a financial institution. They also include firms that have an external source of financing and firms that applied for a loan that was then partially approved or rejected.
Non-credit constrained (NCC)	Non-credit constrained (NCC) firms are those that do not appear to have any difficulties accessing credit or do not need credit. Firms in this category encompass those that did not apply for a loan as they have sufficient capital either on their own or from other sources. It also includes firms that applied for loans that were approved in full.

Source: SME Finance Forum (2019).

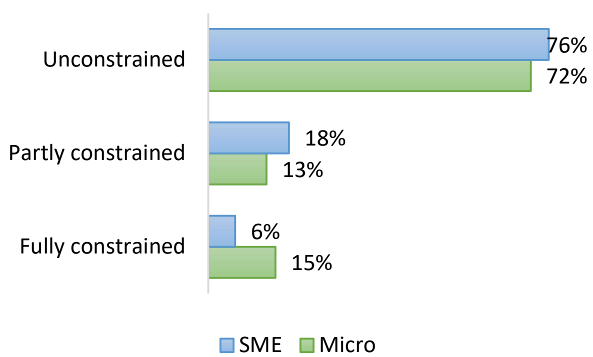
Annex 2: Level of constraint by enterprise type and gender

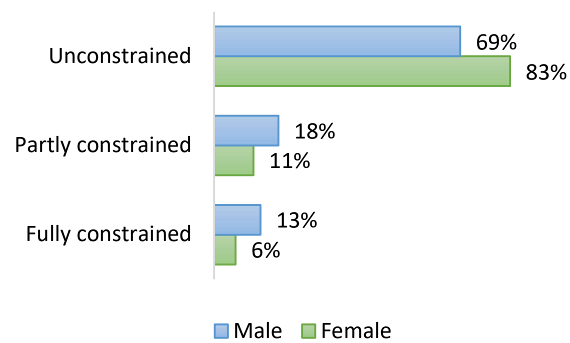
Bangladesh



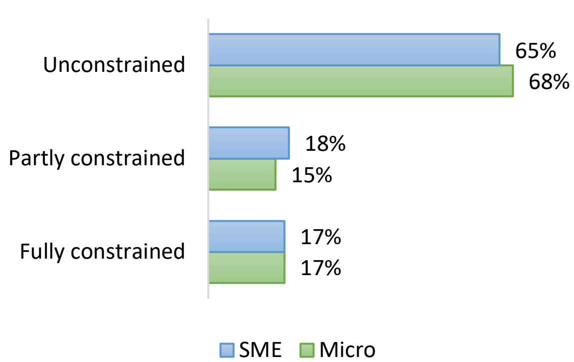


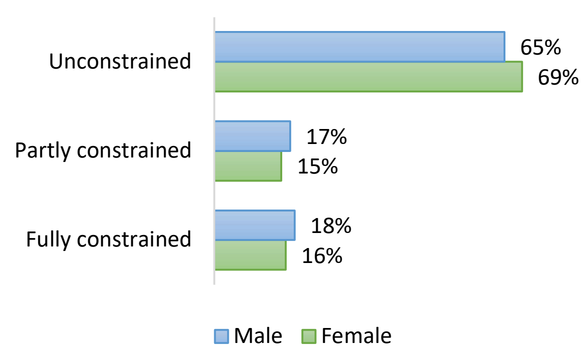
Bhutan



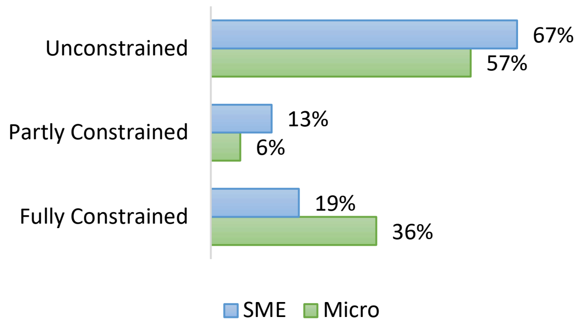


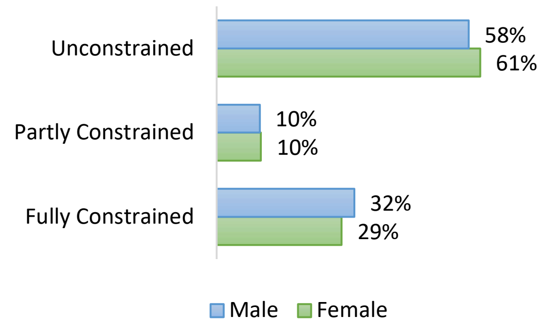
Cambodia



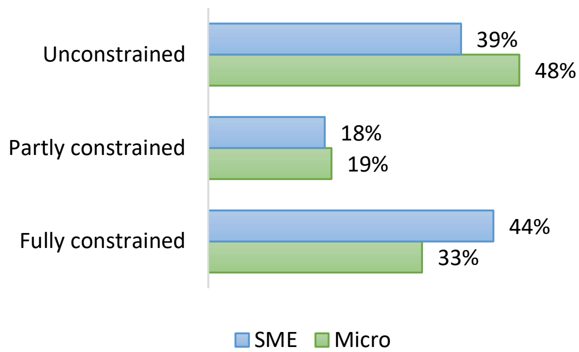


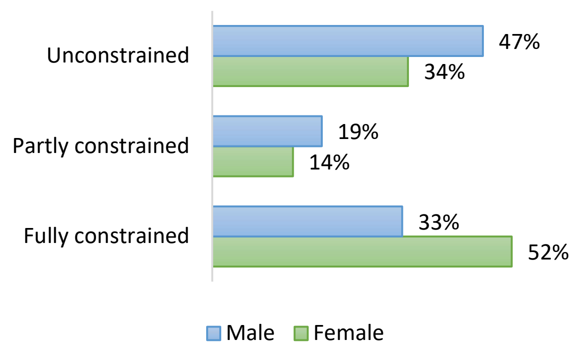
Lao People's Democratic Republic





Nepal





Source: SME Finance Forum (2018a)

Annex 3: MSME segmentation by Banks in Bangladesh

According to the banks, there are 3 distinct segments in the micro and small enterprise lending market. They are as follows:

1. Firms to which banks lend amounts of Tk300 thousand to Tk 1.5 million (US$3.6 thousand to US$17.9 thousand equivalents). These are referred to as micro/ cottage firms. This segment is dominated by the MFIs. Although bank finance could increase maturity, lower rates and formality, there are drawbacks as the operational and supervision costs are high and there are several regulatory restrictions.

