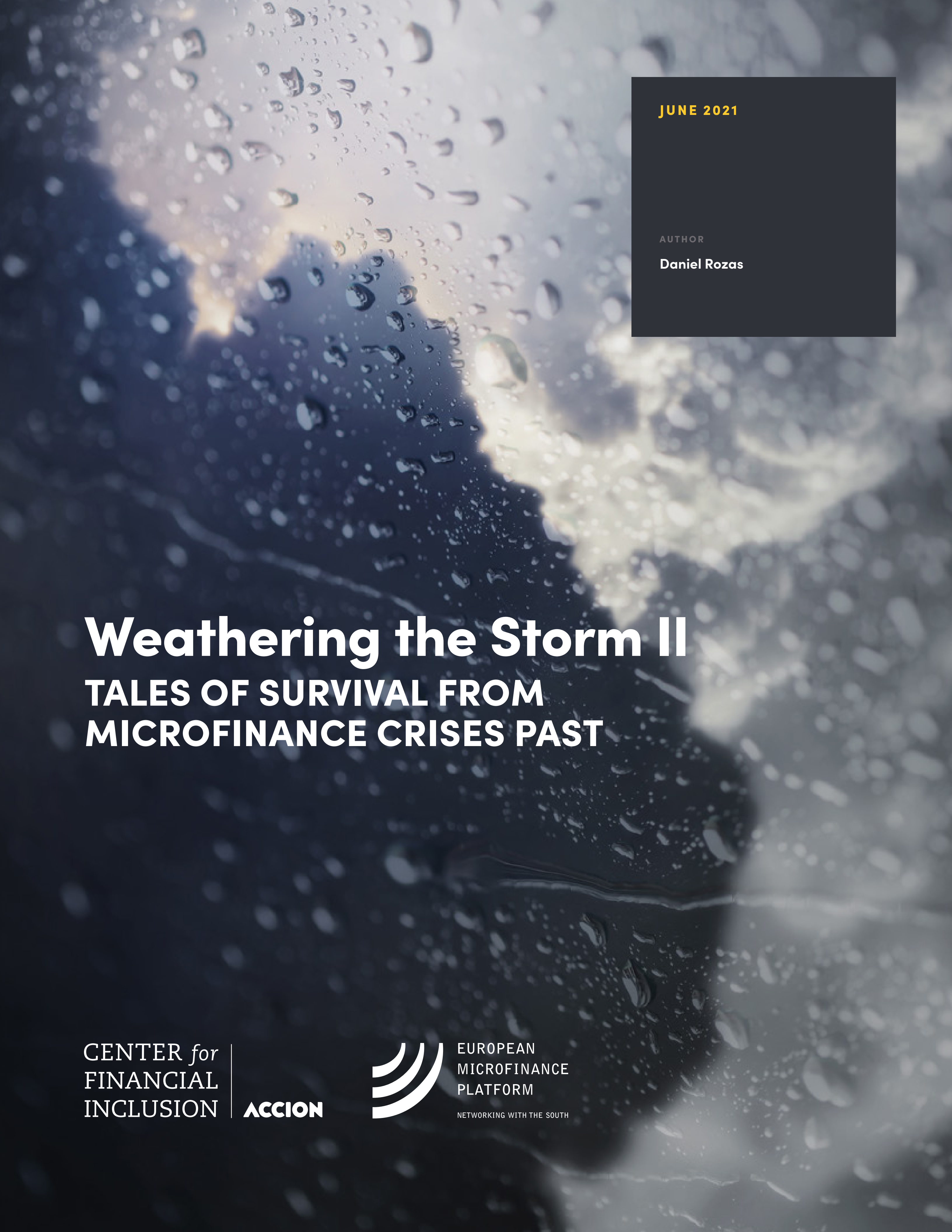

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AUTHOR

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Weathering the Storm II

TALES OF SURVIVAL FROM MICROFINANCE CRISES PAST

CENTER *for* FINANCIAL INCLUSION | ACCION

EUROPEAN MICROFINANCE PLATFORM

NETWORKING WITH THE SOUTH

It is not the strongest that survive, nor the most intelligent, but the ones who learn to adapt.

