Report on The South Asian Micro-Entrepreneurs Network (SAMN) Financial Inclusion Training 2022. Dubau, UAE

Growth in time of crisis: what ahead for South Asia

Connecting investors and investees in Asia's financial markets

The South Asian Micro-Entrepreneurs Network (SAMN) is a regional microfinance industry association working to enhance financial inclusion among low-income population in South Asia.

South Asia Micro-Entrepreneurs Network (SAMN) was thrilled to announce that it has entered a new strategic partnership with IFC - International Finance Corporation for its first-ever South Asia's - Financial Inclusion Training (S-FIT) being held from May 22 - 26, 2022 in Dubai The International Finance Corporation is an international financial institution that offers investment, advisory, and asset-management services to encourage private-sector development in less developed countries. The IFC is a member of the World Bank Group.
To be a part of such an auspicious event, visit at www.thesamn.org

Microfinance investors of all backgrounds have nourished a steady trend, both validating and benefiting from its success, continuously investing and reinvesting in this growing niche. Foreign investment fund assets have enjoyed a 20% compounded annual growth rate since the United Nations year of micro-credit in 2005, reaching over USD 11 billion in size today. The financial institutions they invest in have grown even faster: the microfinance institutions (MFIs) Symbiotic works with have witnessed a 27% compounded annual growth rate in assets and 23% in end clients over the past decade. More importantly, they have evolved and become more sophisticated, providing payments, savings, insurance and mobile solutions but also diversifying the credit range from household consumption and small business lending into education, agriculture, housing or energy loans. Foreign investors in microfinance have most astonishingly contributed to a growth of end clients directly financed from 500,000 ten years ago to 24 million today. This development towards greater global financial inclusion will certainly continue in the coming decades. This being said, some things have not changed for microfinance investors over the period. Just like ten years ago, investors still finance the bottom of the social pyramid – with average loan amounts to end clients unchanged at around USD 1,500. They finance primarily women – around two thirds of end clients over the decade. They finance mostly rural borrowers – around half of end clients. They continue to face very low credit risk default rates on their investments, with average risk provisions at 2.0% and average loss write-offs at 0.5% per annum. Finally, investors have seen a steady return on their investments at a net average of 3.3% in absolute terms both in EUR and USD over the past decade. The performance variance has been very low, remaining in a bandwidth of Libor +1 to +4.5% since 2008. Investors have thus benefited from a double steady trend both in terms of growth of their underlying markets and stable above money market absolute returns, with little volatility or correlation to other asset classes. Their decision to invest was based on this steady track record, but also on the rationale behind this success and the new big picture narrative emerging in the global economy.

A combination of factors will contribute to a new investment paradigm over the coming decades. To name but a few that will be further explored in this paper, strong demographic growth currently happening in emerging economies does so in an environment of severe lack of capital and financial services; credit markets in the Northern hemisphere are low-yielding and saturated whereas those in many emerging markets are still offering market-priced yields; and global internet connectivity will open the eyes for all both in the global South and the global North to the aspirations and living standards of one another. Whether due to these or other factors, no investor portfolio is immune to these global changes, but can indeed profit from them. This text reviews these sources of attraction for microfinance investors. It starts by reviewing the global challenges affecting our pensions and savings in developed markets and further offers perspectives on how we look at the emerging world, as a solution to our challenges rather than a source of concern.

Global Challenges

POPULATION GROWTH ASYMMETRY

At an average reading speed, it will take you no more than 3 seconds to read this sentence. Yet at the same time, the world's population will have grown by 7 people. That is one way of illustrating the population explosion currently happening across the emerging world. By current estimates, this overwhelming variable for sociological and economic development will bring the global population to around 10 billion people by 2050, meaning a net growth of 3 billion people over the coming 35 years That equals a net daily growth of around 200,000 people, every day between now and 2050. Although not statistically certain today, it is probable that the global population continues to grow beyond that, albeit at a lesser pace.

One reason this is not widely debated across Western news channels is that it does not occur in our part of the world. Unlike in the 20th century, European and North American populations will decline between now and 2050, and Latin America will not grow beyond current population numbers. Asia on the other hand will grow by 1 billion to reach 5 billion. The African population will more than double until 2050, growing by 1.5 billion to reach 2.5 billion. Whereas current projections show a stabilization in Asia thereafter, estimates give at hand that Africa will continue on its growth path towards a population of 4 billion by 2100. If correct, 90% of the world's population would by then live in Africa or Asia.

In parallel, due to increased life expectations and lower birth numbers, a structural shift in the population of developed economies will occur. The projected old-age dependency ratio, i.e. retirees as a percentage of working- age population, will grow from 29% in the European Union (EU) today to 49% by 2050. In Europe’s largest economy, Germany, the ratio will increase by almost 25 percentage points to 57% by 2050 In the United States the evolution is more favorable with a 10 percentage point increase to 32%, whereas in Japan where the ratio is already today at 44%, it would increase to a whopping 75% by 2050 if projections hold true The Japanese population is in fact projected to decrease by a dramatic 20 million people, or more than 15%, by 2050.

BANKING AND CREDIT MARKETS ASYMMETRY

Against a backdrop of an ageing workforce and slower economic growth, both public and private debt levels have increased in developed economies. In the current environment of low to negative interest rates and unchanged high savings rates, the (over) indebtedness that has built up can still be supported. Unfortunately however, large portions of the accumulated debt are used to sustain established consumption patterns and do as such not support new, income-generating activities. With banks unwilling to provide business financing, the existing trend of lackluster growth and limited economic opportunity is reinforced. It is therefore not surprising that investors increasingly turn towards the emerging world with its combination of healthy business and income generating activities, low levels of indebtedness and immense opportunities for economic development and financial inclusion.

