

The Impact of the Financial Crisis on Microfinance Institutions and Their Clients

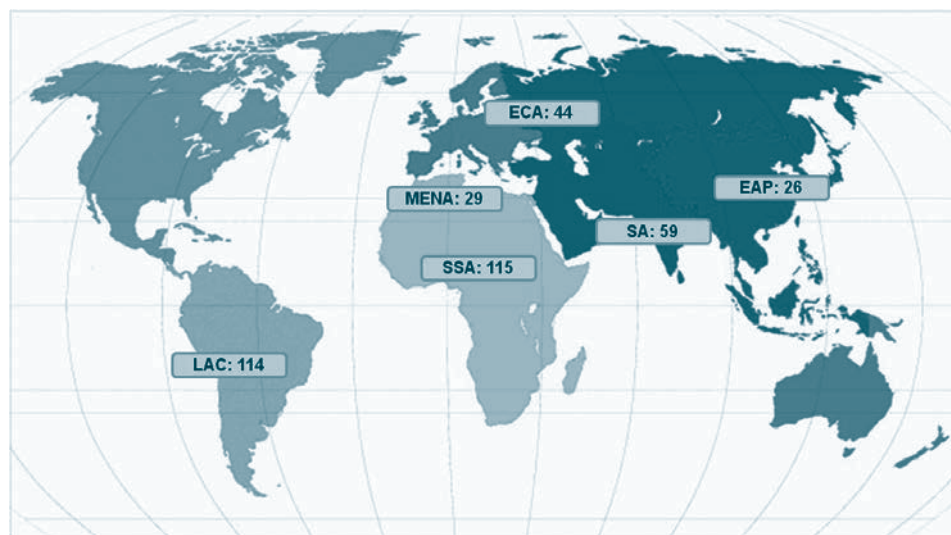
Results from CGAP's 2009 Opinion Survey

The global financial crisis is spreading quickly in emerging markets, but little is known about its impact on the microfinance sector. Which regions are most affected and why? Are microfinance institutions (MFIs) proving resilient to this unprecedented economic downturn? How are MFI clients coping? What is the effect of the crisis on MFI business models? And how do MFIs foresee their liquidity situation in the near future?

CGAP surveyed MFIs in March 2009 to monitor the impact of the crisis. Support from MIX, the Microcredit Summit campaign, and large MFI networks enabled wide dissemination.¹ Over 400 MFI managers responded, providing a good

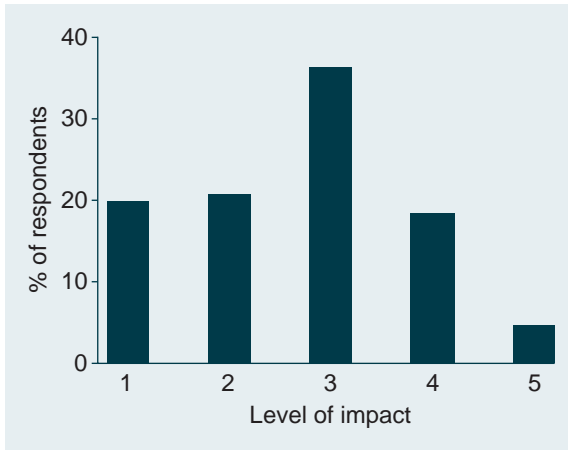
representation of regions² and institutional sizes.³ MFI managers from institutions more affected than others might have more incentives to respond, so this analysis recognizes the risk of self-selection bias.

Figure 1: Regional distribution of respondents



1 ACCION, Grameen, FINCA, Freedom from Hunger, MFN, Opportunity International, Women's World Banking, and Sanabel.
 2 East Asia and Pacific (EAP), Europe and Central Asia (ECA), Latin America and Caribbean (LAC), Middle East and North Africa (MENA), South Asia (SA), and Sub-Saharan Africa (SSA).
 3 Respondents were asked to indicate the asset size of their institutions, for which the following brackets were provided: Tier 1 (assets above \$50m), Tier 2 (assets between \$3m–50m), and Tier 3 (assets below \$3m). Around 76 percent of MFIs in our sample are in Tiers 2 or 3; 24 percent are in Tier 1. Credit unions and cooperatives represent only 14.5 percent of the sample.