— LEON MEGGINSON, INSPIRED BY CHARLES DARWIN

Acknowledgments

Weathering the Storm was conceived over a decade ago, when Elisabeth Rhyne, Deborah Drake, and the staff at CFI realized that the sector needed to look more closely at how MFIs stumble into crisis—and how they emerge. This new version owes its existence to both Deborah Drake and Mayada El-Zoghbi, who joined CFI just months before the world learned of the novel coronavirus. It would also not exist were it not for the support of Christoph Pausch and the entire e-MFP team that took part in the joint effort with CFI. They all recognized that the original *Weathering the Storm* was not enough and needed an update.

A very special thanks to the researchers and authors of each of the five *WTS II* case studies: Joana Afonso for her work on both Viator and Partner, Narasimhan Srinivasan for his work on Spandana, Shradha Modi for her work on Vitas Palestine, and Garrett Jaso for his work on Financiera FAMA.

Thanks to all the reviewers who shared their insights and feedback: Deborah Drake, Garrett Jaso, and Shradha Modi of CFI, and Sam Mendelson of e-MFP. And likewise, thanks to Ezra Mannix and Lauren Braniff at CFI and Camille Dassy and Niamh Watters at e-MFP who helped spread the word and make sure that the messages and lessons of *Weathering the Storm* reached those who could benefit from them.

But above all, a deep and abiding thanks to the MFI managers who never shied from sharing their most difficult moments and greatest successes: Aynur Aliyeva of Viator, Senad Senanovic of Partner, Alaa Sisalem of Vitas Palestine, and Victor Tellería of FAMA; and also Zhanna Zhakupova of ACF and Roshaneh Zafar of Kashf. Along with the managers, a big, hearty thanks to those who supported them during crisis, including investors and other partners who shared their perspectives, as well as those who chose to keep the names of their institutions anonymous. Each of them shared openly and without hesitation their experience and lessons for the benefit of all, and for that we are grateful.

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Center for Inclusive Growth

Foreword

Back in 2010, in the near aftermath of the global financial crisis and several market-level crises within the inclusive finance sector, the Center for Financial Inclusion (CFI) commissioned a paper on how and why institutions fail. It envisioned pulling together case studies of how different MFIs had weathered (or not) crises of various types and, from these initial 10 cases, create a framework for how institution-level crisis management should be conducted. That paper, authored by Daniel Rozas, was called *Weathering the Storm*, and the ideas within it remain as relevant today as they did back then.

But a new crisis exploded last year, one unprecedented in its breadth and depth and which continues to pose critical challenges to financial institutions of all sizes and everywhere. And so, we spotted a need and opportunity to update *Weathering the Storm*: to look at the decade that followed the original paper, to see what became of the organizations profiled within it, and how they're facing the COVID-19 crisis. We also added five new case studies, with researchers digging into primary source data and speaking with managers and investors. In doing so, the two supporters of this project, CFI and the European Microfinance Platform (e-MFP), wanted to ensure that the lessons from crises both past and present are set down for the future.

This paper that has emerged—*Weathering the Storm II: Tales of Survival from Microfinance Crises Past*—is a unique piece that ambitiously expands on what the original accomplished. *Weathering the Storm I* set out to focus on the cause of several organizations' failures. But it was throughout that research that it became clear that focusing too much on the signals that led up to their crises—how to *fail*—risked neglecting the key element of how to *survive*. This became the third section of the original *Weathering the Storm*—the "life rafts"—which became an important resource for MFIs facing crises in the years since.

Weathering the Storm II expands further on this life rafts rubric. What has emerged guides the reader through a Maslow-type hierarchy of crisis management needs, from liquidity to confidence to portfolio and capital—a path up the notional pyramid that can help institutions understand how to distinguish the critical from the merely important; to separate the needs from the wants.

We at CFI and e-MFP are extremely proud to have supported this paper and we're confident it will, like the original, provide a wealth of ideas and guidance to institutions facing all sorts of challenges down the track. We are enormously grateful to everyone who has contributed to it, but especially to its lead author, Daniel Rozas, for his efforts and insights to pull this all together so well.

Mayada El-Zoghbi
Managing Director,
Center for Financial Inclusion

Christoph Pausch
Executive Secretary,
European Microfinance Platform

Executive Summary

What does it take to survive a crisis? Resourcefulness, adaptability, perseverance; the adjectives are plenty, but none can rival experience, which stands above the rest. Thankfully, crises are rare, but that comes with a downside—when faced with crisis, few people have prior crisis experience to draw upon. For that, there is an alternative: learn from the experience of others.

