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Microfinance and the Financial Crisis
[CGAP Virtual Conference]

Consultative Group to Assist the Poor
Submitted by
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CGAP Virtual Conference: Microfinance and the Financial Crisis
November 18-20, 2008

Last week, CGAP's virtual conference welcomed over 600 MFI managers, central bankers, investors and advisers from 34 countries. The 150 entries submitted provided a vivid and powerful report on how the financial crisis is impacting microfinance institutions and their poor clients. The dominos of the crisis – credit crunch, inflation, currency dislocations and global recession – are hitting microfinance in very different ways, depending on location, funding structure, financial state and the economic health of their clients. While many places seem unaffected today, there is little doubt that that there will be impact: integration of microfinance into the mainstream does have costs.

MFI managers from Mongolia, India, Rwanda, Mali and Pakistan reported on **clients** hurt by inflation and early signals of economic downturn: job losses in the US and Europe have already meant fewer remittances from relatives abroad. Client purchasing power has gone down and cash needs have gone up, causing savings to be withdrawn and sometimes straining repayments. Lessons from previous financial crises show how some nimble clients might even benefit if, for example, they can adapt their inventory to meet newly frugal customer demands. MFIs whose customers sell commodities tend to fare better than MFIs providing consumer finance to salaried workers or cash-flow based small business lending. On the whole pressure on customers is expected to translate broadly into higher portfolio at risk.

The most immediate concern is how the global liquidity contraction will affect the cost and availability of funding to **non-deposit taking MFIs**. Money from both domestic and international banks is tighter, slower, more conservative and more expensive. Anecodotal evidence cites rate increases from 1% to 4% in Latin America and South and Central Asia, with some banks pulling out altogether. MFIs are anxious about meeting refinancing needs when loans from foreign banks and MIVs come due in 2009. Those borrowing in foreign currency fear the double hit of both increased interest rates and the costs of having to pay in hard currency with recently weakened local currencies. Declines in MFIs net income from fx losses were cited in the 7%- 43 % range in the past few years, with one Latin MFI reported to have lost 75% in a single year. On top of all this inflation means operating costs are rising, and these costs can't always be passed on to clients.

Institutional investors in microfinance are not seeing significant retail redemptions, but they do expect fundraising in the coming months to be a tougher sell. Retail investors are cautious and loath to realize losses in existing investments in order to make money available for new microfinance investments. Development Finance Institutions have seen demand for funds from MFIs rise dramatically and many are up to their lending limits to MFIs. Several are planning a joint emergency liquidity facility, which would be welcome if appropriately structured.

The strongest message from the conference was that **deposit taking MFIs** are well-insulated from refinancing risks. The many savings-led African institutions have little need for external funds. . That said, most deposit taking MFIs mobilize larger deposits from non-poor customers and these may be more sensitive to the economic downturn. In a world where communications are global and news travels fast and far, there is also a fear that bank failures in the US and Europe will lead to a loss of confidence in local banks and a run on deposits. Large scale savings withdrawals have only occurred in isolated cases where other factors were already at play beyond the financial crisis.

Advice to **MFIs** from conference participants included: increase reserves, cut back on growth and focus on portfolio quality, make sure loan officers are informed and attentive to clients needs, and communicate early and often with lenders and investors. MFIs were also warned that cutting back on lending can undermine repayment; if customers think they won't get a new loan, why repay the old one? Longer term

counsel focused on MFIs accelerating the move to become licensed to mobilize deposits, or at least borrowing locally, improving asset and liability management, consolidating or diversifying funding sources to a manageable but balanced number, and ensuring sound codes of conduct on a customer education, advice and protection. Many of these changes, participants cautioned, will take time, money and expertise that many MFIs lack and will need to build.

Overreaction by **policymakers** was a worry for many. There were concerns that regulators might become excessively conservative (about new licenses for deposit taking, capital requirements or branch expansion). Well-intentioned governments may do things to alleviate the crisis effects that hurt financial access in the long run. These might include debt forgiveness programs, soft loan schemes and unsustainably low interest rate caps. At a minimum, participants felt that progress on helpful policies that stimulate access would falter as governments' attention focuses on the urgency of stability. On the bright side, some felt that the crisis might advance the cause of helpful deposit taking legislation. Clearly, there is a need to demonstrate to policy makers that *inclusion* and *stability* go hand in hand.

Several suggestions for **donors** were offered. These included ensuring that funding catalyzes local funding, promoting transformation of NBFIs, and making sure that donors stand by long time clients to help reschedule loans, recapitalize, or provide emergency funding.