2. Firms to which banks lend amounts of Tk1.5 to Tk30 million (US$17.9 thousand to US$358.8 thousand) are referred to as small firms. This is considered a large segment with substantial opportunities. Firms are relatively dominant in their line of business. They include small retailers and suppliers of raw materials. Nevertheless, this segment is also known as 'the missing middle' — that is, firms that have difficulty in accessing bank finance because of collateral and other constraints (for example, the lack of proper accounts). They are also too big to qualify for loans from MFIs. Additional constraints to bank finance include being in business for an insufficient amount of time to build a credit history, or operating in rural areas.

3. Firms to which banks lend amounts of Tk30 to Tk200 million (US$358.8 thousand to US$2.4 million) are referred to as emerging small firms. This segment includes the wholesalers, large retail outlets, the large flour and rice mills, oil-ginning mills, and so on. Small firms are usually the suppliers to these emerging small firms that are more involved in the manufacturing sector. Some examples include large distributors of Grameenphone (leading telecommunications operator), BKash (mobile financial services company), and so on. This segment also has access problems, especially in rural and peri-urban areas away from Dhaka.

The last two segments, unless under a mortgage, present a significant risk for banks since lending without collateral requires a solid customer assessment. Collateral-free lending is done up to amounts of Tk1.5 million (US$17.9 thousand) (and in exceptional cases of creditworthy customers, up to Tk1.5 million [US$17.9 thousand]). Nevertheless, based on the experience of BRAC, IDLC, and more recently Prime Bank, small and emerging small firms often prioritize the loan repayment. They do so because they place a premium on their bank relationship, as well as to ensure that their Credit Information Bureau (CIB) report remains clean.

Source: Financing Solutions for Micro, Small and Medium Enterprises in Bangladesh. World Bank (2019a).

