Financial Crisis: Lessons from Microfinance[1]

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ABSTRACT

The paper explains why microfinance institutions require increased financing and not less during financial crisis. After briefly describing the rapid expansion of the microfinance section, it explains the impact of a financial crisis in the economy on microfinance institutions based on experiences in Russia, Ecuador, Bolivia and Argentina. The paper focuses on the case of Bolivia to probe further. Other work in this field is also indicated. The paper offers recommendations to Microfinance Institutions for better management of financial crisis.

KEYWORDS

Economic crisis, management, microcredit, microfinance, history, Latin America,

INTRODUCTION

In the wake of the financial crisis and the continued expansion and relatively better performance of microfinance, a question which can be posed is whether there are lessons to be learnt from microfinance for the economy in general and the banking sector in particular. While it would be tempting to say that microfinance has all the answers, our research and experience suggests that microfinance itself has its own crisis and booms and these need to be analysed. The lessons from the microfinance crisis are as much for other microfinance institutions (MFIs) as for the broader financial sector.

How does a financial crisis affects microfinance? On the one hand, we observe rising ratios of non-performing loans (NPL) in many microfinance markets. On the other hand, microfinance is essentially informal and typically directed to entrepreneurial activities that are not linked to the global economy (with the exception of cash crops and tourism-related micro-businesses) – which suggests that the impact of global economic events should not be significant. Indeed, the microfinance sector at large is continuing to experience growth where mainstream providers of financial services have been retrenching in the context of the international crisis. How can we reconcile all this? What can we

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learn from the current global financial crisis and also what have we learnt from past microfinance crises such as those in Russia (1998), Ecuador (1999-2000), Bolivia (1999-2001) and Argentina (1999-2002)? During the current crisis, why have delinquency rates gone up in some countries – e.g. Nicaragua, Morocco, Bosnia & Herzegovina (BiH) and Pakistan – far more than in others?

BACKGROUND: THE DEVELOPMENT OF MICROFINANCE

The success of the microfinance movement and high reimbursement rates by micro-entrepreneurs and other low-income borrowers has been broadly discussed in the literature (Yunus, 2003; Armendariz and Morduch, 2005; Ashta, 2009). High reimbursement rates are based on a range of (often innovative) solutions, such as analytical credit methodologies tailored for informal borrowers3; group/solidarity lending mechanisms; small but frequent repayment instalments; non-traditional collateral; regular monthly savings as a prerequisite for receiving loans; borrower incentives; targeting of typically more reliable women borrowers; and the use of new sources of information (Bernasek and Stanfield, 1997; Bhatt and Shui-Yan, 2001; Armendariz and Morduch, 2005). Regulated financial institutions can then rely on the credit history developed over time by borrowers in the (usually less regulated) microfinance sector to offer follow-up loans. In countries like India and Mexico, this usually involves a migration from group to individual lending, a development also fuelled by the diverging business needs of micro borrowers depending on the degree of success of their businesses and other factors.

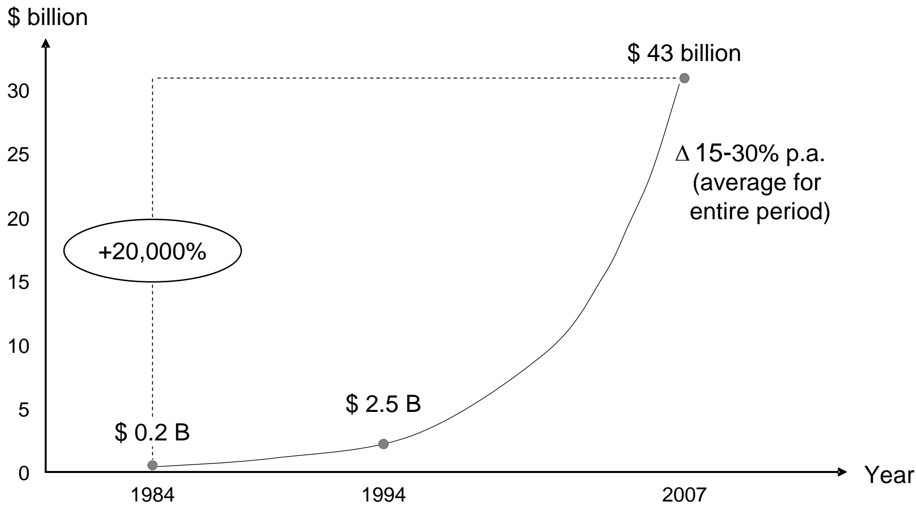
The success of micro-financed enterprises is comparable to the success of small and medium enterprises financed by traditional banks (Yunus, 2003; Labrune, 2010). While Yunus ascribes this to inborn entrepreneurial skills, it may be that group attention or the support services provided by NGOs to low-income micro borrowers to enhance their business management skills. For example, SKDRDP in India uses its field workers to disseminate not only loans but also practical training as well as to organize work sharing groups (Harper et al., 2008). The provision of associated services in microfinance (usually described as “business development services” in industry jargon) may also help to overcome adverse selection and moral hazard. The role of religious institutions in ensuring repayments has also been suggested (Harper et al., 2008). Finally, it may be that MFIs are successfully selecting the micro-enterprises with the best business models and highest chances of success –in turn establishing a virtuous cycle, whereby “deserving” borrowers add access-to-funding to their panoply of competitive advantages vis-à-vis less competent, rival micro-businesses.