But there was optimism amid the anxiety. Perhaps 'creative destruction' may have long term benefits for access to finance. Some markets had become overheated, with sensational growth rates, softening underwriting standards and deteriorating risk-return trade-offs. Slower growth, tighter credit, more conservative policies, better products and even consolidation of weaker institutions into stronger ones may be beneficial in the long run. The crisis may be a booster to actually implement consumer protection policies. And at the very least, the crisis has clearly illustrated the value of adopting a deposit-led approach that aims to build access to domestic, local currency financing.

Thank you all for your observations and wise counsel. We will do our best to ensure that your input is shared with all those who can help MFIs and their clients weather the financial and economic storms ahead and emerge stronger and healthier than before.

Warm regards,
Elizabeth

1. What impact is the crisis having?

Caveat

Generally, most conference participants were eager to discuss the impacts of the financial crisis, but several participants warned against attributing all MFI issues to the financial crisis. Kelly Hattel, echoing Mohammed Khaled, mentioned the need for the sector not to "be too quick in establishing direct causality between the current financial/economic crisis and MFI problems which might have been pre-existing conditions."

Others also cautioned against making broad generalizations from very specific experiences. Chimaobi Agwu from Nigeria wrote: "Talking about the impact of the financial crisis on MFI's and their clients… depends on the economy in question, the operating and funding structure adopted by the MFI and proactive measures put in place by the board and management."

General Impacts on clients

Most participants agreed that client impact is varied and not yet visible in most areas. It is expected that rising inflation (especially for food) and other fuel and commodity price volatility, combined with the effects of recession – namely decreased demand for microenterprise products and decreased remittance flows—would be the main cause of client problems going forward.

Gerelmaa Yu from XacBank reported that in Mongolia, "[m]any of the clients of cooperatives are herders, who have income from selling of cashmere, meat or skin, market price of which has declined during the last months. With yearly inflation of around 30% the living expenses of herders like all people increased significantly. In addition the liquidity shortage has led other banks to stop or restrict loan disbursements in remote areas."

In Pakistan, Syed Moshin Ahmed of the Pakistan Microfinance Network commented that: "anecdotal evidence suggests that MF clients who are economically active have been either positively impacted in the first generation affect of inflation or remained neutral. The only group that has been affected is salaried urban class and people who have taken loan for consumption."

N. Srinivasan also cited the effects from lower lending by MFIs: "New clients have been asked to put on hold their business plans by MFIs in many places. Interest rates are being reset. Many clients might opt for high interest options from informal sources."

Larry Reed from Opportunity International reminded participants that client impact occurred in previous crises. He shared his experiences from past crisis describing scenarios where MFI clients, who were microentrepreneurs, benefited from an economic downturn. He remembered prices going "up on all items, and especially on basic commodities like food." As their traditional consumer base spent more on basic commodities, microentrepreneurs specializing in basic commodities flourished. Microentrepreneurs focusing on higher end items didn't do as well, unless they were able to capture higher end consumers who "could no longer afford to shop in the department stores where they normally shopped." Microentrepreneurs/clients who were able to take advantage of these market changes were able to "maintain their incomes and pay back their loans," provided that new entrants didn't flood the market.

General Impacts on MFIs

Many respondents are seeing the effects from the crisis on their markets. Others are expecting delayed impact. Reports from local MFIs varied according to region and type of institution. For example, West African respondents from Benin and Côte d'Ivoire stressed the immediacy of the food crisis, while in MENA, most MFIs have not yet felt the impact of the financial crisis. Many participants from Mexico to the Philippines noted that deposit taking institutions are holding up better than more credit-focused institutions.

Philip Asare of Opportunity/Ghana wrote that the impact of the crisis on MFIs "will be dependent on the extent to which their host countries are integrated to the international financial market …[but]… no matter the degree of linkage, MFIs are likely to suffer one way or the other."

Laura Burnhill from ACCION also commented on the geographic differences in impact: "Much as the impact of the crisis on mainstream economies and financial sectors continues to spread unevenly, so the impact of the global meltdown on microfinance varies by region. Eastern European MFIs seem to be experiencing deposit runoffs or reductions, whilst Latin American MFIs are reporting more cancelled / non-renewed lines and/or delayed disbursements. Asia and Africa each face different challenges as well. One thing seems certain though, despite falling oil prices, commodity prices remain high, credit has been sharply curtailed on many levels and life at the bottom of the pyramid is more squeezed than ever."

Syed Mohsin Ahmed, giving a bird's eye view of the situation from Pakistan, described the interplay between the effects of the food and fuel crisis, the financial crisis and geo-political variables: "In Pakistan we have our own set of unique crisis though largely insulated from the global financial market meltdown but heavily affected by the recent boom in oil and commodity prices. The above factors along with political and geo-political problems have led to a macroeconomic imbalance in the shape of high fiscal and current account deficit. With inflation, headline at 25% and core at 18.3%, spiking northwards the central bank has been taking policy measures to suck access liquidity from the market and making rupee dearer."