Figure 2: Percentage of respondents: Level of impact on clients (1 = not affected; 5 = very affected)



Sustained high food prices, severe economic contraction, and massive job losses are hurting clients most, according to survey respondents. Clients are prioritizing food expenditures and have more difficulties repaying their loans. Many MFIs are finding it harder to access funding, and their microcredit portfolios are stagnant or shrinking—a significant shift after years of remarkable growth. The crisis and its effects on microfinance differ from country to country. MFIs in Eastern Europe appear to be the most affected, while Middle East and North Africa (MENA) MFIs are generally less impacted.

MFI clients are feeling the effects of the crisis

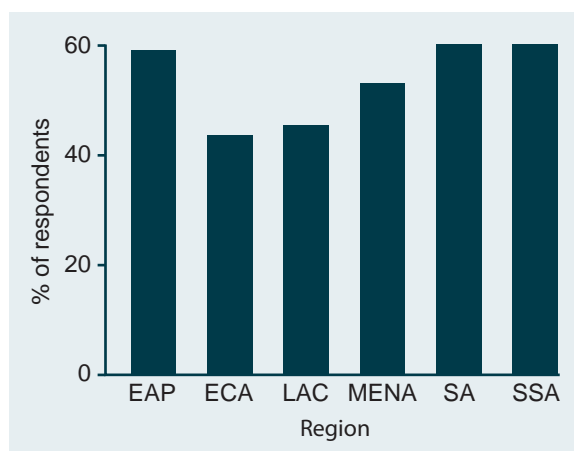
The impact of the crisis on MFI clients has been building over the last 18 months. Food and fuel price hikes in early 2008 have been followed by a severe financial and global economic contraction. CGAP asked MFI managers to rate how their clients are being affected by the global crisis. On a scale of one to five, 58 percent of

MFI managers said their clients were affected “somewhat” (level three) or more. Regionally, clients in Eastern Europe and Central Asia (ECA) are significantly more affected (mean impact 3.5) than clients in the MENA region (mean impact 2.7). Two-thirds of respondents indicated that clients in urban areas are most affected—this is particularly true for the Latin America and Caribbean (LAC) region.

Repayment problems and food price inflation

About 60 percent of respondents indicated that their clients are finding it harder to repay their loans. This phenomenon is most severe in the ECA and LAC regions, with 75 percent and 67 percent of respondents, respectively, reporting clients’ repayment difficulties. MFI managers from the MENA region are reporting lower levels of repayment problems among their clients (41 percent). Borrowers who work in manufacturing, petty trading, and agriculture are said to be most affected by the crisis.

Figure 3: MFIs reporting that their clients are spending more of their income on food now than six months ago



Survey respondents indicated that clients are spending more of their income on food compared to October 2008, especially in Asia and Sub-Saharan Africa (SSA) (62 percent of respondents, for each region, respectively). Several MFI managers emphasized that the price of basic food and production inputs has risen. Clients are coping by lowering food intake or spending more of their available income on food.

Signs of stress on MFIs

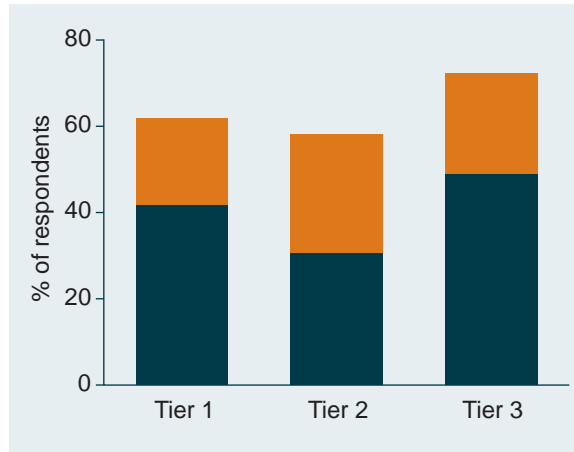
Dramatic slowdown in portfolio growth

Microfinance has enjoyed a decade of exceptional growth. In 2007 alone the overall loan portfolio of MFIs reporting to MIX Market increased by 47 percent. However, the survey results show that this period of rapid growth has stalled. Sixty-five percent of MFI respondents reported that their gross loan portfolios were either flat or had decreased over the last six months. Overall, the credit crunch and the economic recession are forcing most MFIs to slow the growth of their microcredit portfolios.