The impact of microfinance on poverty development is still subject to a widespread debate (Copestake et al., 2001; Armendariz and Morduch, 2005; Chowdhury et al., 2005; Roodman and Morduch, 2009). Whether microfinance can play a role in poverty reduction alone or in conjunction with others (Daru et al., 2005) or not, policymakers are interested in enhancing access to finance among the poor – with many governments passing specific microfinance laws over the last two decades (Meagher, 2002; Attuel-Mendes and Ashta, 2008; Ashta and Fall, 2009).

[3] Micro lending methodologies often involve visits to the business premises and home of prospective borrowers by MFI loan officers to ascertain both ability and willingness to pay. Advanced MFIs operating on the individual lending paradigm typically train their loan officers to construct rough financial statements for the business and the family unit from (informal and formal) information acquired during such visits, thus allowing mainstream credit analysis tools to be deployed in the evaluation of informal businesses.

Microfinance has grown rapidly over the last decade to become a global $40 billion industry (Figure below).

Figure 1: Rapid Growth of the Microfinance Sector, 1984-2007

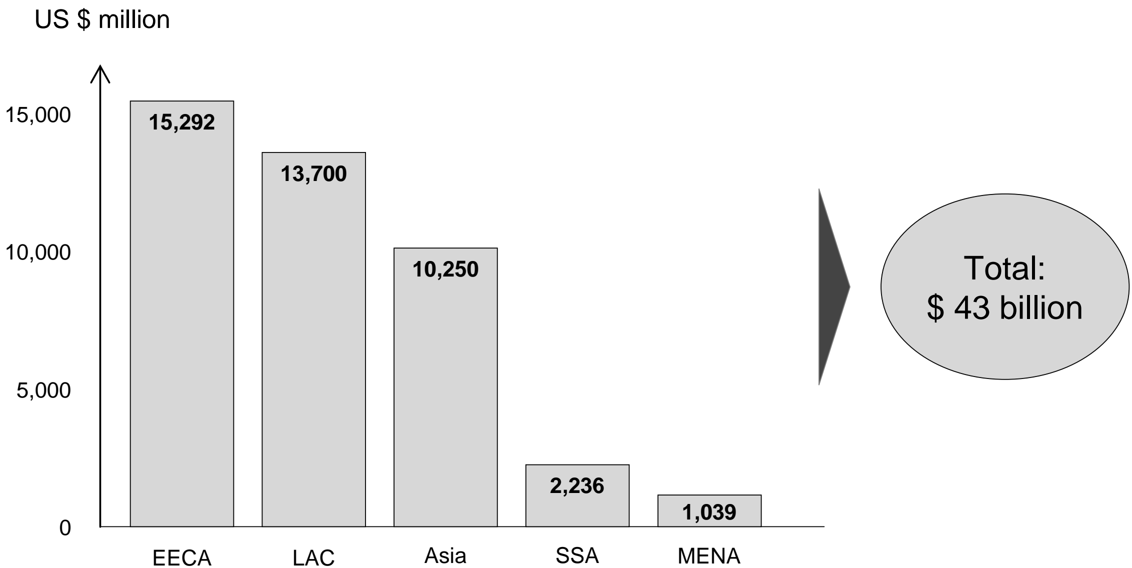


Sources: The MIX; own estimates. N.B. Chart not drawn to scale

Microfinance has also grown from microcredit to include micro-savings, micro-insurance and micro-payments. There are more than 10,000 microfinance institutions (MFIs) with operations totalling over €50 billion. Of these 10,000 institutions, only 2% are large enough to be sustainable (i.e. profitable). These top-200 MFIs are also the ones providing the bulk of financing to the sector.