Annex 4: Supply and demand constraints in access to formal finance for WMSMEs in Bangladesh

Constraining factor	Supply factors	Demand Factors
Awareness	- Human and financial resource constraints limit marketing efforts and non- financial services - Lack of understanding of the business case for lending to WMSEs	- Product awareness limited to concerned FI and not the broader market. - Lack of awareness of government or bank programs leading to limited uptake
Risk	- Perceived as high-risk clients, given their inability to meet conventional appraisal requirements - Lack of various gender-disaggregated data such as NPAs of WSMEs leading to a lack of gendered risk framework - The perception that women cannot manage business (particularly in service and manufacturing sectors) - Perception of greater risks in lending to unmarried women SME entrepreneurs	- Lack of adequate collateral/collateral ownership and financial documents. - Inability to meet documentation requirements - Familial constraints rooted in traditional gender roles
Knowledge	- Most bankers perceived women to have very poor financial literacy, leading to increased costs of administration and reduced incentive to lend - Not keen to offer non-finance services	- Limited financial literacy and awareness on financing options - High dependency on male family members particularly to manage finances - Limited awareness and understanding of loan application processes - Women indicate a need for non-financial services on the loan application forms
Process	- Lack of formal credit histories increase due diligence costs which banks pass on to SME owners - Average loan sanction time of 137 days	- Financial illiteracy, guarantor requirements and indifference intensify these issues for women.

Source: Author compilation. Based on study on mapping the market potential and accelerating finance for women entrepreneurs in Bangladesh. Singh, Asrani, & Ramaswamy (2016)

Annex 5: Ease of Doing Business 2020

Indicator	**2020 Rank (out of 190)**				
	Bangladesh	**Bhutan**	**Cambodia**	**Lao PDR**	**Nepal**
Ease of doing business (overall)	168	89	144	154	110
Starting a business	131	103	187	181	107
Dealing with construction permits	135	91	178	99	148
Getting electricity	176	78	146	144	137
Registering property	184	53	129	88	88
Getting credit	119	94	25	80	99
Protecting minority investors	72	111	128	179	72
Paying taxes	151	15	138	157	158
Trading across borders	176	30	118	78	82
Enforcing contracts	189	29	182	161	154
Resolving insolvency	154	168	82	168	83

Source: Author compilation. Based on World Bank's Ease of Doing Business 2020

Annex 6: Bangladesh Mobile Market and MFS Snapshot

Mobile market	2017	2025	CAGR (%)
Unique mobile subscribers	85 million (51% penetration rate)	107 million (60% penetration rate)	3
Unique mobile internet subscribers	35 million (21% penetration rate)	73 million (41% penetration rate)	10
Total SIM connections	145 million (87% penetration rate)	190 million (102 penetration rate)	3
Mobile broadband connections	29%	82%	-
Smartphones	45 million (31% adoption)	138 million (75% adoption)	

Source: Author compilation. Country Overview: Bangladesh: Mobile industry driving growth and enabling digital inclusion. GSMA (2018)

Overview of MFS growth in Bangladesh

Description	Aug-15	Aug-19
No. of agents	533,898	951,115
No. of registered clients (million)	2.82	7.35
No. of active accounts in (million)	0.95	3.30
No. of total transaction	102,073,061	204,220,475
No. of daily average transaction	3,402,435	6,587,757
Product wise information	**Amount (in crore BDT)**	**Amount (in crore BDT)**
Inward Remittance	2.54	34.37
Cash In transaction	5,399.36	12,524.16
Cash Out Transaction	4,689.25	12,346.07
P2P transaction	2,246.05	8,196.47
Salary Disbursement (B2P)	119.00	903.27
Utility Bill Payment (P2B)	117.64	487.82
Merchant Payment	-	407.23
Government Payment	-	9.42

Source: Mobile Financial Services (MFS) comparative summary statements. Bangladesh Bank (2019)

Annex 7: National Financial Sector Development Strategy 2016-2025

FINANCIAL SECTOR DEVELOPMENT ACTION PLAN 2016-2025

A 10-year Financial Sector Development Action Plan is issued every five years. The current 2016-2025 edition, developed with support from the Asian Development Bank, contains many initiatives relevant to credit and capital markets, to improve SME access to finance. The following table contains a selection of actions, relating to constraints identified in sections on Credit and Risk Capital.

