COVID-19

RESEARCH
TOOLS
WEBINARS
SUPPORT

BY
MICROFINANCE CENTRE

MFC.ORG.PL/COVID19

www.mfc.org.pl/covid19

Impact of COVID-19 Pandemic on the Microfinance Sector in Europe:

Field Analysis and Policy Recommendations

Kinga Dąbrowska, Piotr Koryński, Justyna Pytkowska

MICROFINANCE CENTRE

September 2020

CONTENTS

ABSTRACT

This paper summarizes the data collected by the Microfinance Centre (MFC) through a survey of microfinance institutions in Europe to assess the impact of COVID-19 crisis on the situation of microfinance institutions and their clients. The results show that while the pandemic touched all countries in the EU, the severity of its impact was markedly different, from very strong in some countries to almost negligible in others. However, all countries implemented some form of a lockdown which affected MFIs and their clients.

The microfinance institutions appear to have survived the first impact of the pandemic relatively well, although some had to make significant adjustments to their internal operations and make some difficult decision, like reducing their lending activities at the time when liquidity was most needed by the borrowers or reducing salaries for their employees.

The clients, on the other hand, do not appear to have fared equally well. Many micro- and small businesses have been forced to close which consequently reduced their ability to earn revenue. They were also subject to the indirect impacts from the disrupted supply chains and often inconsistent and insufficient public support during the pandemic. Only a small percentage of clients report improved revenue during the crisis.

This lopsided impact of the pandemic shows that while MFIs have become resilient and able to withstand the crisis, their clients remain extremely vulnerable and are not able to weather extreme adverse economic conditions. The analysis also shows that MFIs, while able to survive as institutions, are too weak to extend financial support for their clients in bad times, therefore falling short of their primary mission to support the lower-end entrepreneurial sector in the EU.

This preliminary research shows that governments need to extend more support to the self-employed and micro-entrepreneurs to allow them to sustain their business operations, and that microfinance institutions are in dire need of a lender-of-last-resort funding vehicle that can step in with emergency funding and provide financing when private lenders and investors are unable to or unwilling to do so.

The paper ends with a set of other specific recommendations for various stakeholders which would help the MFI clients to stabilize and return to normality and help MFIs to strengthen their capacity to respond more effectively to a systemic crisis like the COVID-19 pandemic.

1. INTRODUCTION

Microfinance is no stranger to crisis, but the COVID-19 is different. Unlike previous downturns which originated from financial markets, the current crisis is spread through an invisible virus which is difficult to contain and control. The virus not only negatively affects businesses and commerce, it also kills people in numbers unseen for a century. It creates social disruption and changes the way we live and work.

In 2008, the crisis began with turmoil in the US real estate and financial markets and only spread to financial and real economy in the rest of the world after a certain time delay. The COVID-19 pandemic is exerting a more radical and abrupt effect and spread very fast. It has put the real economy out of action immediately suffocating market supply and demand simultaneously.

Numerous micro- and small businesses were ordered to stop operating or use alternative channels to communicate with clients and sell their products and services. Many small businesses, including clients of MFIs, have suspended, or closed down their economic activities, leaving the owners and workers without income and employment. This strained microfinance institutions which themselves faced their own internal challenges to maintain their core activities during the government mandated lockdowns and social distancing rules.

This paper explores the initial impacts of the COVID-19 crisis on microfinance institutions and their clients, and reviews the response to crisis by MFIs, microfinance stakeholders and the governments. The paper is organized as follows.

Section 2 provides a short background of the pandemic and its impact on the economy and the microfinance sector globally. Section 3 discusses the impact of the COVID-19 on microfinance clients and on microfinance institutions using the information obtained from interviews with MFIs and microfinance associations in the Europe. Section 4 summarizes the institutional responses to the crisis situation by MFIs, governments, and microfinance investors. Section 5 reviews the key challenges lying ahead of microfinance institutions and their clients on their way to emerge from the crisis and to resume normal business activities. Section 6 proposes several policy and programmatic actions that various players could implement to facilitate the post-crisis transition. Finally, Section 7 offers closing thoughts on the crisis and lessons learned that can serve as guidance for the future development of the microfinance sector in Europe.

2. BACKGROUND

Social distancing and other restrictions aimed at slowing the spread of Covid-19 has caused sharp declines in economic activity as businesses were ordered closed and workers stay at home, although some of them continued working on a limited scale. For an extended period of time people were required to isolate and avoid participation in public gatherings.

These drastic and abrupt measures weighed heavily on the domestic demand for goods and services and reduced the domestic supply. They have disproportionally affected the self-employed and micro-entrepreneurs who are the dominant client segment of microfinance institutions in Europe.

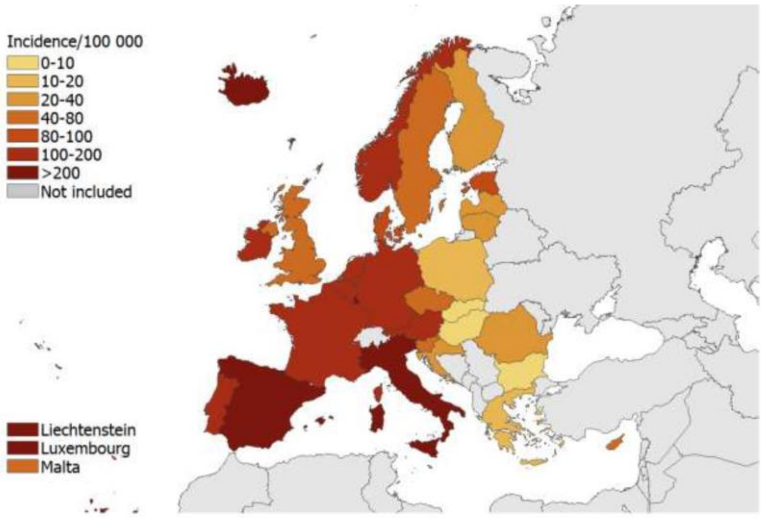
2.1 Severity and Spread of the Pandemic in Europe

COVID-19 is a disease caused by a new type of coronavirus (SARS-CoV-2). First identified in China in December 2019 in the Chinese municipality of Wuhan, it quickly spread to other regions of China and the world. By January 2020, cases had started to appear in some EU member states and the US.