INTEREST RATE ASYMMETRY

The introduction of zero and negative interest rates policies (ZIRP-NIRP) in developed economies have brought with them a new market paradigm and reinforced the trend towards over-indebtedness, further impairing growth prospects. The recovery since the 2008-2009 financial crisis is the weakest in modern history and there is little proof, neither academic nor practical, that ultra-low interest rates have done more to support the recovery than provide artificial breathing for unsustainable, ‘zombie’ businesses and banks. Yet politicians and central bankers continue to support negative rates, hoping to increase the credit appetite and thereby consumption and business development. In certain economies the interest rate regime is additionally supported by protectionist policies serving to prevent an excessive currency appreciation through a global flight to quality. This latter phenomenon has its root in the scarceness of investment opportunities among developed economies and hereby a flight towards the most advanced nation. The problem is further reinforced in volatile times when investors pull money out of high- growth regions and repatriate it domestically.

Investment Solutions

In the new paradigm shift the global economy is facing, more advanced economies may increasingly face declining populations, flat growth perspectives and negative interest rates. But the new generations also face a paradox as they are able to cumulate very large amounts of wealth per capita, remaining professionally active much longer than their parents and grand- parents. Additionally, with appreciation pressure on their home currencies and low- to no financing cost, their wealth is structurally meant to continue growing. This happens alongside growing deficits and over-indebtedness, which counterintuitively reinforce the spiral further. In parallel, the current working generation in the developed world is an opposite replica of the base of the pyramid in emerging and frontier markets, which sees strong population and economic growth, but where still often half of the adult population lacks access to finance and live in countries with very limited corporate or sovereign financing markets, logically inducing higher interest rate expectations.

These dynamics can develop side-by-side in an unsustainable manner – until one day they break onto themselves. Alternatively, which seems more likely and certainly more desirable, they can join forces in a globalized world and thereby unlock a virtuous win-win cycle. Massive capital savings can flow out of saturated markets into highly underserved and growing markets, positively rebalancing developed financial markets and generating a strong and lasting financial sector development in developing countries. If approached with the right objective and strategy, this financial inclusion at the benefit of the Global South will not only benefit the investment portfolio performance of retirees, insurers and private wealth managers of developed economies, but also induce improved social progress, better employment opportunities and stronger private sector development in emerging markets. Overall, it will thus provide a number of positive contributions to United Nations' Social Development Goals (SDGs).

OPTIMIZING RISK ADJUSTED PORTFOLIO PERFORMANCE

The common view of investments in emerging markets as being volatile and unpredictable is largely driven by rapid capital flows induced by foreign investors and motivated not by the development of the market they are invested in and repatriated from, but rather by factors in investors' home markets. This means that traditional investments in emerging markets typically also exhibit significant correlation to other asset classes and global market developments. Private equity and private debt products, which by definition offer less liquidity and thereby less possibilities for repatriation, tend to capture the underlying value of emerging economies better. This is also true for investments in microfinance, something an increasing number of investors have noticed over the last decade.

Microfinance debt investments are not marked to market, being typically structured as untraded, private loans. If the underlying currency exposure is hedged, volatility is driven solely by defaults, of which well-managed portfolios have very few. Bad loan default rates peaked in 2010 and 2016, due to global and emerging market crises in the previous respective years, but have remained low, at 5.0% in peak year and below 2.0% on average. As one of the largest foreign debt providers in the industry, Symbiotic has for example a loan write-off rate cumulated over 12 years of only around 1% on a total loan volume exceeding USD 3 billion, across more than 70 markets and 3000 transactions. Low default rates produce a remarkably steady return stream as is illustrated by the Symbiotic Microfinance Index (SMX-MIV Debt USD), a reference benchmark calculated since 2003 on the average performance of the largest microfinance fixed income funds in the industry, hedged in USD Between 2003 and 2016, a period of around 150 months, the index has produced a positive return in all but three months, with its largest drawdown limited to 0.3%.

Enabling Social Program at the base of the pyramid

Over the last decade, Microfinance portfolios have proven to support local Market and real economy needs to the great satisfaction of Investors often frustrated by other types of emerging market Investments. The main reason is the significant difference in allocation between microfinance and traditional emerging market debt portfolios. Looking for example, at Latin America, traditional investments will mostly be directed to sovereign quasi-sovereign or corporate debt across a few large countries, such as Colombia, Mexico or Brazil. By contrast a corresponding microfinance portfolio will invest predominantly in frontier economies such as Bolivia the Dominican Republic, Ecuador, Nicaragua and Paraguay, not doing so trough sovereign or corporate bonds but rather directly targeting the base of the pyramid, reaching out to micro small and medium enterprises as well as directly low and idle income households.

It will hereby create an income stream that is uncorrelated to traditional benefits the local population. Microfinance investments are neither a holy grail, nor a panacea. Most importantly, by definition they do not produce anything themselves, but t rather put capital at the disposal of others. They thus largely depend on the microfinance institutions they partner with for upholding principles of social responsibility, financial savviness and purposeful implementation, as it is these that channel the capital further towards micro-entrepreneurs. Institutions in turn depend on end clients and their capacity to manage opportunities and risks, and thereby plan their path out of poverty towards a more sustainable and prosperous lifestyle. Keeping this in mind, microfinance investors do however have the merit of contributing to the paradigm shift of the 21th Century by providing a channel for capital to be invested in market out of the mainstream with high capital demand and value creation potential. Most importantly whilst doing so they are also acting in their self -interest diversifying and stabilizing their portfolios and giving a long term perspective and depth to their savings plans.

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29 May 2022