The most developed microfinance markets (in terms of dollar loan portfolio) are to be found in Eastern Europe and Latin America (see Figure 2 below).

Figure 2: Distribution of Loan Portfolios between Regions



Abbreviations:
EECA = Eastern Europe & Central Asia; LAC = Latin America & Caribbean; SSA = Sub-Saharan Africa; MENA = Middle East & North Africa

Sources: MIX 2008 Analysis & Benchmarking Reports N.B. Chart not drawn to scale

Table 1 below, based on voluntary data provided by 1395 Microfinance Institutions to the MIX (Microfinance Information Exchange) during the period 2003-2008, shows that the number of borrowers grew at an average rate of 21% per annum, while gross loan portfolios grew even faster at an average rate of 34% per annum (i.e. loans sizes increased on average across the sample). Together, these 1395 MFIs served about 86 million borrowers with a gross loan portfolio of $44 billion and 96 million savers with total savings of $16 billion.

Table 1: High growth rates of MFIs

Annual Growth rates	**(%)**	2003	2004	2005	2006	2007	2008	Compound Average
Number of borrowers		14.5	21.0	26.5	22.0	22.0	20.0	21.0
Gross loan Portfolio	($)	32.8	37.8	32.4	38.1	45.4	20.1	34.2
Number of savers		13.2	11.2	12.1	11.7	1.5	25.9	12.4
Voluntary savings	($)	33.9	22.9	13.8	29.2	31.9	16.8	24.5

Source: Adrian Gonzalez, MIX, Microfinance at a Glance - 2008, Updated on December 31, 2009

(Gonzales, 2009) also indicates that the write-off ratio until 2008 was 1.7%, while Portfolio-at-Risk over 30 days (PAR30) was 6.7%. PAR30 represents total outstanding loans of clients falling behind repayment schedule for a period exceeding 30 days, as a percentage of total gross portfolio. CGAP estimates that PAR30 doubled during the first 5 months of 2010 for a smaller sample of 200 high-performance MFIs (Reille et al., 2010).

CRISIS AND MICROFINANCE

In this section, we first provide a small note on financial crisis, then we indicate how financial crisis would a priori impact MFIs, we look at the past experience to see what really happened in earlier crises and finally see what are the impacts of this current crisis.

A. ECONOMIC CRISIS

If microfinance institutions have indeed been relatively immune to international crisis, it may be of interest to understand the factors which create financial crises in the first place to determine why they do not have a similar impact on microfinance. According to Bruner and Carr (2007), for example, the financial crisis of 1907 originated in the complexity and interdependence of the financial system. Asymmetry of information – in the sense that few people understood exactly what each financial transaction entailed – was behind the spread of panic across US financial markets. Linkages between institutions, moreover, can have snow-balling effects with international repercussions.

High growth typically precedes a slump, either because of increased demand for liquidity choking-off growth or because there are too many competitors coming in and demand does not justify all the new entrants. In times of economic expansion banks increase lending by accepting less credit worthy borrowers. The resulting higher risk profile of loan portfolios leads banks to retrench (by accelerating loans to borrowers who no longer satisfy loan agreement covenants and by not extending loans on maturity) as they realize that they are overstretched (when the boom ends and the value of the collateral falls). Bank retrenchment, in turn, exacerbates the liquidity crisis in the real economy.

Behavioural reasons for financial crises are usually fear and greed. Collective action led by a responsible and recognised leader may abate the crisis (Bruner and Carr, 2007) – as happened in 1907 with the system-wide intervention of private sector banks led by J. P. Morgan. Such a leader could also be the government acting in its capacity as a lender of last resort, if private sector participants cannot identify solvent (illiquid) banks or are only willing to assume the risk of lending to them at prohibitively high rates (Flannery, 1996).