At the end of February 2020, Italy reported a significant increase of COVID-19 cases concentrated in the northern regions of the country. Most other EU member states started reporting cases of people infected. By March 2020, all EU member states had reported COVID-19 cases. The number of cases has since continued to increase although at different pace resulting in quite a diverse map of the prevalence across Europe.

The spread and severity of the pathogen causing COVID-19 was uneven and had a differential impact on the EU countries. As shown in Figure 1, at the peak of the spread, the incidence of the new virus cases was uneven with the Southern European countries showing more cases than countries in Central and Eastern Europe.

Figure 1: Incidence of reported COVID-19 cases /100 000 population in the EU/EEA countries and the UK from January 1 to April 7, 2020.



Source: https://www.ecdc.europa.eu/sites/default/files/documents/covid-19-rapid-risk-assessment-coronavirus-disease-2019-eighth-update-8-april-2020.pdf

This uneven spread of the virus has implications for the type and speed of the post-COVID recovery for the microfinance institutions and their clients in Europe.

2.2 COVID-19 and Microfinance: A Global Perspective

While the current crisis has left no microfinance institution (MFI) or region of the world indifferent, European MFIs have fared much better in comparison with MFIs in others parts of the world .

The COVID-19 crisis caused numerous challenges for MFIs: difficulties in disbursements, collection of reimbursements and meeting with clients face-to-face, and reorganizing internal systems and flow of work. Consequently, portfolio performance deteriorated for many MFIs although at different rates in different parts of the world.

Since the spread of the COVID virus was uneven throughout the world, it is not surprising that there are significant differences the crisis has had on MFIs in different regions. The impact depends not only on the location of MFIs in relation to the COVID prevalence, but also on the types of services that MFIs provide and their internal operational systems.

MFIs that collect savings and depend on deposits for making loans, for example depositing taking institutions in certain regions of the Sub-Saharan Africa, were deeply impacted but it has not been the case in Europe where MFs are not allowed to take deposits. MFIs that rely on digital technologies were able to pivot towards new ways of communicating with clients and making loans virtually. Others which rely more on the traditional methods of personal relations and physical contract with clients were severely affected by the mobility restrictions due to the pandemic. This was the case for many MFIs in Latin and Central America, Central Asia, and the MENA region but to a much lesser degree for MFIs in South East Asia or Sub-Saharan Africa .

There are also regional differences in the portfolio at risk (PAR). Only 17% of MFIs in Central Asia, Europe, and LAC experienced doubling their PAR 30 during the pandemic while this is the case for 41% of MFIs in Sub-Saharan Africa, 27% of those in South Asia and 33% of those in MENA. Regardless of these differences, the majority of MFIs reports deterioration of their loan portfolio quality. However, it must be noted that these results are immediate short-term impacts on the portfolios and not all impacts are fully visible in the risk measures. It is still difficult to assess the long-terms impact of the COVID crisis on the MFI loan portfolios.

Not all MFIs signal a need for additional funding during the crisis as Europe and Central Asia (ECA) region where 57% of MFIs report having no additional needs, and 22% state that their funding needs have decreased. The need for liquidity is markedly different in other regions. about 30% of the institutions in the MENA, SSA and LAC regions have funding needs that are between 20% and 50% higher than what had projected before the COVID crisis.

Regardless of the severity and prevalence of the pandemic, MFIs have taken active measures to face the crisis. MFIs have made various adjustments to their internal operations, risk management and client interface. Many MFIs have implemented their business continuity strategies, crisis management and monitoring committees, and negotiated with investors and other stakeholders .

Despite the challenges and difficulties resulting from the crisis, there are some potentially positive outcomes for the microfinance sector. Out of necessity many MFIs accelerated digital transformations to be able to operate in the new environment which allowed them to transition to the new virtual world and become competitive in relation to fintechs. Many MFIs were also forced to seek new markets and development new products. This will contribute to greater flexibility and resilience of MFIs in the future.

2.3 Emerging from the Crisis in Europe

MFIs emerge from the crisis at different pace according the national rules and policies. Return to the pre-COVID situation and the longer-term growth of the microfinance sector depends on the extent of damage that the crisis has inflicted on MFIs and the type of economic activities of borrowers that MFIs support. If microfinance clients are engaged in sectors which are most severely affected by the crisis, such as retail, transportation, accommodation and food services and arts and recreation, they may face permanent loss to their activities which will negatively impact the loan portfolios of MFIs. Also, tourism-dependent economies such as Cyprus, Greece or Montenegro may see longer time to recovery than countries with more diversified economic activities.

In general, European MFIs are in a relatively good position to exit social distancing restrictions and return to normal ways of doing business. At the same time, individual country circumstances vary significantly and there is still risk of the virus making its come back which could reverse the gains already achieved and set the clock back on the long-term recovery.

3. IMPACT OF THE PANDEMIC ON CLIENTS AND MICROFINANCE INSTITUTIONS

While it is fair to say that the COVID-19 crisis spared no one, the impact of the pandemic has been unevenly distributed across clients and institutions, and to some degree, not all impacts are negative.