CREDIT	
• Registration	Laws to address online registration, privacy Inclusion of sole proprietorships Faster cheaper hard land titles
• Secured Transactions	Amend Law on Secured Transaction Implement secured transaction registry
• Leasing	Improvements to regulatory framework
• Credit Guarantees	Implement laws and regulation
• MFI	Adopt new MFI strategy, including service diversification
RISK CAPITAL	
• Cambodian Stock Exchange (CSX)	Ongoing improvements and incentives to list, in particular state-owned enterprises and financial institutions
• SME listing	Streamline regulations to facilitate SME listing, in particular disclosure Introduce legal and regulatory framework
• Crowdfunding	Grant initial licenses
OTHER	
• Financial stability	Promotion of Riel / eventual de-dollarization Develop monitoring and early warning system Promotion of financial literacy in schools and media
• Enhanced stability and confidence	Improvements to accreditation and regulation of financial intermediaries and service providers. Strengthen accounting and auditing standards
• E-Commerce	Introduction of e-commerce law

Source: Entrepreneurial Ecosystem Assessment Country Report on Cambodia. (Totten, Kry, Smiddy, & Emerging Market Consulting (2019)

Annex 8: Cambodia payment services performance as of December 2018

Type	Particulars
Internet banking transactions	1,032,674
Value of internet banking transactions	US$ 5.1 billion
Mobile banking services transactions	14,074,983
Bank and NBFI payment transactions	92,924,651
Bank and NBFI payment transactions value	US$ 16 billion
Bank and NBFI payment agents	10,285
PSP Agents	24,164
PSP transactions	51,800,296
Payment transaction value	US$ 7 billion

Source: Author compilation. Based on Annual Supervision Report (2018), General Directorate of Banking Supervision (2019

Annex 9: Financial institutions in Lao People's Democratic Republic

Type of FIs

Type	Number*
Commercial Banks	**43**
- State-owned commercial banks	3
- Specialised bank/DFI	1
- Joint venture banks	3
- Private banks	8
- Subsidiary banks	9
- Foreign bank branches	19
NBFIs	**185**
- Deposit-taking MFIs	20
- Non-deposit taking MFIs	77
- Savings and Credit Unions	30
- Leasing companies	29
- Pawnshops	27
- Transfer agencies	5

*As of December 2018

Source: Bank of Lao PDR (2019b)

Commercial Bank Assets (as a % of total Commercial Bank assets)

Type	Dec-12	Dec-13	Dec-14	Dec-2015	Dec-16	Dec-17	Dec-18	Aug-19
State - Owned Commercial Bank	55.61%	52.70%	51.52%	45.70%	44.04%	43.45%	42.97%	43.63%
Joint State Commercial Bank	9.35%	10.90%	10.01%	10.20%	9.91%	9.86%	9.44%	9.00%
Private Bank	17.96%	18.57%	17.34%	18.52%	18.39%	18.36%	18.73%	18.55%
Foreign Commercial Bank Branch	17.08%	17.84%	21.13%	25.59%	27.66%	28.32%	28.86%	28.82%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Source: Bank of Lao PDR (2019b)

Annex 10: Demand and supply constraints faced by WSMEs in Lao People's Democratic Republic

Constraining factor	Supply factors	Demand Factors
Awareness		- Low levels of awareness of tax laws - Low levels of awareness of collateral procedures
Risk	- The perception that women are high-risk borrowers. In case a WMSEs did have a credit history, they are asked to provide a higher level of collateral than male counterparts under similar circumstances	- Low rates of formalisation of enterprise - A 'deeply embedded' socio-cultural belief that the primary role of women is caregiving and household work and not enterprise owners
Knowledge		- Lack of confidence and knowledge to navigate formal financial systems - Given women's lower levels of education and literacy, access to information is harder for women as compared to men - Low level of skills related to business planning, marketing, accounting
Process	- Banks are not keen to lend to women due to the higher costs associated with due diligence of micro and small enterprises	- Distance from banks for those living in rural areas - Need to pay taxes in lumpsum based on sales rather than net-profit is disincentivising - Most women seek out formal credit in the name of their husbands - Ethnic minority women may face additional barriers associated with land rights which may be inherited verbally thus preventing them from using land as collateral

Source: Author compilation. Based on Leahy, Lunel, Grant, & Willetts (2017), Hunt (2016), International Labour Organisation (2006)