Weathering the Storm II brings together the experience of sixteen different institutions that dealt with crisis and makes it available to all. These case studies come from 14 countries on four continents, including nearly every type of institution—from NGO to bank. The cases span a period of over 15 years—with the earliest crisis dating back to 2004. The crises they faced were caused by both internal and external problems; sometimes both. Whether it was fraud or massive currency devaluations, unsustainable growth, or political interference, nearly every *Weathering the Storm (WTS)* institution went through a period where its survival was at stake. Most found a way forward, not only surviving the ordeal but even finding a path to true prosperity; others were not so lucky, experiencing the bitter taste of failure.

What are the main lessons in crisis survival from these institutions? Chief among them is separating the critical from the merely important—and prioritizing accordingly. Managing liquidity in the midst of crisis stands before all; after all, for financial institutions, the quickest path to failure is running out of money. Even so, managing liquidity is not the same as hoarding cash; that cash must be put to use—to retain the confidence of key stakeholders. That means paying staff, providing loans to reliable customers, and ensuring the trust of those who provide the funds: depositors, whose withdrawal requests must be honored at all costs, and creditors, whose confidence can be retained by negotiating credible debt rescheduling and restructuring solutions when needed.

Weathering a crisis requires a level-headed approach to managing a loan portfolio. Loans will fall delinquent, sometimes to unimaginable levels—*WTS* cases include financial service providers (FSPs) that saw their long-term delinquencies surpass 60 percent, yet they still managed to survive and eventually thrive. One common theme among survivors is that shrinking portfolios is practically inevitable and should not be avoided, though continuing to lend to reliable customers during even the hardest days and actively seeking out new borrowers is no less crucial. Managing a portfolio during crisis also means focusing seriously on overdue collections, providing repayment flexibility to struggling clients, and being persistent with those who can pay. After all, recovering payments on overdue loans provides one of the most efficient means to protect capital, which is needed not only to ensure solvency, but also eventual recovery.

These lessons in effective crisis management are not limited to financial institutions. Most successful crisis turnarounds involve flexibility and coordination among creditors. Regulators likewise play an important role, be it providing appropriate forbearance or stepping in to take more direct action when necessary. And equity investors have a crucial role during the recovery phase, not waiting until the waters have calmed completely, but providing growth capital as soon as the affected institutions have stabilized and are ready to embark on full recovery.

Weathering the Storm and its accompanying case studies offer a wealth of lessons in effective crisis survival. The best crisis is the one avoided, but when that's not an option, *WTS* is an opportunity to learn from the experience—and the mistakes—of those who have gone before.

The Crisis Case Studies

The case studies comprising *Weathering the Storm* were researched over two periods: during 2010 (*WTS I*), and during 2020 (*WTS II*). The oldest of these dates back to 2004, while the most recent was a crisis that began in 2018. A few of the *WTS I* case studies also include updates from 2020, covering the decade following the initial crisis.

Most of the case studies in *WTS I* were anonymized to protect the confidentiality of contributors. With the permission of current management, several of these have been disclosed, with the original pseudonyms in parentheses, to facilitate reference to the original cases. The names of others remain anonymized, using the same pseudonyms as in the original publication.

The full case studies can be found by clicking the header links in the table below. For reference, a summary of each is provided.

Weathering the Storm II — Case Studies

Financiera FAMA, Nicaragua

Driven by a mix of economic pressures, excessive credit, and political opportunism, the "No Pago" ("Don't Pay") movement in Nicaragua in 2008 is a major milestone in the history of microfinance. In response, FAMA's management refocuses operations on its core customer base: microfinance clients borrowing small loans. It separates the operational roles of sales and client assessment and secures liquidity support from key investors. By 2011, recovery has begun, but the cost is substantial, with FAMA eventually writing off 18 percent of its peak portfolio.

Partner, Bosnia and Herzegovina

One of the leading MFIs on the eve of the microfinance crisis in Bosnia in 2009, Partner reacts quickly to the unfolding recession, slowing its disbursements in light of decreased demand and repayment capacity among its clients. Reacting to the large increase in excess liquidity, Partner repays some of its creditors early. It also aggressively writes off uncollectable loans. In three years, its loan portfolio shrinks by 55 percent, but Partner's operations are stable. For the next decade, it grows slowly, but with a struggling economy, Partner does not reach its pre-crisis peak.