B. MODEL: HOW ECONOMIC CRISIS COULD IMPACT MICROFINANCE

Each MFI is linked to the economy on both sides of the supply chain: upstream, microfinance investment vehicles (MIVs) provide funds to MFIs and downstream MFIs provide funds to poor entrepreneurs. To answer our question, the impact of the financial crisis on both sides needs to be examined.

Upstream, on the financing side, MFIs were essentially donor financed in the early days of the microfinance industry. However, over the last few years, MFIs have increasingly accessed financing by commercial banks and MIVs. This is especially true of the 200 large, profitable institutions that do most of the microfinance business. A financial crisis could impact both the availability of donor funding as well as the commercial funding because MIVs become reluctant to take risks.

However, many MFIs (mainly regulated financial institutions) are now financed by the savings deposits of the poor. As a result, they should be fairly immune from the international finance nature of this economic crisis. This would explain why microfinance, to some extent, continues to grow unabated.

Downstream, on the lending side, MFIs lend essentially to small traders, artisans and service providers, often in the informal economy. These traders should also be immune from the financial crisis, except to the extent that their demand is linked to the global economy (cash crops, tourist market).

The basic business model of the profitable, top-200 MFIs should allow them to weather a possible decrease in funding if this is not severe enough to lead to a decrease in scale below breakeven levels. At the same time, donors in particular have so far tried to maintain their levels of financing to the microfinance sector; and even (through special facilities channelled via international MIVs) to increase such funding to make up for the possible retreat of private sector money. Indeed, much of the slowing market demand on the part of micro-entrepreneurs

The basic model of the MFI, explained above, is weakened when repayment instalments by micro borrowers are essentially being refinanced through new, larger loans – themselves funded by ever-growing donor loans similar to a pyramid/ Ponzi scheme. Providing ever-increasing loans to clients, per se, is not necessarily a bad thing. If the borrower is using the funds to finance a growing business with increasing working capital needs and can generate the cash flows required to service the loans, the result is virtuous expansion for both the micro entrepreneur and the MFI.

Matters however are complicated when external events (such as the economic crisis) impact micro-businesses and render their working capital illiquid. The wisdom of refinancing in these cases is more contentious, depending on whether problems faced by the microenterprise (e.g. on the demand side) are of a temporary or long-lasting nature. MFIs are not always equipped to make this judgement and

are therefore reluctant (especially in the initial stages of the crisis) to restructure or refinance any loans whatsoever. In this respect, loans to poor people for their enterprises does not differ from loans to poor nations (Armendariz de Aghion, 1993).

Therefore, whether entrepreneurs are impacted or not by the crisis, it is difficult for an MFI to stagnate: there seems to be an inbuilt snowballing effect. High average interest rates of 28% (Rosenberg et al., 2009) make it even more important (than in mainstream credit markets) for micro-enterprise borrowers to maintain the margins and sale volumes required to service their loans. At the same time, MFIs are subject to similar economies of scale as mainstream financial institutions (e.g. due to the importance of information systems in managing a large client base), so that reduced lending volumes combined with rising NPL ratios can have an immediate impact on profitability.

C. EXPERIENCE ON HOW PREVIOUS ECONOMIC CRISIS ACTUALLY IMACTED MICROFINANCE

The current financial crisis comes after a decade of rapid growth in microfinance worldwide. However, it is not the first of its kind to strike the nascent microfinance industry: shocks and crises had already taken their toll on microfinance sectors around the world at the turn of the millennium (i.e. in the follow-up to the East Asian crisis of 1997-8). Figure 3 below outlines the type of crisis and its impact on each of four microfinance markets: Russia, Ecuador, Bolivia and Argentina.