Portfolio quality down globally

The quality of MFI portfolios is deteriorating. Sixty-nine percent of the survey respondents reported an increase in portfolio at risk (PAR). This trend is found among all MFI types and sizes and probably reflects clients' increased economic hardship. The ECA region is hit hardest by loan delinquency, where 88 percent of the surveyed institutions report increasing PARs. Fewer MFIs in East Asia and the Pacific (EAP) and MENA are reporting PAR increases.

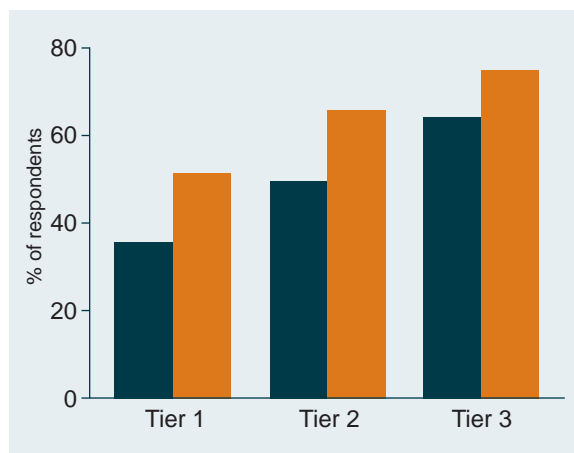
Figure 4: Portfolio same (orange) or down (blue) over the last 6 months, by tier



In search of liquidity

The liquidity constraints highlighted during CGAP's December 2008 virtual conference are still present, but they are less dramatic than the drop in portfolio growth and the broad increase in nonperforming loans. Overall, 52 percent of the MFI respondents reported facing

Figure 5: Liquidity constraints now (blue bars) and over the next 6–12 months (orange bars), by tier



liquidity constraints over the past six months. As expected, smaller MFIs are more affected, with 64 percent of small (Tier 3) MFIs reporting funding problems versus only 35 percent for large (Tier 1) MFIs. Small and medium MFIs appear to be struggling more with liquidity issues: 74 percent of Tier 3 MFIs managers expect their liquidity situation to worsen in the next six months. Regionally, the most pressing needs for capital are in SSA and in South Asia (with 68 percent and 57 percent of respondents, respectively, reporting liquidity problems). Interestingly, MFI managers mobilizing savings have been less affected by the credit crunch, and 57 percent reported they were willing to expand loan portfolio in the next six months. Funding diversification and access to savings are important resilience factors to the liquidity crisis.

MFI response: Interest rates steady, but hiring slows

Since funding costs are rising by an estimated 2–4 percentage points in most markets, MFIs could be tempted to pass the cost along to their clients. However, it can be difficult and unpopular to raise interest rates when clients are struggling. Most MFIs (61 percent) reported no changes in their lending rate to clients (9 percent said they have lowered rates). The survey also found that 23 percent of MFIs responding

have been downsizing their staff to trim costs. This marks a clear reversal of the expansionary trend in staff levels over the past years.⁴

Outlook

The survey responses of over 400 MFIs across the world reveal that MFIs and their clients are being hurt by the food and financial crises. On the client side, we foresee a further deterioration in food consumption and loan repayment in many markets resulting from sustained high food prices and a drop in incomes. As in previous crises, the most vulnerable, particularly children and women, are likely to be hit hardest. On the MFI side, liquidity issues and credit risk are clearly the biggest managerial concerns. The situation might worsen as the full effects of the crisis become clear in emerging markets in the coming months. Surprisingly, MFI managers appear optimistic. Three quarters of respondents believe that their performance will remain stable or improve over the next six months. While this may be wishful thinking for some MFIs, it could also indicate that MFI managers are undertaking measures to confront the crisis and prevent further deterioration. This year will be a key year to test the resilience of microfinance to macroeconomic turmoil. Ultimately, the fate of microfinance depends on how the crisis will impact its clients.

⁴ This is a 43 percent overall increase between 2004 and 2006 (MIX Trend Lines 2004–2006).

AUTHORS

Xavier Reille, Christoph Kneiding, and Meritxell Martinez