> "Domestic deposits stand to decline with declining economic activities. Significant number of developing countries finance significant portions of their budgets with foreign aid. As the donors face the heat, their ability to help will definitely decline. Declined governement budgets will imply declined expenditure and investments. Incomes will be impacted and domestic savings will shrink.
>
> Added to the above is the possibility of remittances from relatives from abroad to decline as some of our relatives in the developed countries face job losses."
>
> —Philip Asare of Opportunity/Ghana

Cordaid, gathering a group of 15 MFIs, concluded that the impacts of the financial crisis on the operations of MFIs are: (1) reduced demand for loans as client businesses suffer (2) cost of capital has increased – costs that cannot be passed on to clients (3) reduced growth in the sector due to the liquidity crunch and (4) an increase in short-term loans to finance portfolios. The liquidity crunch will come as there is (1) a decrease in international investment flows (2) a decrease in loans from local banks, especially those with longer tenors (3) foreign exchange losses (4) lowered remittances (5) significant withdrawals of deposits and savings. They also believed that "emerging, small and medium and weaker MFIs are most affected…..[and there is] potential that larger MFIs will acquire small, weaker ones, with potential mission drift."

Overall, participants identified the following impacts (each discussed in the following section):
- Liquidity crunch
- Risk of increased PAR
- Foreign currency exposure is an added risk and cost
- Other risks to MFIs (commercial bank failure, drop in remittance fees)
- Investor inflows
- Policy implications

The Liquidity Crunch

Many participants commented that deposit taking MFIs are less exposed to liquidity squeezes. In general most saw material evidence of liquidity tightening, especially on non-deposit taking MFIs that fund themselves primarily through foreign debt. In many cases, no changes were seen yet, but there is a great deal of anxiety about what will happen in 2009.

Martin Holtmann summarized the sentiment across the industry:
"(1) Refinancing risks for MFIs that are mostly funded from external sources such as DFIs, MIVs and local or international financial institutions. While liquidity seems fine through the end of 2008, some organizations are likely to experience problems in refinancing their debt obligations through 2009, especially if they have accepted "hot money" from fickle investors.

(2) Liquidity risk for deposit taking institutions. Historically, deposit taking institutions have been more insulated from funding problems. However, in the current situation, there are likely to be (hopefully isolated) crises of confidence that could affect some MFIs."

Increased cost and decreased availability of capital from banks and investors
Participants generally cited the increased cost and decreased availability of capital as the biggest challenge facing MFIs. Alex Silva, of the Emergency Liquidity Facility/Omtrix, explained that not all MFIs will be affected equally: "Different types of institutions differ in their vulnerability to the crisis depending on their funding structure. NGOs, in a weaker position if international flows, in particular lending from MIVs, are curtailed."

In West and Central Africa, however, we heard from several participants (Karara Charles & Diane Bizimana from Rwanda and Burundi respectively) that there has been little impact thus far, principally because MFIs are deposit-based. Chimaobi James Agwu from IMFB/Nigeria cited: "that the 800 microfinance banks are unperturbed by the global happenings due to the viable policy environment and the fact that we are all savings and deposit led with less dependence on government, bank and external funding."

In contrast, in Central America where many MFIs are NGOs that "have their funding structure concentrated in loans from international sources, local second tier lending institutions, and regional banks," these NGOs "are in a weaker position if international flows, in particular lending from MIVs, are curtailed." (Alex Silva/ Emergency Liquidity Facility-Omtrix)

Syed Moshin Ahmed reported that, in Pakistan, the "cost of borrowing has jumped by almost 50%, "liquidity from domestic capital markets has become tighter" and "financing from international sources, especially debt is not allowed by the central bank because of reserve pressures." Peter Marchetti, FDL/Nicaragua, shared that one of his funders is increasing interest rates on loans by 2%, while Chuon Sophal, TPC/Cambodia, has seen a 1% increase in capital costs.

In India, N. Srinvasan reported that: "In the last sixty days, the liquidity constraints and the heightened perception of risk has pushed up the rates further (by as much as 200 to 300 basis points). If the MFI is willing to pay this higher rate, it does not mean that loans are available." N. Jeyaseelan of Hand in Hand/Tamilnadu shared his observation that "banks are taking more time to lend to MFIs.