Figure 3: Impact of Crisis on Microfinance – Examples from the Late Nineties

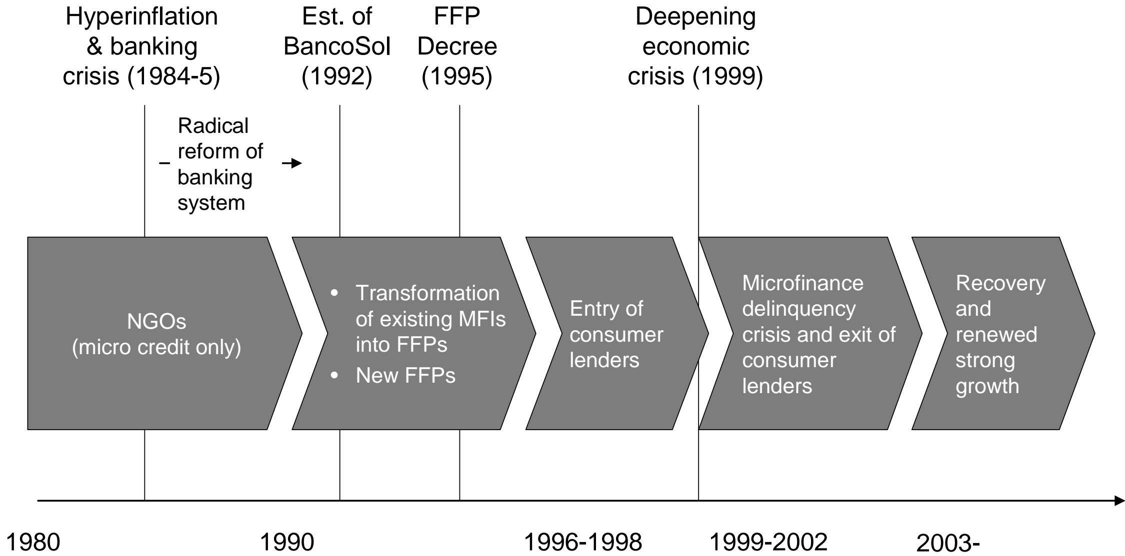
	Type of Crisis	Impact on Microfinance
Russia 1998	Financial and banking crisis (default on Russian government bonds and devaluation of rouble)	Collapse of most commercial banks working with EBRD but resilience of microfinance portfolios
Ecuador 1999-2000	Financial and banking crisis (collapse of national currency; freezing of banking accounts; dollarization)	Near-collapse of Banco Solidario, retreat of most commercial banks
Bolivia 1999-2001	Economic and financial crisis	Delinquency crisis in microfinance sector, exit of consumer lenders
Argentina 1999-2002	Economic crisis; abandonment of dollar parity; collapse of banking system; default on government bonds	Collapse of largest Argentine MFI (Fundación Emprender)

The micro and small business finance sector that developed in Russia from 1995 onwards, under the tutelage and with funding of the European Bank for Reconstruction & Development (EBRD), was characterised by exceptional loan quality and high (relative to loan size) portfolio yields. The entire sector came near to demise as the private-sector, commercial banks providing finance to micro and small enterprise in the context of the EBRD Russia Small Business Fund collapsed under the weight of defaulted government obligations (GKOs). Notwithstanding the collapse of the banks, micro/small loan portfolios transferred to a specialised bank established by the EBRD showed remarkable resilience (in terms of repayment) to a crisis that shook the entire Russian economy. This example

shows that prudent micro (and small business) finance can resist the brunt of even acute financial crisis. There are other examples (including the growth of Compartamos in Mexico) that lend credence to the view that in times of financial crisis, when bankers stop lending to the poor, the latter are forced to turn towards money-lenders or (where possible) to microfinance institutions. This is the basis of the view that microfinance may not only have a low beta – but the beta may even be negative in some countries.

