Sustaining Microfinance in Post-Disaster Asia

CGAP

Guidance for MFIs and Donors

As the communities most affected by the recent devastating tsunami courageously begin to rebuild their lives, microfinance institutions (MFIs) can play a powerful part in the path to recovery. Since the immediate aftermath of the tragedy, MFIs have been tirelessly providing and coordinating emergency relief, and a few are beginning to help local communities reconstruct homes and return to economic activity.

The following guidelines are intended to help MFIs provide the appropriate range of emergency and longer-term assistance to their clients, while helping both MFIs and donors ensure that the ultimate mission of the MFI – to be a sustainable provider of financial services – is not compromised. Contact CGAP at cgap@worldbank.org or by fax, at 1-202-522-3744 to provide information about your MFI's activities and the challenges you're facing. We'd be happy to provide you with technical advice on any of the guidelines described below and contacts for relief agencies.

Key Principles for MFIs

Maintain a commitment to sustainable operations. Where possible, MFIs should work with dedicated agencies and donors that specialize in emergency relief rather than providing relief directly. In the absence of dedicated relief agencies, established MFIs often have to provide relief assistance immediately after disasters. But this period of post-disaster assistance must be well-defined, and should be followed by a return to unsubsidized loans in the rehabilitation and reconstruction phases.

Customize solutions according to clients' needs. Some clients may be severely affected by the tsunami, others less so, and a few fortunate ones not at all. MFIs should be able to provide each household with the appropriate menu of services depending on its circumstances. For those hit hardest, emergency relief would be a better first intervention than financial services. To make customization work, staff must have the training to assess the situation and the authority to make on-the-spot decisions. For the MFI, this approach offers a more efficient use of limited funding than a blanket policy for all clients, and ensures that staff maintains contact with clients throughout the recovery period. Specific criteria should be defined for loan officers to make decisions about rescheduling and providing grants.

Be realistic about MFI role. MFIs should consider where they can contribute best in disaster response and avoid embarking on activities beyond their capacity and mission. Smaller MFIs may not have the liquidity, resources or flexibility in their information systems to handle relief efforts and provide medium-term loans required to rebuild assets such as houses that don't generate regular cash income. In these instances, partnerships with commercial banks and possibly other MFIs may be considered.

MFI Guidelines

- *Relief Efforts.* MFI participation in relief efforts should usually be limited to locating clients, linking clients and other community members to on-going relief operations or by transporting these people to locations where they can receive services. However, MFI field staff can play a vital role in transmitting public health messages, such as the importance of consuming only clean water. Coordination with relief organizations is essential. Where relief providers are not present, an MFI may temporarily conduct relief but should ensure that clients recognize its role as being, fundamentally, a financial services provider. MFIs can reinforce this message with visual signals, such as by having staff wear special "disaster response" shirts while providing relief. MFIs should also keep relief funds separate from microfinance operational funds, to accurately track relief spending, provide records to donors, and possibly find reimbursement for these expenses.
- *Managing Client Savings*. MFIs should lift compulsory savings requirements in affected branches until the emergency stage has passed and clients have begun reconstruction. This gives MFIs the opportunity to rebuild branches and locate clients, and ensures that clients retain as much cash as possible to cope with the crisis. When considering the opening of deposit accounts to clients for withdrawal, MFIs should consider their liquidity position and any prior promises made to clients about the availability of savings during emergencies.
- *Rescheduling Loans.* Rescheduling loans on a case-by-case basis can help MFIs avoid losses and defaults on their loan portfolio, and ensures that any cash flow earned by those hardest-hit stays in the household. This can also build trust and loyalty to the MFI during a time of crisis. MFIs usually choose between having clients continue to pay interest while the principal payments are postponed, or stopping the accumulation of interest until after principal repayment has resumed. In some exceptionally bad cases, the MFI may consider writing off loans to the client but should be cautious about sending the wrong signals to the community. More established MFIs are likely to experience better repayment on rescheduled loans than those with new client relationships, so younger programs may need to take additional steps to build loyalty, such as by maintaining continuous contact with clients.
- *Reconstruction Loans.* Reconstruction loans are most effectively given once the emergency stage is over and MFI staff can assess the damage to property, and the credit standing, of clients. Repayments on these loans must be monitored carefully, particularly if they are used to finance homes or latrines, which don't generate regular cash income. The amounts of many such "asset replacement" loans require the borrower to also go through three or four income generation loans to earn enough income to service these reconstruction loans.
- *Going into New Areas.* MFIs considering entering unserved areas to provide emergency financial assistance should plan their long-term presence in these areas carefully. Clients without prior knowledge of an MFI's commercial rates and commitment to sustainability may initially view the organization as another relief agency or temporary donor program. To manage the transition from providing emergency financial support through emergency loans or grants to longer-term cost-recovering operations may require the MFI to create a new image for itself during the emergency phase. Using visual signals (see

Relief Operations above), and being explicit with clients about the organization's true mission, are essential.

- *Managing Micro-insurance Claims.* Insurance claims should be processed as soon as possible to afford clients access to emergency cash. Care should be taken to screen out false claims and to ensure the sustainability of the micro-insurance program. Emergency loans can be provided against approved insurance claims if there are delays in disbursement.

Donor Support

Donors must understand the options available to MFIs in post-disaster situations as well as the corresponding constraints. In general, donors should:

- *Be responsive to the local context.* It sounds obvious, but in many communities, the success of microfinance hinges on a hard-earned trust between lender and client. That trust helps loan officers maintain high repayment rates while enabling institutions to charge interest rates high enough to cover their costs. But such practices may be wholly inappropriate in the face of disaster. By collaborating with local stakeholders – community leaders, microfinance practitioners, nongovernmental organizations, and other agencies – donors can help microfinance institutions balance the immediate needs of their communities with the long-term need to remain sustainable.
- *Ensure separation between relief and microfinance.* MFIs are not relief agencies. While the imperative of the situation may force some MFIs to conduct relief activities immediately in the post-disaster phase, donors should ensure separation between relief and microfinance as soon as possible. Clients should not perceive mixed messages, so that the credit culture is not damaged.
- *Stick to microfinance good practices.* Donors and their partners must understand clients' needs and their capacity to use financial services. But where these services are feasible, donors should encourage microfinance institutions to restructure, rather than forgive, loans. Encouraging microfinance institutions to forgive loans, or act as social safety nets, will make it harder for them to operate sustainably – and reach more people – as the recovery effort moves from relief to reconstruction and development.
- *Avoid setting disbursement targets.* Donors should avoid setting a target number of "clients served" for microfinance institutions, as this may encourage some to take on clients who are unable to repay debt. This hurts both the clients and the institutions, weakening the impact of microfinance in the long term.