Spandana, India

When the Andhra Pradesh government shuts down the microfinance sector, Spandana is the second-largest MFI in the state, where it has 50 percent of its $700-million portfolio. Its largest creditors lobby the central bank to allow Spandana to enter into a corporate debt restructuring (CDR), which it completes 11 months later, through which its 48 creditors receive a mix of loan extensions and a convertible note, and Spandana begins its long recovery. By 2017, it receives capital from a private equity fund that also buys out the remaining CDR holders. Two years later, Spandana completes a successful IPO, marking one of the most remarkable turnarounds in the history of microfinance.

Viator, Azerbaijan

One of the smaller MFIs in Azerbaijan, Viator is hit by the sudden shock of a 25 percent devaluation in the country's currency. In response, Viator shifts into local-currency lending, but a second devaluation later that year throws the economy into full-blown crisis. Viator struggles with 74 percent of its portfolio overdue by more than 90 days a year into the crisis. With help from a crisis management consultant, Viator reorganizes its collections process and develops a new product—a jewelry-backed loan. With its creditors entering into a loan restructuring agreement, Viator continues to operate, but at great cost, with its portfolio shrinking by 87 percent from its pre-crisis peak.

Vitas, Palestine

Operating in an environment that's regularly buffeted by political and economic crises, Vitas is not new to crisis management. So in 2018, when the salaries of civil servants were delayed and then cut by 20 percent, Vitas knew what to expect. With portfolio quality declining rapidly, it set aside its prior growth plans and refocused its attention on managing liquidity, improving portfolio quality, and controlling operational costs.

Weathering the Storm I — Case Studies

Asian Credit Fund, Kazakhstan
"Sailing the High Seas"

A "missing middle" MFI with exposure to real estate is hit by a major economic downturn. With client incomes on a steep slide and home prices collapsing, its portfolio goes into a tailspin. Its "missing middle" market is damaged for years. Undeterred, the MFI pivots 180 degrees, throws out its old business model, and dives head-on into rural group lending. And it pays off. Within two years, the MFI successfully transforms itself into a rural group lender, emerging from the crisis with fewer than 100 "missing middle" clients and just one loan officer to serve them.

A decade later, ACF has nearly 30,000 mostly rural clients and a portfolio that's 2100 percent larger than it was at the end of 2010.

Kashf Foundation, Pakistan
"When Agents Strike"

In an environment of intense competition, Pakistan's foremost MFI accelerates its growth. Its group leaders adopt the role of commission agents and multiple lending becomes rampant. When a local politician advocates waiving the loans of a group of borrowers, he sets off a non-payment wave that quickly spreads across the region. Within months, some 80 percent of borrowers stop paying. Kashf pursues a dual strategy: establishing Kashf Bank to serve SME and middle-income customers, while Kashf Foundation refocuses on its low-income rural clients.

Despite provisioning for more than half of its portfolio and even dipping into insolvency, the Foundation rebuilds itself from a traditional group-lending model into a client-centric individual lending model. It expands its offers of non-financial support services for clients, building an institution that's globally recognized for its emphasis on social performance. Its sister company, Kashf Bank, is sold to a consortium of investors and currently operates as FINCA Bank.

Belavoda, SE Europe
"The Crowded Kitchen"

When the economic crisis gathers force, the MFI's portfolio weaknesses are revealed, and delinquency rises steeply. It does not take long to violate the many financial covenants of its 12 creditors, resulting in the freezing of all new disbursements and threatening a liquidity crisis when the next batch of principal payments come due later in the year. The CEO and board chairman sit down with the MFI's 12 creditors to begin talks on rescheduling. Though most lenders recognize the issues at stake, the different personalities involved and the necessity of reaching a unanimous decision make the process far more difficult than expected.

As midnight nears, the rescheduling agreement is reached. Belavoda also receives an additional equity injection from its largest shareholder. However, the crisis is not over. During 2010–15, Belavoda's portfolio remains depressed, delinquencies high, and staff turnover at nearly 50 percent. With new management appointed in 2015, the MFI finally executes a turnaround and embarks on a new phase of growth.

Artemis, Ghana
"The Run that Wasn't"

A badly and fraudulently managed depository MFI is found to be insolvent and is taken under conservatorship by the regulator, while management and board are replaced. An external consultant is brought in to assess the situation and is later hired as interim CEO. During the turnaround, the MFI overhauls internal processes, reduces cost basis (including staff and expense reductions), implements a loan recovery process, and embarks on a new lending strategy (a shift from individual to group). Throughout the far-reaching restructuring, the MFI is able to maintain client confidence and thus successfully stave off a bank run by its depositors.