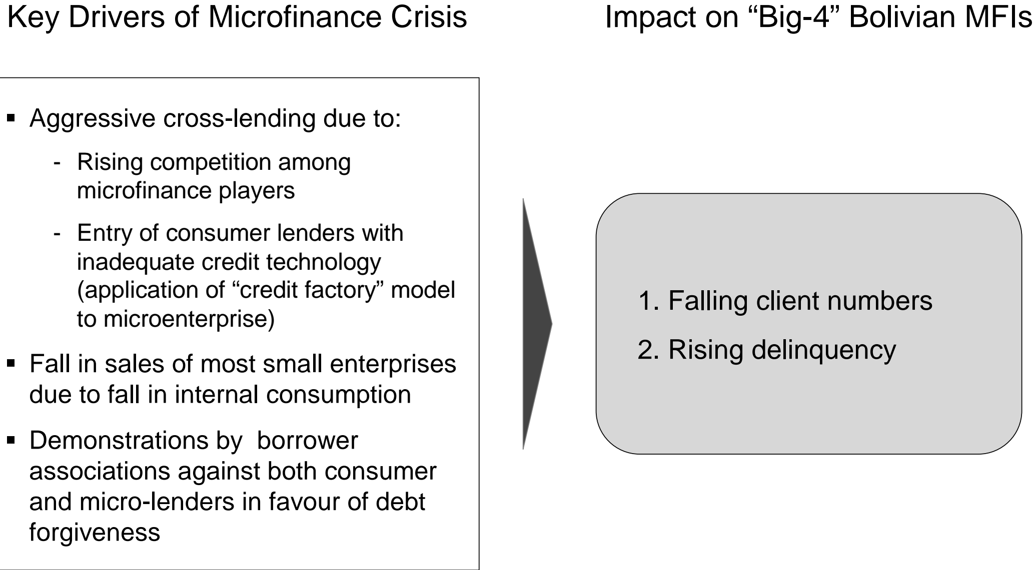
Bolivia in 1999-2001 offers possibly the most instructive case study of crisis in the microfinance arena. Bolivian microfinance evolved rapidly from the 1980s onwards under the combined influence of regulatory change and economic crisis (see Figure 4 below). The analysis focuses on the four leading microfinance players, of which one was a regulated bank (BancoSol) and three others were regulated trusts or FFPs (Fondos Financieros Privados).

Figure 4: Stages in the Evolution of Microfinance in Bolivia



Economic difficulties, intense competition and inadequate lending practices led to a deep crisis in the microfinance sector, in the midst of the broader contagion of the Bolivian economy from the international financial and economic crisis. Figure 5 below illustrates the key drivers of the Bolivian microfinance crisis, namely: rising competition among existing microfinance players and new competition from consumer lenders entering the microfinance sector; falling micro-enterprise sales due to decline in internal demand; and demonstrations by borrower associations against microfinance and consumer lenders. As a result, loan delinquency (as measured by PAR30) increased by an average of 4% (i.e. from less than 5% to almost 9%) over 1999-2001 for the four main microfinance players (i.e. excluding consumer lenders); while the number of clients served by the same MFIs fell from over 180,000 in 1999 to little over 145,000 in 2002, a loss of some 35,000 clients. By way of comparison, the Bolivian financial system as a whole lost 220,000 (or over 30%) borrowers in the period 1999-2002, while average loan delinquency (again measured as PAR30) of the five largest, traditional Bolivian banks reached 17% at the end of the same period.

Figure 5: Microfinance Crisis in Bolivia, 1999 to 2001 – Key Drivers and Impact



Sources: Arriola 2003; Rhyne 2001

"Big-4": BancoSol, FFP Caja Los Anders, FFP Prodem, FFP FIE

The delinquency crisis had far-reaching consequences for both the microfinance segment and the broader Bolivian credit market. Consumer lenders entering the market in 1996-8 had virtually abandoned the microenterprise segment only two years later. The crisis thus marked the failure of the "credit factory" model deployed by consumer lenders in microenterprise and informal borrower segments – and the market exit or outright collapse of hitherto fast-growing consumer lenders (e.g. Acceso, CrediÁgil, Banco Económico) (see Rhyne 2003).

D. EXPERIENCE ON HOW CURRENT ECONOMIC CRISIS ACTUALLY IMACTED MICROFINANCE

CGAP undertook a four-country study of increasing delinquency (Chen et al., 2010) in Pakistan, Morocco, Bosnia and Herzegovina and Nicaragua, where Portfolio at Risk (PAR) exceeded 10% or was coupled with aggressive write-offs. The study found that the delinquency crisis affected MFIs across the board in three countries (although the extent of this impact differed widely among MFIs) and a few large ones in Pakistan. In two of these, Nicaragua and Pakistan, borrowers collectively decided to not reimburse loans.

The CGAP study suggests that there are three main factors which led to increased delinquency: concentrated market competition and multiple borrowing; overstretched MFI systems and controls; and erosion of MFI lending discipline. These factors also emerge as fundamental drivers of the microfinance crisis in our analysis of both Bolivia in 1999 and several Eastern European markets in the current context. Moreover, in all four countries examined by the CGAP paper, links with external funding were strong, with international funding playing a major role in Nicaragua and B&H, and internal micro savings were not developed and remained less than 10% of the portfolio, compared to a global average of over 40%. The international economic crisis was considered an aggravator and not the primary cause of the crisis; our analysis of the Bolivian crisis would broadly confirm this conclusion, with the international financial and economic crisis acting as a trigger rather than as the

fundamental cause of the problems faced by specialised microfinance and other players entering the microfinance market in the course of the nineties.