3.1 Microfinance Clients

In general, most if not all clients of MFIs have been impacted by the COVID crisis, directly or indirectly. The direct impacts were due to the mandatory or self-imposed closures of business activities or own decisions to temporarily discontinue their businesses for personal reasons such as health risks or family situation. The indirect impacts include the consequences of the mandatory closures due to the COVID pandemic which caused the disruption of the supply chains and decreased the demand for certain products and services offered by the microfinance clients.

Impact on Business Continuity

Most businesses had to change their way of working during a state of emergency, even those which were declared essential business activities needed to adjust to the new physical distancing procedures and increased sanitary requirements.

Many businesses suspended their activities during the state of emergency, and the service sector (in particular street vendors, restaurants, hairdressing, beauty salons) was the most affected. Shops, market trading activities, personal transport, and construction were among the segments that were first in line to close or substantially reduce the scope of their activities. Of those which did not have to close down their activities, the majority were in agriculture where the direct immediate impact was less pronounced but this may be only a temporary phenomenon due to the nature of agriculture and the time lag between production and market sales.

Businesses which could easily pivot to new channels of marketing and sales, for example to online selling, suffered fewer closures but they experienced more internal changes to adjust to the new ways of doing business. Those businesses which were either unable to move to new ways of doing business compatible with social distancing rules or activities which cannot be altered, for example personal services like hairdressing or cleaning, suffered more, and the percentage of permanent closures among them appear to be higher.

Businesses that have multiple activities in general fared better than single-activity enterprises because not all business lines had to discontinue or slow down at the same time or at the same rate.

Finally, there is a substantial percentage of entrepreneurs and business owners, for some MFIs reaching 20% of their client base, who suspended their activities voluntarily for fear of the getting infected or because of their personal situations.

It is also interesting to note that although the situation may be difficult and in some cases the chances of restarting a business or returning to the pro-COVID levels of sales may be small, the number of actual permanent closes among the microfinance clients is very small. The majority of businesses and entrepreneurs remain optimistic about their ability to rebound and continue although the way of operating will likely to be different.

Impact on Business Performance

In general, only a small percentage of MFI clients did not experience a decrease in sales or turnover, and only a small percentage declared an increase in sales.

For the most of micro- and small businesses revenue from sales has reduced substantially, although clients in certain sectors such as nursing homes, construction, industrial production, information technology, manufacturing, and home-based craft production experienced a smaller decrease in sales revenue.

To survive the majority of MFI clients used economic assistance measures adopted by the national governments, if such were available but often these measures were limited in scope and duration, and often the self-employed and small entrepreneurs did not meet the requirements which were developed mostly for larger enterprises. Even when assistance may have been available, many clients did not have enough information and clarity how to access the potentially available programs.

Impact on Employees and Salaries

Most MFI clients do not have paid employees beyond the owner, and if they have employee they are mostly family members.

Those who have employees have sent their employees on paid leaves or organized their work from home, especially when they were able to use a government salary support programs to be able to continue paying salaries. Still one-third of clients had to reduce the salary of employees to be able to keep them employed.

Most of those who plan to use government measures plan to use tax and deferral of social contributions in combination with other measures such as direct salary assistance or a moratorium on loan repayment. Only a small number plan to rely solely on tax relief methods proposed by the government.

Impact on the Future Outlook

Most clients expect that when the state of emergency is lifted, their businesses will return to the situation from before the pandemic, although this conviction is not unconditional. Many clients' outlook is based on the ability of the economy to stabilize and the governments to provide support during the transition period. There is also a belief that the recovery may be long and slow. The more pessimistic outlook on the future recovery is among urban entrepreneurs who have been affected more than the rural ones.

Still quite a large number of respondents are not sure about their future: they need to see what happens after the state of emergency is over. They cannot assess their ability to restart their businesses and cannot predict what type of assistance would be more effective for them.

It is interesting to note too that almost a quarter of clients indicate that they may not be borrowing money at all in the near future due to the economic uncertainty and the losses incurred during the current crisis.

Winners and Losers

Although every client and every business has been affected by the crisis, some were more on the winning side than the losing side.

The biggest winners during the pandemic are clients who were:

- Not mandated to close their businesses and who could continue operating their activities.
- Located in the rural areas and depended on retail outlets for selling.
- Able switch to online selling and marketing.
- Able to take advantage of support programs during the pandemic.

The biggest losers during the pandemic are clients who were:

- Forced to close down their business activities and were not offered any financial compensation or support.
- Operating in the services sector, with those providing personal services suffering more closures and loss of business revenue.
- Not prepared to or not able digitalize their operations and use online channels to promote and sell their products.
- Early stage businesses which did not have time to establish themselves on the market and reach a stage of a positive cash flow.

3.2 Impact on MFIs

The impact of the pandemic on the microfinance institutions has been moderate and in general most MFIs managed to adjust quickly to the new situation. So far none of the MFIs has suffered major losses that would force them to go out of business or put them on the brink of insolvency. This demonstrates the readiness of MFIs for dealing with a crisis situation and the resilience of their internal operational and governance structures.

Portfolio Performance

Unlike MFIs in other parts of the world which suffered substantial deterioration of portfolio quality, the European MFIs in general have been able to maintain their risk levels, and even improve them in relation to the pre-pandemic period.

MFIs in countries like Macedonia and Bosnia and Herzegovina have remained stable and their portfolios showed excellent performance. In other countries MFIs experienced an increase in PAR, in some case even doubling the PAR30 during the pandemic but this increase was from a low beginning PAR number, for example from 2.1% to 4.4% as reported by one organization.

Significantly higher PAR30 results are recorded by some of the Western European MFIs, but again, these higher numbers reflect the nature of lending by these organizations which focus on start-ups and early stage businesses whose ability to survive during the crisis are much lower than that of more established enterprises. In summary, PAR30 statistics reported by MFIs are not alarming and do not paint a picture of a major deterioration of the quality of their portfolios.