From Romania, George Staicu reported that "an MFI in Kosovo had to postpone loan disbursements….and take drastic measures to restrict some of its administrative expenditures. There were days when the MFI's bank account had a balance of just a couple hundreds Euro while the approved loan applications amounting thousands of Euro were on the "waiting list"

Els Boerhof, of Goodwell Investments BV, saw this same impact from an investor perspective: "Although India has a strong domestic capital market, liquidity is becoming tighter, especially for smaller MFIs. For us as an equity investor this means that we have to spend more time with (potential) investees and funders to work on complete financing package, which includes debt as well. The Central Bank in India is taking action and the government banks are trying to fill the gap which the commercial banks are leaving behind.""

Risk of withdrawals of deposits
We also received a number of messages about the risk of bank runs. For example, Daniel Mensah from MicroBusiness for Health in Ghana reported that clients are withdrawing savings from credit unions to cover consumption needs. He wrote: "at recent meeting of some of the credit union executives, it was reported that the number of members taking loans or withdrawing their savings is going up." Laura Burnhill mentioned that "Eastern European MFIs seem to be experiencing deposit runoffs or reductions" and Marc Breij from Cordaid mentioned that a meeting of 15 MFIs believed there was going to be a "significant amount of withdrawals of deposits and savings (in cooperatives)….and [f]light into more 'secure' lenders and assets (gold)."

Erik Heinen of Oikocredit wrote, "What we have been seeing is that especially MFIs that depend a lot on savings deposits face the risk of a run on the institution. 'Trust comes on foot, but leaves on horseback' is an expression we hear a lot these days in the Netherlands and it is true for savings. But so far, we have seen very few MFIs that faced a crisis of trust."

Increased Risk of PAR

Incentives to repay may be undermined.

Participants noticed that they were seeing clients, not expecting MFIs to be able to continue to disburse loans as needed, losing their incentive to repay.

Laurence Uwambaje from the National Bank of Rwanda, commented that: "The financial crisis reduced the external funds granted to MFIs, and so that reduced the disbursement of loans to the MFIs' clients. This affected the clients confidence about the MFIs' ability to disburse loans to them as needed. It reduced also the loans portfolio quality because some clients decided to not repay the loans granted to them because they do not hope to receive the next loans. So as response to this, MFI has to do more in managing and increasing effort on monitoring the loans portfolio quality." Chuon Sophal agreed and stated that his Cambodian MFI's "PAR ratio increased from 0.63% in Aug, to 0.70% in Sep and to 0.95% in Oct 2008."

Ability to repay is threatened in some places.

Participants saw inflation and the global economic slowdown as the key risks to client repayment ability.

Many participants, particularly those from MFIs, referred to the increased vulnerability of clients due to the food and fuel crisis and other inflationary pressures. As Fahan Bamba of AE&I Abidjan wrote: "The actual financial crisis may just be an additional crisis to the existing crisis such as social, political and food crisis."

Munhmandah Ochirsharav of Xacbank, Mongolia agreed: "Commodities and fuel prices are increasing dramatically during the last few months here, there's no certain view that our clients, especially small and micro-entreprenuers are vulnerable on loan repayment." Gerelmaa Yu, his colleague, added: "Many of the clients of cooperatives are herders, who have income from selling of cashmere, meat or skin, market price of which has declined during the last months. With yearly inflation of around 30% the living expenses of herders like all people increased significantly."

The global economic slowdown, on the other hand, will affect client businesses and remittance flows. While many microenterprises are subsistence activities that will be unaffected or even boosted by economic downturn, others may suffer. Martin Holtmann, IFC, noted that MFIs with heavy consumer lending or focus on SMEs (which tend to have bigger repayment problems when the real economy suffers) are the ones most likely to suffer. Alex Silva of ELF also wrote that: "[a]n eventual spreading of the financial crisis to the local economies would have an impact on the income generation capacity of the MFIs' respective clients which could eventually derive in an increase in portfolio arrears."

The slowdown could also mean a slow down in remittance flows to clients. Adama Kodio, of Milfed/Mali, commented: "A further impact that the financial crisis could have on MFIs in West Africa is the recession which will have a negative impact on remittances. Some MFIs capture remittances as medium term savings. Also, a large part of credits given out by these MFIs are consumption loans for relatives waiting for remittances of migrants having left the country recently."

Foreign currency exposure is an added risk cost

Overall it appears that MFIs that rely on savings or are borrowing in local currency are less exposed than those borrowing in dollars. Julie Abrams from Microfinance Analytics reminded participants of the impact of unhedged foreign exchange exposure in past years, including a Latin American MFI that experienced "a 75% decline in net income due to FX losses in a single year" and two Eastern European MFIs that experienced "a 14% drop and a 43% drop" respectively.