Following the turnaround, Artemis continues operations for another nine years, but due to unknown reasons, the regulator withdraws its license in 2019.

Phaethon, Morocco
"The Dangerous Race"

A leading MFI wants to be #1. Undeterred by its already overextended systems and an overheated market with 40 percent of clients holding multiple loans, this $30 million organization embarks on a two-year growth of 570 percent. This cannot last, and soon enough, delinquencies balloon, forcing a write-off of one-quarter of the portfolio. Unable to absorb the losses, the MFI announces that it will declare bankruptcy, thus threatening the stability of the entire sector. To avert a market meltdown, the Moroccan government engineers a merger with Eridanos, Phaethon's erstwhile competitor.

Despite Phaethon's problems, Eridanos gains significant value from the acquisition; five years later, its senior management includes several of Phaethon's original staff.

FuegoNord, Nigeria
"Tale of the Shrinking Star"

A depository MFI is founded by a Nigerian expat entrepreneur with no experience in banking or microfinance. The MFI grows rapidly in the context of an overheated market with little regulation. Internal processes are weak; board governance is ineffective. The MFI goes through two cycles of crisis and restructuring, each time shrinking the portfolio as it rebuilds. The MFI also invests large portions of its equity in real estate and the stock market. When the financial crisis hits Nigeria and its deposits start flowing out, the MFI shrinks its portfolio to nearly zero, and is eventually closed after failing to secure new equity.

Loki, SE Europe
"The Invisible Pyramid"

A promising MFI led by a widely respected CEO gains a new investor and sets off on a rapid growth path, funded entirely by foreign loans. But the growth is a mirage created by a con artist who is building the microfinance equivalent of a Madoff fund—much of the MFI is a Ponzi scheme, so masterfully executed that it remains undetected even after three portfolio audits. Once the full scale of the fraud becomes known, investors decide to liquidate the organization.

Weathering the Storm I — Mini Cases

PADME, Benin
"The Beacon of Law Goes Dark"

An MFI's plans for transformation run afoul of the government's wishes to retain control. Using trumped-up charges, the government effectively nationalizes the institution.

ShoreBank, USA
"Caught in the Great Storm"

A low-income bank with a residential mortgage portfolio falls victim to the housing crisis and subsequent recession, and is closed.

Bank Dagang Bali, Indonesia
"The Price of the Prodigal Son"

One of the first modern MFIs becomes insolvent when a set of insider transactions by the founder's son goes bad. It is subsequently closed and liquidated by the central bank.

Unpublished case[1]

A young, locally dominant NGO MFI struggles to compete when one of the country's largest institutions opens branches in the region and begins to lend to the same clients. The MFI tries to adapt to the new competitor's methodologies, but misses crucial controls, and within months finds itself dealing with rapidly rising delinquencies. As losses begin to exceed its equity, it tries to maintain liquidity by withholding payments to some creditors, even as it continues to pay others. The resulting loss of trust with creditors becomes irreparable, bringing lawsuits and, ultimately, collapse.

1 Research conducted as part of *WTS I*, but the case study was never published by request of the organization.

Introduction

When an institution finds itself in severe crisis, it's normal to panic. As delinquencies mount, staff morale declines, and investors start calling and demanding answers, managers can be forgiven if they pine for the simplicity of the OMS—the Ostrich Management System. There is nothing quite so calming as sticking one's head in the sand while the world goes crazy.

It's exactly for such moments that *Weathering the Storm* is intended. So take a breath, shut the door, hold the calls, and immerse yourself in the stories of your predecessors.

Imagine yourself as Spandana's founder Padmaja Reddy in her office in Hyderabad, Andhra Pradesh, on Oct 14, 2010, suddenly learning that half of her branches can no longer legally operate, then watching 49 percent of her portfolio go up in smoke, most of it never to be collected. Or put yourself in the shoes of Aynur Aliyeva, still settling into her new role as acting CEO of Viator, Azerbaijan, as she wakes up on the morning of Feb 21, 2015, to learn that her country's currency had just lost 25 percent of its value—and then, after nine months of intense work to help Viator's clients adjust to the resulting economic hardships, watching it be cut again, to just 50 percent of what it had been less than a year before. Or maybe you identify with Victor Tellería, CEO of Financiera FAMA in Nicaragua, who in early 2008 watched as groups of MFI borrowers began putting up barricades in the streets, shouting, "No Pago!" ("Don't Pay!")—a chorus that soon gained the vocal support of the country's president.