However, this initial conclusion needs to be qualified at least in two ways.

First, many regulators allowed rescheduling of loans under the pandemic relief programs and allowed to include these rescheduled loans as part of the regular portfolio, effectively treating them as performing loans. This however these loans may not be performing, therefore the available statistics on PAR provided by MFIs, although accurate and correctly calculated according to the regulatory requirements, may not reflect the true quality of their portfolios. The true quality of the portfolio will only be known after the moratoria expire which will take place in most cases by the end of the year.

Second, it is still too early to assess the full impact of the pandemic on the financial situation of the borrowers. Many borrowers were able to take advantage of various support measures proposed by the governments and the MFIs themselves, and were able to meet their financial commitments and keep paying off their loans. This may change when such support measures are no longer available in the near future.

Demand for Credit

Not surprising, the demand for loans in general has decreased, especially at the beginning of the pandemic when the situation was quite unclear about the future and there was little appetite on the part of the clients to draw more credit. The situation however varies from MFI to MFI and country to country. Some MFIs have experienced a significant decrease in loan applications during the pandemic period, and they do not see a reversal of that trends. The loan disbursement of new loans decreased substantially by 60% and more for some MFIs in comparison with the pre-pandemic period and similar time period the previous year.

Yet the majority of MFIs see an increase in demand for new loans, especially in the month of June and July when the economies started to re-open and there was more clarity about the market demand and business opportunities. However, this new demand is different from the demand in the past. Loans that are requested are for smaller amounts and they are predominantly for working capital purposes to cover the current operating costs. Few loans are sought for investment and business expansion, which is consistent with the continued uncertainty of the current situation and the business outlook for the near future. However, since banks have reduced lending, MFIs may be able to capture a new segment of small businesses funded until recently by banks.

Credit Rationing

Weaker demand by clients for new loans is also coupled in some instances by intentional credit rationing by MFIs due at to three reasons.

Some MFIs found themselves to be liquidity constrained and had to limit the disbursement of loans requested to match their ability to fund the new loans. Even if the MFIs had sufficient liquidity to fund new loans, some have introduced limits on disbursements to lower the credit risk during the uncertain times. In addition, most MFIs adjusted their risk assessment policies and procedures which led to more stringent credit assessment and an exclusion of certain business activities that may be considered high risk from the point of view the pandemic impact.

Product Offer

In general MFIs did not change their product offer although they may have adjusted some of their features and eligibility criteria, for example by offering interest free periods for the first three months of the loan. Some MFIs introduced new products that were specifically designed for and motivated by the current crisis. These were mostly short-term liquidity products to help the clients overcome short-term cash shortages and short-term business needs. This was the case when the national governments and development agencies introduced special emergency lending programs for small businesses during the pandemic. In some cases MFIs were eligible for funding from such programs.

Working with Clients

Communication and interaction with clients changed dramatically during the pandemic. The inability to make site visits for due diligence and monitoring created a need to open up new channels of digital communication which have been used by most MFIs to some degree already and have now been expanded. MFIs started to use various ways of communication with clients such as Skype, Zoom, WhatsApp or Viber, and made the loan application possible online or via mobile phones.

They also adjusted certain procedures and requirements to match the current situation, for example substituting physical documents by electronic documents when it is practical and allowed . It is still difficult to say for who the change of communication has been more difficult. MFIs had to make numerous internal changes in their business processes, but clients had also to learn to communicate using new tools. Although most people have mobile phones, we cannot assume that every client will know how to deliver the required documents in the digital form or be able to sign the loan documents electronically.

Risk Management

Most MFIs decided to adjust and modify their risk management to take into account the new risk related to the exposure to COVID-19. Changes included the use of time- and risk-adjusted cash flow projections (such as discounted cash flows), decrease of the maximum loan amounts, and adjustments related to new laws regulating business activities, such as restaurants, tourist businesses, etc. The new risk policies may also exclude certain types of business activities in general or reduce the share of certain business activities in the overall loan portfolio.

Some MFIs decided not to change the risk management policies until the crisis is over to be able to take full account of the new economic situation.

Internal Operations

Like other businesses, MFIs were subject to the lockdowns and social distancing regulations which have substantially impacted the internal work arrangements of microfinance institutions. MFIs have instituted work from home and work in smaller teams taking turns in the office, all of which required major change in the workflows and communication channels. There are examples of MFIs which decided to close down their regular office and moved to a co-working space for meetings, and relying mostly on work from home.

Work from home and virtual collaboration was particularly difficult for loan officers who are accustomed to being in the field and having direct personal contact with clients. Those MFIs which continued to work out of their offices had to accommodate the requirements of social distancing and invest in protective materials like masks, disinfectants, and other precautionary methods.

Another change that MFIs had to introduce was to create online loan applications and arrange for online payment systems that would allow clients to apply for loans and make payment using online and digital methods. At this point all MFIs offer online loan application solutions and payment systems although there is still a lot of work to be done in this respect. For some MFIs who introduced online systems before the crisis in parallel to the traditional loan application process saw an increase in the use of the digital applications during the pandemic.

Financial Management

The financial position of the majority of MFIs in Europe remained satisfactory, and only a few MFIs signaled problems with liquidity which was one of the major initial concerns of MFIs. Most MFIs started the year with a solid liquidity cushion and did not experience liquidity shortages. At the same time, lower demand for credit also eased the pressure on liquidity.

Some MFIs which ran into liquidity shortages had difficulty to receive funding under already negotiated and signed contracts with the investors which were reluctant to disburse cash during the pandemic. At the same time some microfinance investors had developed a special liquidity product for MFIs which provided short-term cash relief for the microfinance institutions.