Mark Flaming commented that: "It seems reasonable to expect that the impact of the current crisis will fall hardest on non-deposit taking MFIs that fund themselves primarily with foreign debt." Peter van Dijk underlined the extent of the risk: "To accentuate, in some regions and countries over 70% of (impressive) growth of MFIs comes from foreign debt."

Other risks to MFIs may emerge

Julie Abrams pointed out that banks servicing MFIs may also be at risk of failure: "Another area of risk to MFIs that should be considered is risk of bank failure in which an MFI either holds substantial concentration of assets (the MFI's deposits, CDs, investments), and/or liabilities (debt and other forms of credit). In an earlier country-specific economic crisis that included severe currency devaluation, an MFI held 18% of its cash, 91% of its investments, and 32% of its short-term funding liabilities in a single bank that went under, despite the fact that it was considered one of the nation's largest banks and presumed to be among the most secure."

Adama Kodio, of Milfed/Mali, also noted that the downturn in remittances will affect MFIs that provide money transfer services and rely on commissions from such services as income.

Investors inflows to microfinance investment vehicles seem cautious but steady

On the investor side, Microvest and Calvert have seen their investor bases remain constant. Cecilia Beirne from MicroVest wrote, "Everyone is increasingly cautious – to free up capital to invest in mf private equity funds sometimes requires liquidation of existing investments at a substantial loss – emotionally difficult regardless of the social imperative. But so far we are have not experienced a slow down, especially with respect to equity."

Eliza Erikson from Calvert, has also not seen large redemptions, and Calvert's investors "seem content to stay put for a number of reasons: (1) the microfinance/community investment portion is a relatively small piece of their overall portfolio; (2) we provide a fixed return, which provides some stability; and (3) they feel as if lower-income populations are likely to need help now more than ever." However, she also warned that "while the socially-responsible retail investor base may stay stable, the capital from larger retail investors may not increase in the immediate future."

Erik Heinen from Oikocredit, on the other hand, is experiencing a slowdown in inflow capital. As a result, Oikocredit has changed its investment priorities: "With capital becoming scarce due to excess demand, we have prioritized our lending focusing on tier 2 and tier 3 institutions having difficulty to gain access to international capital. We aimed even more for smaller MFIs and MFIs from rural areas. And we became more selective in committing capital."

Marc Breij of Cordaid has had a similar experience. Cordaid has experienced a: "(1) Decrease in investment flows from private, social and commercial investors. This prohibits Cordaid from initiating new investment funds (where we want to play a catalyst role) (2) Decrease in local funding. We see banks originally committing to lever our investment simply withdrawn or increase pricing making any lending unattractive) (3) Increase in the number of defaults / rescheduling requests as a result of (i) lack of local funding (ii) eroding margins as increasing interest rates cannot be passed onto clients."

Donor flows may shrink and be diverted to other sectors

Overall aid budgets are likely to shrink in coming years and the priority for donors may shift to agriculture and other emergency support. Xavier Reille notes that "[f]oreign aid has dropped by 8.4% in 2007 and we can expect more aggressive cuts in 2008 and 2009."

Alice Brooks/USAID-Bolivia commented that: "Donors with a varied portfolio of economic growth activities including support to the microfinance sector are also examining whether they should reshuffle their portfolio to best protect the poor from the crisis. The widely hailed robust, anti-cyclical characteristics of the MF sector may actually work against the sector in this instance, as some donors may reduce support to this sector under the hypothesis that MFIs are better placed to take care of themselves as the crisis unfolds, whereas the most vulnerable sectors will soon be desperately needing increased support."

Policy Implications may help or hurt

The crisis has the potential to trigger changes in regulation, either by distracting regulators from implementing helpful policies or by encouraging them to take more conservative/restrictive approaches to microfinance.

Claudio Gonzalez-Vega/OSU cited other ways short term government actions could harm microfinance in the long run: "The risks include interest-rate ceilings, mass loan forgiveness, the encouragement of delinquent borrower associations, the development of credit programs in government agencies that lack financial expertise, and the like. Several of these actions are already observed in a number of Latin American countries.

On the positive side, the relative stability of deposit taking MFIs may motivate transformation or adaptation of regulatory frameworks allowing strong performing NGOs to mobilize deposits (e.g. current initiatives in Bolivia)."

2. What can the microfinance industry do?

MFIs

Overall, participants emphasized the need for MFIs to systematically deal with the effects of the financial crisis. They shared experiences and advice.