Annex 11: Financial Inclusion Roadmap summary of priority areas for Lao People's Democratic Republic

Priority area	Key activities
Priority 1: Improve Availability and Sustainability of Credit	- Credit expansion to MSMEs via the extension of wholesale credit and guarantee fund - Revisit the interest rate cap system - Encourage cashflow based lending
Priority 2: Consumer Empowerment and Protection	- Ensure accuracy and timely reporting by all FIs - Push for FI level grievance redressal mechanisms - Transparency in all laws, regulations, directives - Push for consistency in regulatory requirements and interpretation of law/regulation
Priority 3: Strengthen Village Funds for Sustainability and Relevance to Rural Populations	- BoL to take over regulatory and supervisory responsibility of VFs - Establish a set process for operational and financial management - Mobilise political support for regulation of VFs - Utilise existing capacity-building experience to support VF capacity - Sole DFI to be considered as a wholesale credit provider to VFs
Priority 4: Improving the payments eco-system through mobile money, digital financial services, and improved payments infrastructure	- A comprehensive legal and regulatory framework for Mobile Money - Support development of payment infrastructure - Support mobile money pilots and development of viable models
Priority 5 – Extend the outreach of banks and other financial service providers	- Remove regulatory barriers (in particular additional capital requirement for branch set-up) - Support innovative product development in the medium terms - Extend the branch network via BLB - Support strategic partnerships between banks and MFIs to further outreach

Source: Lao PDR: Financial Inclusion Roadmap (2018-2025). Bank of Lao PDR (2019c)

Annex 12: Financial Inclusion Roadmap summary – Priority 4

Priority 4 – Improving the payments eco-system through mobile money, digital financial services, and improved payments infrastructure

Interventions	Activities
Regulatory	• Finalise draft mobile money (MM) regulations to provide more certainty in the regulatory environment for MM service providers
	• Finalise a comprehensive legal, regulatory and reporting framework for payments, encompassing both core high-value clearing and settlement systems, as well as retail payments service providers
Payment infrastructure	• Ensure that high-level settlement infrastructure (RTGS) is effective and functional, and require banks to participate
	• Establish a clearing mechanism for interbank payments instruments (cheques, EFTs) with appropriate data communications channels
	• Consider national switch linking banks, retail point-of-sale (POS) terminals, mobile companies etc., enabling payments functionality across channels (e.g. bank/mobile)
	• Participate in regional (ASEAN) cross-border payments and settlement system
Mobile money	• Support mobile money systems; get pilots up and running
	• Refine business models on the basis of pilot experience and move from pilot to full nationwide roll-out as quickly as possible
	• Ensure that agent networks function effectively, providing adequate liquidity for cash-out demands and mobile money agents have convenient facilities for rebalancing cash and e-value
	• Ensure that agent networks penetrate areas beyond the current reach of banks
	• Encourage other banks and MNOs to consider MM products
	• Support cross-border mobile money (especially Thailand-Laos)
	• Introduce products linking mobile money to bank accounts
Developmental	• Facilitate cross-border mobile money
	• Consider the case for offering grants/subsidies to agents in more remote areas in the early stages of mobile money development
	• Establish payments service providers association for discussion of issues of concern to the industry
	• Promote inter-operability between different mobile money platforms and between non-bank mobile money providers and banks

Source: Lao PDR: Financial Inclusion Roadmap (2018-2025). Bank of Lao PDR (2019c)

Annex 13: Electronic banking in the commercial banking sector (Nepal)

SN	Particular	Mid-July					
		2013	2014	2015	2016	2017	2018
1	Number of Branchless Banking center	205	504	503	812	1,008	1,248
2	Number of mobile banking customer	452,909	768,424	997,463	1,604,578	2,438,222	4,711,097
3	Number of Internet customer	286,732	328,434	396,362	489,835	766,958	810,674
4	Total no of ATM	1,239	1,303	1,483	1,661	1,874	2,252
5	Number of Debit card holders	3,193,137	3,641,960	4,146,237	4,142,390	4,694,066	5,307,970
6	Number of credit card holders	38,587	57,898	43,895	52,014	68,966	104,721
7	Number of prepaid card holders	57,453	66,204	69,322	82,797	101,458	96,816

Source: Annual Bank Supervision Report 2018, NRB. Bank Supervision Department (2019)

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