Cost Reduction

Several MFIs indicated that they were forced to reduce their operational costs to be able to survive the crisis and to be in good financial standing. The costs cuts included elimination certain expenses such as training and professional development, lowering salary levels, furloughing, or laying off staff and postponing making certain investments till after the pandemic.

Impact on the Future Operations

The current pandemic has also impacted the outlook for the MFIs' future. MFIs are under pressure to get to normal which by all appearances will not be what it used to be. The changes made under the pressure of the pandemic are likely to remain in place and MFIs' activities will continue to be more digital and impersonal than before. In that respect, the pandemic has shaped the future of credit delivery and accelerated the digital transformation processes.

Winners and Losers

Although MFIs in Europe are emerging from the COVID crisis in relatively good shape, some have done better than others.

The biggest winners during the pandemic are MFIs which:

- Are larger and better established and have supportive stakeholders.
- Entered the pandemic with a comfortable liquidity cushion.
- Have completed their digital transformation and were able to use digital tools for internal operations and external communication with clients.
- Have a healthy expose to sectors which are less affected by the COVID-19 pandemic.
- Have operated in an environment with strong government support for micro- and small businesses.

The biggest losers during the pandemic are MFIs which:

- Are smaller and less established.
- Operate on a narrow or risky market segment such as business startups or services.
- Did not use digital solutions and did not manage to switch to online and virtual communication.
- Had weaker liquidity position and were not able to negotiate additional funding in the short time.
- Operate in an environment with limited government support for micro- and small enterprises.

4. INSTITUTIONAL RESPONSES TO THE CRISIS

Institutions and agencies on all levels reacted to the emerging health crisis offering various support mechanisms within their area of competence and authority.

4.1 Microfinance Institutions

Although the context and environment within which MFIs operate varies, the response of MFIs to the COVID-19 crisis appears to be quite similar. While not all of the approaches and instruments were used by each MFIs, the following are the most common responses implemented by the MFIs.

Internal Operations

MFIs had to adapt their internal operations to new circumstances. Some of the measures that we applied include the following:

- Implementation of a business continuity plan: these often ignored and forgotten procedures found their use during the crisis to adjust the organization to the new conditions and reassign responsibilities differently that during normal operations.

- Virtual work arrangements: all MFIs moved to virtual work by mandating staff to work from home and use technology to communicate and collaborate. Even with the easing of restrictions on movement and social distancing, most MFIs continue to work in a virtual way although some declare to slowly return to the personal face-to-face contacts with clients.

- Office safety procedures: new health safety procedures were implemented by all MFIs, which included rules on social distancing, hygiene, and collaboration.

Lending Process

New lending slowed down during the crisis, both because clients demanded less credit and because MFIs constrained the credit supply due to the emerging and still little understood risks. Yet some new loans were made, and old loans had to be managed on a continuous basis which challenged many MFIs to change their lending procedures and cash management systems. The following are the most common adjustments done by MFIs in respect to lending:

- Online loan applications and loan approvals: most MFIs had online application options, but the crisis eliminated any possibility of submitting a loan application other than in electronic form. The crisis has forced the institutions and the clients to use the online and mobile system which were in place but not sufficiently used.
- Digital disbursements and collections: those MFIs which still disbursed cash and accepted cash repayment of loans had to quickly develop online options using banks, mobile phones or credit and debit cards.
- Distance monitoring: since the face-to-face and onsite monitoring was not possible, MFIs turned to technology to monitor clients and their ability to repay the loans. Various options were used: Skype, Zoom, WhatsApp, Viber, and other communication platforms, relying mostly on mobile phones as most clients have mobile phone with video capabilities.

Debt Restructuring and Emergency Lending

Debt rescheduling was the most common reaction of MFIs during the initial months of the COVID crisis, followed by introducing new options of emergency loans. The following options were reported by the majority of the MFIs:

- Loan rescheduling and internal moratorium on loans: while practically all MFIs introduced some form of moratorium on loan repayment and loan rescheduling, there were differences as to how it was executed. Some MFIs offered loan rescheduling to all clients (which was fairly rare), the majority took a more limited approach offering loan moratoria on a case-by-case basis and only to those who requested rescheduling and made a case for it. Most rescheduling was on a month-to-month basis leaving the MFIs with an option to request loan repayments as soon as the clients were resuming their business activities.
- Implementation of external loan moratoriums: In addition, or in parallel to potential internal rescheduling, MFIs implemented mandatory loan moratoria if such were introduced by the government and/or regulators.
- Post crisis loan products: While the majority of MFIs curbed substantially limited the amounts of new lending, some MFIs introduced emergency loan products in an effort to support their clients with liquidity during the crisis. The demand for such new products turned out to be modest as the borrowers may not be willing to take additional burden during the uncertain times.

Client Communication

Personal relationships and onsite interaction with clients - the hallmark of microfinance that separated MFIs from fintechs - have been dealt a major blow during the crisis. The communication may have remained personal and intimate, but it had to be changed to virtual channels using technology. Most MFIs used the following two approaches:

- Loan officer contacts: loan officers contacted their clients to assess their situation during the crisis. In most cases all clients were contacted at least once, and often the loan officers maintained regular contact with their clients throughout the crisis period.
- Client surveys: some MFIs administered client surveys to learn about their challenges and to better gauge the scale of the problems faced by clients.

Support for Clients and Their Businesses

Many MFIs, even those that did not provide business support and development services to their borrowers, started to deliver webinars and trainings on business topics. Some MFIs that offer mentoring and coaching services also provided training and support to their coaches to help them move to provide the support services virtually. Although it was not applied uniformly, many MFIs provided the relevant information on funding opportunities and other support programs offered by the national and local governments to make sure that clients take advantage of such assistance. However, beyond providing information MFIs did not offer assistance to their clients on how to apply for such programs.