Mark Breij of Cordaid outlined suggestions for MFIs wanting to "maintain their operating margins and strengthen their operations during the crisis…:

- Tighten credit evaluation and utilization check
- Commit to simple lifestyle – spending for wants and needs;
- Adhere to code of ethics; minimize competition in the sector;
- Review portfolio; best time to take stock
- Sustain confidence of MF clients – visibility of the leadership of the MFI be more transparent; be in touch with the various needs of clients; opportunity for them
- Lever with government and NGOs; get other investors to get in
- Restrict services, however, health and education are priority needs of families – MFIs need to address;
- Recognize the risk / loss upfront than wait for the loss to happen."

Julia Abakaeva from CGAP had four suggestions: (1) increasing loan portfolio monitoring (2) focusing on portfolio quality rather than growth (3) working with shareholders on short-term liquidity issues and funding plans (4) as a last resort, look at consolidation/merger options with other MFIs.

Dealing with liquidity crunch

Many responders advised that MFIs focus their efforts on developing local funding and local deposits. MFIs were also advised to leverage existing funding conditions by diversifying funding sources (deposits and equity and maturities). If borrowing in foreign currency, some suggested MFIs to hedge either explicitly by buying currency swaps or implicitly by depositing money with a local bank and using it as collateral for the loan portfolio. Finally, a number of respondents encouraged MFIs to maintain a small and manageable group of funders.

> "What MFIs can do to mitigate liquidity risks, my proposition is thus: Be savings led and inspire your clients to save, match savings with loans, avoid funding mismatch, develop an array of savings and deposit products, be market and fund driven, never depend on bank loans, rely less on donor and oversee funds, do not compete with commercial banks, avoid high volume loans, lend short and lend small, slow down on lending-race up to savings." C.J. Agwu, Agric Banking FMFB, Lagos Nigeria.

Judith Brandsma commented that: "Non-bank MFIs may also need to strengthen their equity position not only because it may be depleted due to increased provisioning but probably also to ensure continued access to funding whether from IFIs, social-

commercial funds or local financiers. The - by some of you - observed 'trend' that IFIs and other financiers appear to be reluctant or unable to lend (or renew loans) also poses interesting questions regarding the sustainability of the non-bank business model."

Judith Brandsma also raised a note of caution to those who were particularly enthusiastic about encouraging MFIs to develop savings products and to work with regulators to develop MFI savings agendas. "Can I please ask for caution, for the following reasons: 1. Savings are other (poor) people's money. 2. Savings are all about confidence. 3. Savings are a service (and yes also a source of funds). Mobilizing savings requires a whole new set of skills, systems and procedures and the decision to mobilize savings should not be taken lightly."

Reduce risk/Sticking to the basics
Chuon Sophal from TPC in Cambodia was among the participants who advised MFIs to improve internal discipline. He wrote, "The credit agents must be trained about the current situation of the financial crisis, enhancing them to respect lending practices, plan of the institution, being not aggressive in lending, and spending more time in doing qualitative and quantitative analysis before making decisions. To encourage the credit agent to follow up … when there is a signal of a problem loan and taking appropriate measures to solve it."

Slow growth
Oyungerel Byambajav of Xacbank in Mongolia shared: "The crisis pushed us to revise our growth targets downward and more concentrate on portfolio quality and restrict consumption loans as the salaried people are considered riskier to be affected by the crisis."

TPC of Cambodia has also taken a similar approach. Chuon Sophal explained: "TPC has to maintain its own current strategy to not be aggressive in lending. To manage the disbursement growth rate per CA, moderating the clients recruiting plan per CA, and reducing the size of the loans in according to the availability of MFI 's liquidity plan."

Maintain the social mission
N. Srinivasan commented that: "From a context of social performance, ensuring that the clients get sustained service without disruption is the most socially relevant service that an MFI could offer in the current context. Borrower counseling on how much of what to take for for what purpose is a necessity. We do not want the industry to push credit and look at the portfolio as "sub-prime" months later. This would push up cost of operations and clients may have to pay more. They may not mind if we assure them that we would stay in the market even in a crisis!"

Investors

Promote savings
Martin Holtmann, IFC, advised donors on what they can do: "I believe that the DFIs ought to focus on helping to mobilize local funding for MFIs through instruments such as partial credit guarantees, and that they need to encourage MFIs to mobilize local deposits. In the long run, that will be the soundest and most sustainable way for microfinance to grow."

Karla Brom agreed, but added an additional comment for funders: "The liquidity issue does point to the need for long term stable client deposits but also a reasonable set of funders. It is important to not be over reliant on any one source of funding lest it go away, but over diversification has its costs as well in terms of time spent managing relationships, reporting, etc."

Being flexible and focused on your mission
Mark Breij of Cordaid wrote: "We would seriously endorse a commitment by all investors (either commercial / social) not to walk away, seek 'bilateral' opt out solutions but to arrange for a collective response, albeit at investee level; no need for large bail out plans)."