Each of these factors has behavioural implications. High repayment by microfinance borrowers, especially in individual lending, often depends on the "carrot" of receiving larger loans from the same MFI in the future. Competition, however, erodes this dependence since the borrower can access parallel loans from other MFIs. At the same time, high MFI growth rates stretch the capacity of experienced loan officers to manage ever increasing client portfolios, leading to less personal interaction between credit staff and borrowers and lapses in follow-up and monitoring. A further element is the diminished credit discipline that comes with moves to increase staff productivity, reduce transaction costs and enhance the attractiveness of the credit product in a context of rising competition and falling interest rates.

For example, by reducing face-to-face contact, the increased use of technology diminishes the potential for inter-personal trust building. Similarly, growing use of monthly as opposed to weekly repayments increases the onus on loan officers to evaluate correctly the micro-entrepreneur's cash flows, managerial ability and character. The reason is that borrowers with short-term horizons find it both more difficult and less appealing to service the resulting, far-larger monthly instalments; while less frequent instalments mean that loan officer and MFI are unable to respond as swiftly to repayment problems. A well-known mantra in microfinance is that time is a key factor in assuring the collection of non-performing loans, far more so than in traditional lending, due to the typically lower level of fixed assets and higher mobility of micro-borrowers.

Retail credit (i.e. personal loans to employees) constitutes an important part of MFI product lines in some regions (e.g. Eastern Europe). In Bosnia & Herzegovina, for example, housing and consumer loans to employees (as opposed to micro entrepreneurs) may have represented anything between 20%-40% of loan portfolios across the microfinance sector. Exposure to retail lending to employees radically alters the risk profile of MFI portfolios, increasing the likelihood of losses significantly over the economic cycle (Rhyne (2001), for example, suggests expected loan delinquency of 3-5% for microenterprise credit as opposed to 15-20% in a Bolivian context); increasing correlation with the mainstream economy; and making demands on MFI processes and systems that they are ill-equipped to meet.

A further important channel for risk to flow from the mainstream international economy to MFIs is that of remittances. Remittances are an important source of cash flow for micro borrowers in several countries – and have generally suffered as result of international crisis. Thus although microenterprise (and informal small business finance) may have low correlation with global economic crises, family units with high dependence on remittance cash flows may well face payment difficulties in a generalised crisis.

These two channels – retail credit to employees and remittances – imply a fundamental change in the credit risk equation for MFIs and diminish the insulation of the microfinance sector from the mainstream and international economy. Thus it is the departure of MFIs from classical microenterprise lending models that increases correlation rather than faults in earlier analytical thinking that considered (classical) microfinance largely immune to mainstream economic and financial crisis.

We should also mention here that the Bolivian experience of 1999-2001 (and perhaps the example of Pakistan in the current crisis) suggests that group lending is more likely to suffer during economic crisis through contagion from bad to good borrowers within the group. In the Bolivian example the negative impact of the crisis on group lenders led to them effectively abandoning the solidarity lending model for the more sophisticated individual lending paradigm (BancoSol, for example, today operates largely as a provider of individual micro loans, whereas group credit represented the lion's share of its loan portfolio prior to the 1999 crisis). It remains to be seen, therefore, whether the current crisis has a similar impact on microfinance sectors in Pakistan (a development that can be followed through the evolution of at least one major Pakistan MFI) but also on other booming microfinance markets such as India and Mexico. As opposed to the contagion/acceleration impact of group lending, there are some inherent advantages of groups such as information sharing and reduced transaction costs of lending which make for a more complex analysis and render any decision on group versus individual lending models more difficult.

RECOMMENDATIONS: LESSONS FROM MICROFINANCE

Leading microfinance players, on the other hand, weathered the storm in Bolivia and in the world more generally through a combination of internal strategies and external cooperation. This section lists some of the methods used (see also Rhyne, 2001; Arriola Bonjour, 2003; Navajas et al., 2003; Vogelgesang, 2003).