Risk Management

Almost all MFI have introduced changes in their risk assessment of borrowers although not all changes were yet introduced as official policies and procedures. The changes mostly relate to the exposure of a business to potential risks created by the pandemic such as the potential consequences of social distancing on the ability to operate a business, or the location of a business. These temporary measures will be included in the regular policies and procedures when these risks are better understood and can be quantified.

Liquidity Management

Despite the initial fears, only a few MFIs reported having liquidity problems in which case the MFIs had to reduce, if not completely suspend, lending and reduce expenses in the short run. As mentioned earlier, some MFIs were able to receive funding from their lenders and investors under the existing contracts, others had to enter into tough negotiations to receive funding. Larger MFIs were able to obtain cash loans from local banks to cover their cash shortages to pay salaries and other current expenses. Those MFIs which were not able to access the needed cash had to introduce more drastic measures like reducing staff salaries or even laying off staff. However, most MFIs entered the crisis in relatively strong liquidity positions which helped them survive the crisis without major negative consequences.

Other Measures

In addition to the above mentioned most common responses to the COVID crisis, each MFIs had used other measures which were needed in a particular country context and the specific requirements of the local authorities. In some cases, MFIs independently or through their national associations, drafted letters to their governments and advocated for support their own institutions and their clients.

4.2 Microfinance Investors

The response of the microfinance investors seems to be mixed, from those which took a conservative approach restricting lending to MFIs to those lenders which offered additional financial assistance and other support during the pandemic.

Some of the supportive measures undertaken by the microfinance lenders and investors include the following:

- Continuation of lending to MFIs and honoring prior lending agreements: although not common, some investors chose to respect the outstanding commitments to MFIs although not without additional due diligence and scrutiny.
- Debt rescheduling for MFIs: in several cases microfinance lenders and investors have been open to renegotiate repayment of debt by MFIs due because of the COVID crisis. For those MFIs which could not meet the repayments on time, the investors agreed to suspend late payment penalties and reschedule the debt for later date.
- A few investors organized technical assistance to clients of MFIs in which they have invested to strengthen their capacity to survive and repay loans to MFIs.
- Some investors joined forced and agreed among themselves to coordinate the periodic communication with the MFIs and to receive report in a unified format so as not to burden the MFIs with additional reporting work.

4.3 Regulators

Central banks and regulators in many jurisdictions instituted temporary lending and risk management measures to adjust the lending procedures to the extraordinary conditions during the pandemic. Such measures include the following actions:

- Temporary moratoria on loan repayment: several central banks issues temporary rules allowing the borrowers to suspend loan repayments for a certain period of time during the pandemic. In most cases, these moratoria were an option that a borrower could exercise at their discretion, and MFIs made efforts to communicate this option to their clients. Some countries introduced moratoria on bank loan repayment but not on MFIs. While the moratoria provided the needed temporary relief, for MFIs they have had adverse effects as relaxed repayment discipline may lower the overall quality of portfolios.

- New rules for risk management and loan risk classification: regulators in some jurisdictions allowed banks and microfinance institutions to change the classification of loans late on repayment due to the COVID and treat them as a separate category of loans. This has allowed the MFIs to disaggregate the portfolio performance into two categories (directly affected by the crisis and not directly affected) and do not count the rescheduled loans as part of their PAR calculation.
- Different treatment of COVID-rescheduled loans in the credit registries – some regulators allowed the loans rescheduled due to the COVID crisis not to be recorded by the credit bureaus as impaired loans. This allowed the clients to maintain their credit score and access funding in the future.

4.4 Governments

Governments in each country have undertaken various measures to protect the population from spread the virus and create safe conditions for living and working. At the same time, governments offered financial support and relief to support businesses to continue operating. The most frequent government measures include the following:

- Tax postponement: this measure was introduced practically by all governments allowing entrepreneurs to defer their tax payment and social security contributions till a later date, sometimes even till next year. These measures were optional and gave the MFI clients a choice to pay now or later.
- Salary support for employees: some countries provided temporary salary support for workers by providing the employers with partial payment for salaries, however this had a limited impact on MFI clients as they typically do not have many employees.
- Unemployment benefits: such benefits were made available by some countries for employees who were made redundant or furloughed, however this measure was not very useful for MFIs and their borrowers.

5. KEY CHALLENGES TO EMERGING FROM THE PANDEMIC CRISIS

As we approach the end of the summer 2020, the pandemic is slowly easing its grip on the economy although some countries witness a new increase in the COVID cases indicating that the crisis not over. National governments are opening up economic activities with various degrees of restrictions and limitations in an effort to return to "normality", although it is still difficult to say what "normality" means. For some clients and MFIs, it may mean going back to the pre-COVID situation and for others it may be adjusting to the new post-COVID reality. Whichever it may be, there are many challenges lying ahead of microfinance institutions and their clients.

5.1 Microfinance Clients

The challenges facing microfinance clients revolve their ability to restart their business activities and repay loans and other financial obligations accumulated during the pandemic. Here are some of the key challenges for the entrepreneurs are likely to meet:

- Financial challenges
  - Paying loans to MFIs and other lenders: MFIs offered loan rescheduling on their own or by the decree of the regulators, but there was no debt forgiveness program for clients who are still liable for their outstanding loans to MFIs and other financial institutions (such as banks or financial companies). Loan rescheduling, while helpful in the short time, raises the cost of debt t clients, making it more difficult to repay the loans, especially when the business recovery is uncertain.
  - Meeting other financial obligations: governments in many countries instituted deferral of certain government payments such as taxes, contributions to the social security systems and the like. Similarly to the rescheduled loans, payment deferment does not reduce or eliminate the need to pay, adding to the financial stress on businesses trying to restart their activities, potentially with lower ability to earn revenue than in the period before the pandemic. Regardless whether a business gets restarted, these financial obligations must be met by the borrowers.