Erik Heinen described the approach Oikocredit has been taking: ”Scaling down our commitments towards MFIs, especially the top-tier ones that have not been our long time partner yet. We also lowered the average amount per transaction so as to spread our resources more widely over our partners:

- Requesting our in-country staff to increase monitoring efforts
- Cutting of investments and putting some of our plans for geographical expansion in the fridge
- Inviting institutional investors to step into Fund Management agreements where Oikocredit through its global network takes care that the capital comes with high social performance and a sustainable financial return.”

Policy Makers

Avoid over-reaction

Kathryn Imboden and Claudio Gonzalez-Vega raised some policy considerations for participants, including warnings against the over-reaction to the crisis by regulators. Well intentioned short term support measures could potentially contradict sound practice. Kathryn Imboden wrote: “Over the short-, medium- and long-term, it will be critical to watch risk profiles, performance and regulatory responses, engaging with policy makers to be sure that regulated MFIs are treated as they should be under a sound and access-friendly approach and that the message that financial inclusion can indeed be synonymous with stability is reinforced.”

Claudio Gonzalez-Vega/OSU agreed: “I much agree with Kathryn's warnings about potentially costly over-reactions of regulators and about their limited ability to recognize both the differences in the resilience of microfinance clients (compared to traditional bank clients or the clients of consumer credit financieras) and the differences in the ability of lending technologies based on personal contact with the client and the value of their relationship with the MFI (relationship lending)…These are times when the ability of regulators to separate different types of risks is critical. Otherwise, incorrect regulatory norms may prevent microfinance from playing its counter-cyclical (less pro-cyclical) role. Times of crisis may be the worst time for changing regulation.”

Promote deposit-taking

Others raised the potential policy implications of becoming deposit taking institutions. Peter Marchetti reminded us that “[a]ll of us microfinance managers want to increase our domestic funding, but doing that - becoming regulated - depends on a long series of preconditions.”

Lauren Burnhill of ACCION commented on the need for deposit insurance: “Deposit protection for poor savers would seem to be an element of 'consumer protection' that we should think about going forward.”

Kathryn Imboden added: “The evidence in our exchanges thus far, that savings based institutions have fared better, only reinforces the message that savings are important. Prudential regulation of deposit-taking microfinance institutions has been generally built on sound principles. Over the short-, medium- and long-term, it will be critical to watch risk profiles, performance and regulatory responses, engaging with policy makers to be sure that regulated MFIs are treated as they should be under a sound and access-friendly approach and that the message that financial inclusion can indeed be synonymous with stability is reinforced.”

3. The crisis as opportunity? Going forward

Some participants raised the point that MFIs and the industry itself could find opportunities within this crisis. Potentially, it could force MFIs to grow more conservatively or consolidate while improving capacity and internal controls. Additionally a few participants felt that the crisis provided an opportunity to focus on consumer protection.

New products

Franz Gomez-Soto from USAID funded MIDAS program in Columbia highlighted the fact that: “[t]he liquidity problem may become the right incentive for regulated MFIs to develop and launch more attractive

savings products. The non-regulated MFIs may decide to become regulated institutions in order to get a more stable source of funding."

Greater conservatism, better risk management, stronger systems
There were several participants who thought that slower growth would mean improved risk management and an opportunity to build stronger systems. Cecelia Beirne/MicroVest wrote: "On the risk side, the crisis does present an opportunity for strengthening the industry as a whole. While we all applauded the impressive growth rates of MFIs, one wonders if the infrastructure could have kept up with this rate of growth indefinitely…Are we building a "bubble" of overindebtedness? If so, then a slowdown in growth will provide the opportunity to reconsider the basics of underwriting."

Els Boerhof/Goodwell Investments commented: "I am not so confident that all MFI's have their ALM in order and I hope the present crisis will demonstrate the importance of it."

Franz Gomez-Soto from MIDAS Program (USAID - Colombia) also chimed in: "The funding issue will reduce the MFIs loan portfolio rate of growth, which reduces the growth risk. This type of risk arises from an MFI experiencing a rapid growth without having a strong internal control system which ultimately leads to a greater delinquency rate…. Under a period of crisis, lending should be done in a more conservative fashion. So MFIs will need to improve their screening system. Moreover, they will need to improve their MIS in order to have more detailed information to keep track of the situation. In summary, this is a good time for improving their risk management system."