(I) Adjustments in credit technology

(II) Law to establish collateral registry for movable goods (danger of collateral and documentation requirements creeping higher for microfinance sector)

(III) Multiple loans prohibited or discouraged

(IV) Improvements in, and more intensive use of, central credit bureau (located at Superintendencia de Bancos)

(V) Reformulation of credit staff performance targets including relaxation of quality parameters and refocus of incentives more narrowly on collection

(VI) Rescheduling of delinquent loans in the light of an amnesty for several months by the Superintendencia de Bancos (in 1999, BancoSol reported USD 6 million and Los Andes USD 1 million in rescheduled loans, relative to respective portfolios of USD 73 and 37 million)

(VII) Higher diversification of credit products

(VIII) Increased development of non-credit products and services

(IX) Improved service quality

(X) Microfinance players moved into gap vacated by mainstream financial intermediaries by expanding in new product and geographical market segments:

- Increased presence in SME, retail and rural credit markets

- o Establishment of branches in areas of higher social strata and traditional banking areas to capture deposits and offer credits products and other services

(XI) Greater emphasis on marketing and advertising – also in traditional media

(XII) Changes in Human Resources policy:

- o Shift from social to economic science education backgrounds (to accommodate move from group to individual lending)
- o More staff with banking experience, especially in management positions
- o Increased focus on internal training
- o Results-based, incentive schemes for different staff levels

(XIII) Measures to enhance administrative and operating efficiency (possibly under pressure from falling loan portfolio yields and rising delinquency)

Of particular importance were adjustments in credit methodology (point 1 above) and organisation, which consisted in the main of the following changes:

- A shift from group to individual lending, with share of individual lending rising from 41% in 1997 to 78% by 2000
- Increased emphasis on in-depth financial analysis
- Strict scaling of loans abandoned
- Greater price (i.e. interest rate) differentiation according to risks and costs
- Follow-up mechanisms for delinquency and loan recovery refined (e.g. specialised staff for loan recovery; earlier and greater participation of legal department in loan recovery)
- Strict verification of credit history and total indebtedness through increased reliance on credit bureaus
- The Bolivian example shows that crisis is risk but also opportunity.
- Expansion into areas – products and/or segments – abandoned by mainstream banks and other players
- Enhance flow of credit information between MFIs
- Consolidation in MFI sector (Mergers? Acquisitions?)
- Positive regulatory reforms? Opportunity to influence political agenda?

CONCLUSION

Similar to global crises that follow booms, crises in microfinance are also a victim of their own runaway success. Although to a significant degree insulated from the effects of international financial crisis, we have noted some relationships.

First, the financing of larger MFIs has not been severely affected by the crisis, with deposits in some countries reducing the dependence on institutional funding and multilateral organisations structuring special credit facilities to ensure that liquidity for the microfinance sector (at least for the larger players) did not dry-up. Secondly, the repeat needs of existing micro-entrepreneurs and new loans to previously excluded micro-entrepreneurs have meant that the sector has continued to grow. Thirdly, the fast growth of microfinance and the continued high reimbursement rates in the past rendered MFIs complacent, opening the door for lax practices and failures in credit discipline. Fourthly, the impact of the international crisis has differed widely across regions, with local factors rather than the global situation per se driving developments. Finally, NPL ratios have perhaps increased because some micro-entrepreneurs are indeed linked to the formal international economy (i.e. cash crop producers and providers of goods and services for the tourist industry). A global economic crisis increases this vulnerability.

At the same time, we have seen that as microfinance markets become saturated (especially in urban areas) competition is likely to lead to cross-lending and over-indebtedness: the examples of Bolivia (in the 1999 crisis) and Bosnia & Herzegovina, Morocco, Nicaragua and Pakistan (in the context of the current crisis) are instructive in this respect. In such a context (and as a pre-crisis avoidance strategy), microfinance institutions have to focus particularly on: strengthening credit risk management through appropriate underwriting methodology, loan pricing policies and collection processes; consolidating and streamlining back office and front office operations; increasing communication with staff and investors; as well as on enhancing balance sheet management and broader risk management across the institution. We would suggest, furthermore, that policymakers should renew attention on regulatory structures and institutions such as credit bureaus to provide the required support to fast-evolving microfinance sectors in emerging markets.

The lessons for the broader financial sector are similar to those for the success of MFIs. Painstaking adherence to the basis principles of prudent lending should be followed in spirit as well as in letter. Funding is one element in the success of a project and bankers must be convinced that all the other elements are also present before providing the financing.

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