- Business challenges
    - Restarting business activities: restarting business activities may take several forms. For some, it may be quick and simple as soon as the pandemic restrictions are eliminated, they may be able to return to the pre-COVID situation. Many services businesses fall into this category, for example restaurants, hotels, personal services, and the like. However, there are businesses which will need to change the way of they were doing business either because they will need to align themselves with new health and safety requirements, or simply because the pandemic changed consumer preferences and there is no way of going back to the old ways. Finally, there will be a group of businesses and income-generating activities which will be impossible to restart, leaving the entrepreneurs with an option to either exit completely or engage in a new line of business.
    - Rebuilding the client base and restoring prior business relations: the pandemic has changed the client base for many businesses, for example online sellers may have replaced the traditional smaller shops, and it may be difficult to regain the old customers some of whom may want to continue in the new ways of purchasing products and services. Similarly, the old supply chain relations may have been altered during the crisis, and they may need to be rebuilt.
    - Adapting the business to the new rules of doing business: many business owners assume that they will be able to continue their activities as before but at least for some this may not be feasible. The pandemic has changed the way people buy things and communicate, and these new ways are likely to continue and evolve even further, rather than reverting to the past practices.

- Personal challenges
    - Learning new skills to operate in the virtual and digital world: as mentioned above, the ways of doing business have changed and business owners need to adjust their skills, especially using communication technology and doing business online. This may be a challenge for some borrowers who may find it difficult to pivot towards new technology-based business operations.
    - Overcoming the fear of failure when restarting the business: for some entrepreneurs restarting a business may be an easy afterthought, but others may have concerns about potential failure and incurring additional costs in uncertain times. The decision to restart may be more challenging for the entrepreneurs who already have debt and may need to borrow more money to get their business going again.

While these challenges are real, in general microfinance clients indicate that they are willing to continue their business activities and are willing to take the risk of restarting their operations.

Actions and policies that may help clients of microfinance to restart their businesses and/or repay their outstanding loans:

- General support packages to restart or re-profile a business after the COVID-19 crisis, including loan guarantees, salary support, government purchase or subcontracting, etc.
- Targeted support incentives that may increase demand for products and services offered by microfinance clients, for example tourist vouchers to provide incentives to travel and use tourist infrastructure which will provide demand for the microfinance clients.
- Conditional full or partial loan forgiveness for entrepreneurs who will restart their businesses or create new jobs within the next 12-18 months, with forgiven loans to be remitted to the MFIs that originated such loans.

5.2 Microfinance Institutions

It is not the first time in recent years when MFIs had to face a major crisis, and this may be one reason why most MFIs are better equipped to deal with crisis situations. However, emerging from the crisis is never without challenges. Here are some of them that MFIs are likely to face in the months to come.

- Operational challenges
    - Those MFIs which have not digitalized their operations face an imperative to adopt new technologies to be able to operate in the increasingly virtual environment.
    - Risk management policies and procedures need to be adjusted to account for new types of risks associated with the pandemic which imposes restrictions on certain types of business activities and make certain activities more exposed to the risk in case of the virus reoccurrence.
    - Work processes may need to reorganize and adjust to meet the new challenges of physical distancing, which may require rearrangement of the physical spaces in the offices and changes in the work routines such as field visits and meetings.

- Market challenges
    - The demand for credit may be lower in the aftermath of the pandemic because the borrowers may remain more prudent and reserved in their business activities.
    - Borrowers may shift to other credit providers such as fintechs which are better equipped for virtual operations and may have captured parts of the microfinance segment during the pandemic.

- Financial challenges
    - The cost of funds is likely to increase to compensate for the increased credit risk associated with the pandemic.
    - Digital transformation may require improvements and investments in new systems that may be costly for MFIs.
    - Access to funding in the post-COVID times may be constrained as the economies may be slowly recovering from the crisis, and funding microfinance operations may be considered a risky proposition.

- Strategic challenges
    - Crisis is a time that changes the market dynamics and disrupts the linear strategies challenging MFIs to redefine their objectives and strategic positioning in the new economic and social conditions after the pandemic.

MFIs face numerous challenges – financial, operational, strategic, and regulatory – that need to be addressed to facilitate the emergence of the microfinance organizations from the current crisis and build resilience for the future. Some of the supportive actions may include the following:

- Access to liquidity, either through direct borrowing, credit guarantees and other credit enhancement mechanisms or other credit facilities
- Risk management: MFIs could use help with understanding the broader risk implications of COVID-related risks using evidence from diverse sectors and institutions, to develop appropriate risk strategies for their institutions.
- Digital technology application. As the current crisis showed, MFIs must invest in digital technologies both for internal purposes and for interaction with clients. MFIs could benefits from low cost developmental loans to upgrade their systems as their internal financial resources may not be enough to make the required investments.
- Payment systems. Most MFIs are not connected with and integrated with the national payment system which now became a necessity to serve clients, and also to create truly inclusive financial systems at least on a country level.

6. RECOMMENDED POLICY AND PROGRAMMATIC ACTIONS

Actions to mitigate the consequences of the pandemic must address both clients and microfinance institutions and should be implemented by all stakeholders at various levels starting with the microfinance association and ending with the EU-wide response.

6.1 Microfinance Associations

Professional microfinance associations – national and regional – have an important role to play to advocate for the necessary support for MFIs and their clients.

- National associations
    - Represent the microfinance segment with one voice vis-à-vis their local and national governments and regulators, and negotiate the operational, financial, and regulatory support that the MFIs need to continue provide services.