Mohammed Khaled from CGAP provided a useful wrap up of what he saw as opportunities for the industry from the crisis:

- Regulated MFIs develop and launch more attractive savings products
- Some of the non-regulated MFIs become regulated institutions in order to get a more stable source of funding which will lead to more poor people have access to different savings products.
- Governments develop deposit insurance schemes which cover regulated MFIs and their clients
- Better Consumer Protection Schemes/Regulations are in place
- MFIs develop stronger internal control systems and a healthier growth rate
- MFIs develop a better screening and risk management systems
- Credit bureaus are more common and MFIs are part of that
- MFIs are more efficient and their operational cost is lower
- Donor coordination is better and their Aid Effectiveness is higher
- MFIs show that they are a better investment option than many of the other options there.

Consolidation and "flight to quality"
Kate McKee from CGAP wrote about the potential for increasing portfolio quality (due to the crisis) to create an opportunity for "alternative" or "development lenders. Additionally she wrote, "Central banks and regulators using the credit crunch as a mechanism to reduce their headaches by letting consolidation happen, etc.). In the microfinance sector, we might speculate that the big will get bigger, deposit-takers will fare better, and investors, donors and regulators will focus more energy on ensuring that bigger institutions (which can also pose more systemic risk if they flounder) weather the storm."

Barbara Magnoni cautioned the industry to adjust how some MFIs have operated. "This is an opportunity for the sector to consolidate in some countries, or at least to sit tight and reduce growth projections until the outlook is more clear and portfolios are healthier…." Guy Dionne/UNDP BiH agreed: "The top microfinance institutions will see an opportunity in purchasing portions of weaker portfolios at discounted prices."

On the other side, Rich Rosenberg of CGAP commented: "Will the industry produce consolidation? MFI managers tend to be highly resistant to mergers/takeovers. Maybe they are no different from other managers this way. But in MFIs that don't have a substantial amount of equity owned by commercially-orientated there is often little effective counterweight to balance the managers' incentive to keep control of their empires."

Responsible Finance/Consumer Protection
N..Srinivasan's remarks were representative of those discussing responsible finance: "From a context of social performance, ensuring that the clients get sustained service without disruption is the most socially relevant service that an MFI could offer in the current context. Borrower counseling on how much of what to take for what purpose is a necessity. We do not want the industry to push credit and look at the portfolio as "sub-prime" months later. This would push up cost of operations and clients may have to pay more. They may not mind if we assure them that we would stay in the market even in a crisis!"

Increased demand
Ali Ghezawi of the Development and Employment Fund in Jordan was the first participant to remark about increased demand for loans: "I would like to say that the financial crisis could have positive outcomes for Microfinance institutions. Our data and analysis suggest that we are seeing more business as a result of the crisis (especially form of quality startup projects)."

4. Questions for further reflection:

Many participants raised issues that weren't fully discussed during the conference but are worthy of further reflection and discussion. Below are some of these open questions.

Relative impact of crisis on MFIs
Judith Brandsma: "[W]ould it be correct to assume that MFIs that also engage in consumer lending would already today feel the impact on the loan portfolio quality, especially if the consumer loans are made in foreign currency? Would the loan portfolio quality of MFIs in those countries that do not engage (or do not substantially engage) in consumer lending be less affected?"

J.D. Von Pischke: "Is there any evidence that some microentrepreneurs are getting more business from people in higher brackets who move down-market as their household budgets shrink?"

Els Boerhof/Goodwell Investments BV on group loans: "When the crisis hits groups…what will happen? Will problems submerge later because a loyal group is hiding internal problems too much? Or will they be able to settle the problem because they are a group? Are MFI's who provide individual loans in a better position to monitor portfolio quality because repayment problems become visible immediately?"

Solutions for MFIs
J.D. Von Pischke: "Are MFIs adjusting their approaches to delinquency? Microentrepreneurs selling "high end" goods (e.g. cosmetics or dental work that can be deferred) would presumably be doing less well than microentrepreneurs who deal in daily necessities such as matches and chipatis. How can MFIs tailor their work-outs based on the different cash flows of their clients' businesses?"

The Role of Donors and Investors
Judith Brandsma: "When, how and under what circumstances to bail-out? …What are the terms and conditions for the bail-out?... If IFIs and other financiers end up owning more (quasi-) equity than they care for - what would their exit policy be?"

Eric Duflos/CGAP: "How are Apexes reacting to the financial crisis? Are they still lending to MFIs?"

Peter van Dijk: "Does experience with credit guarantees provided by foreign donors especially demonstrate a bridging effect to attract, in the longer term and as an objective, local funders (banks, depositors)?"

Kate McKee/CGAP: "How are retail investors (ranging from more sophisticated individuals supporting microfinance as one part of their social investing portfolio vs. newer and less sophisticated investors of the kiva.org type) reacting to the changing financial and market circumstances?"