- Regional associations
    - Advocate for the microfinance institutions and their clients on the level of EU and other international organizations.
    - Provide operational support for MFIs to help them adjust to the new requirements of the digital and virtual world.
    - Strengthen knowledge management, education, and learning to ensure that MFIs can learn from the current events and build their capacities based on the best practices emerging from the crisis.
    - Engaged in research and development to inform the sector, policy makers and the EU agencies about the needs, challenges and potential opportunities associated with the COVID crisis.

6.2 Microfinance Investors

Microfinance investors and lenders play a critical role during and after the crisis whose policies determine to a large degree the ability of MFIs to emerge from the crisis.

- Offer fair pricing in the time of crisis and refrain from price gouging to take advantage of the liquidity during the crisis.
- Adjust the financial indicators and benchmark to account for the changes in portfolio performance during and after the crisis.
- Refrain from reneging on the existing funding contracts and provide the needed liquidity for MFIs to maintain unconstrained operations.

6.3 Governments and Regulators

On a country level, the national governments and regulators have an important role to play in the process of supporting MFIs emerging from the crisis:

- Governments
    - Expand the existing credit guarantees and other financial support instruments to MFIs and their clients
    - Develop restart programs for self-employed and entrepreneurs whose activities have been stalled due to the crisis
    - Create equitable access for MFIs and their clients to information, programs and funding that are available to other segments of the business community during the crisis.
- Regulators
    - Adjust the legal regimen to allow clients to provide the required documents and enter into contracts.
    - Amend the risk framework for microfinance institutions to allow the adequate financial management in the post-crisis situation.
    - In jurisdictions where it is still not the case, allow MFIs to be a part of the national payment system to facilitate online transactions between MFIs and their clients.

6.4 EU Commission and EU Agencies

EU Commission and its agencies have at their disposal the resources and the capabilities to influence the enabling policies for the microfinance sector to recover from the crisis and continue their growth.

- Encourage national government to provide equitable support for the self-employed and micro-entrepreneurs as well as the microfinance institutions.
- Design emergency funding and technical programs through EU institutions such as the European Investment Bank to support the growth of the microfinance sector in Europe
- Create a lender of last resort mechanism for the microfinance sector in Europe to fill in the funding gap that the crisis has brought to bear.

7. SUMMARY

Interviews with the MFIs in Europe showed that in general microfinance institutions managed the crisis relatively well, and they showed a good amount of resilience to successfully overcome adverse events such as a widespread pandemic. The same cannot be said about the clients of MFIs who remain vulnerable and have received little support during the crisis.

While the situation of MFIs summarized in this paper appears to be fairly positive, in particular in comparison with MFIs in other parts of the world, it must be stressed that the pandemic is not over and that we are still in the middle of an evolving crisis whose full impact cannot be known as yet. Therefore, the results presented here must be viewed as a preliminary view from the field which must be followed by more rigorous analysis in the next few months when the impacts of the COVID-19 pandemic will have run through the whole economy and the true impacts will start to emerge.

Nevertheless, the recommendations proposed in Section 6 may be helpful to mitigate the overall impact of the crisis on MFIs and their clients and make the transition towards “normality” easier.

Read more on COVID-19 pandemic response - visit our Resource Centre at :

http://mfc.org.pl/covid19

Writing of this paper was made possible thanks to the information obtained from 22 representatives of the microfinance sector in Europe. We wish to thank the following contributors to the report who kindly shared their insights into the situation and their reflections about the potential future developments.

- Herjola Spahiu, NOA Albania
- Desara Gjoka, Besa Albania
- Eranda Bajramaj and Lindiana Zyfi, AgroSocial Fund, Albania
- Brunilda Isaj, Albanian Microfinance Association, Albania
- Lens Lapauw, Microstart, Belgium
- Elma Zukić, Association of Microfinance Institutions in BiH
- Sadina Bina, EKI, BiH
- Adrien GIZON, Adie, France
- Agni Pagouni, Vaso Paraskaeva, Kepa, Greece
- Garrett Stokes, Microfinance Ireland
- Maria Luisa Cagia, PROXIMIS, Italy
- Samuel Paulus, Microlux, Luxemburg
- Svetlana Roganovic, Monte Credit, Montenegro
- Goran Gemovski and Biljana Jovanovska, Moznosti, North Macedonia
- Goran Lazarevski, Alliance of Microfinance organizations in Macedonia, North Macedonia
- Vase Davaliev, Horizonti, North Macedonia
- Piotr Rogowiecki, Polish Association of Loan Fund, Poland
- Rafael Drummond, Cresacor, Portugal
- Cristian Jurma, Vitas, Romania
- Laura David, BCR Social Financ, Romania
- Maria Doiciu, Romanian Working Group, Romania
- Francesca Malizia, Oportunitas, Spain

This initiative has received financial support from the European Union Programme for Employment and Social Innovation "EaSI" (2014-2020). For further information please consult: http://ec.europa.eu/social/easi

CONTACT US TO LEARN MORE:

Microfinance Centre (MFC)
Noakowskiego 10/38
00-666 Warsaw, Poland
tel: + 48 22 622 34 65
microfinance@mfc.org.pl
www.mfc.org.pl

ABOUT MFC

The Microfinance Centre is a social finance network that promotes fairness, inclusion, equality and responsible service. We unite 113 organisations (including 77 MFIs) across 36 countries of Europe, Central Asia and beyond, who together deliver responsible microfinance services to over 1,000,000 low-income clients.

OUR MISSION

Our mission is to empower individuals and sustain communities through innovative social finance and microfinance

OUR VISION

Our vision is a financial system that works for all people and all communities in a responsible and fair way.
Our members and partners are guided by the principles of fairness, inclusion, equality and ethical service delivery. They acknowledge and contribute to the MFC's values of empowerment, forward-thinking and mindfulness.