All three of these cases featured major market-wide crises that ended in the failure of multiple institutions, large and small alike. Yet all three managers—Reddy, Aliyeva and Tellería—managed to navigate them and survive, and in some cases, even thrive. Spandana marked the 10th anniversary of the Andhra Pradesh crisis with a highly successful IPO. Nor are these three cases unique. Among the fourteen *WTS* cases where turnarounds were attempted, eight succeeded.[2] In short, even among the hardest-hit institutions, survival is not only possible, but likely.

This paper and its accompanying case studies are meant to guide institutions seeking to survive and successfully recover from a crisis, regardless of what caused it: external forces, internal problems, or both. Whether you are a manager, investor, regulator, or other stakeholder of a financial service provider caught in a crisis, you can learn from the experience of those who have faced similar challenges.

Financial Institutions' Hierarchy of Needs During Crisis

Crises are like snowflakes—no two are alike. Surviving a crisis requires plenty of invention and adaptation to the peculiarities of both the crisis and the organization facing it. In other words, there is no off-the-shelf methodology that guarantees success. Even so, like those same snowflakes, crisis management follows a surprisingly consistent structure that can guide a number of clear dos and don'ts for financial service providers (FSPs) dealing with crises.

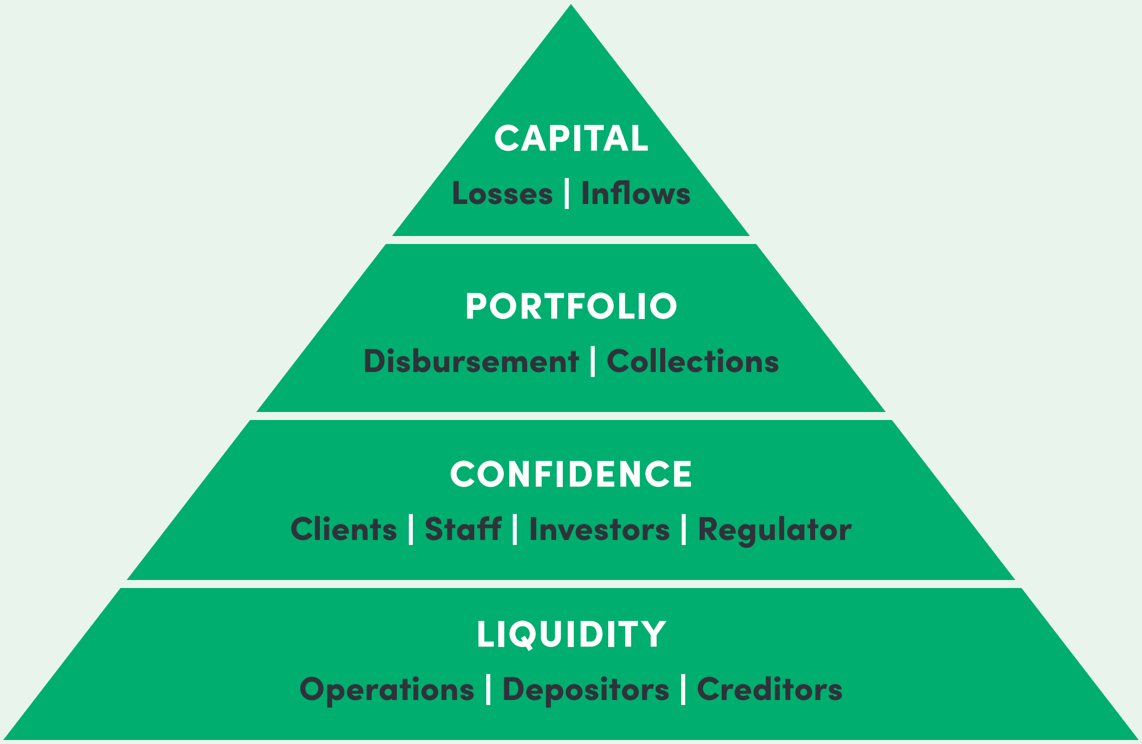
Big crises often feature multiple things going wrong at the same time. To manage them effectively, one must prioritize. To help guide the response and set the appropriate priorities, *WTS* uses a hierarchical framework: The Financial Institution's Hierarchy of Needs During Crisis (Figure 1).

The hierarchy starts at the bottom and rises upward. Thus, liquidity gets priority, then confidence, portfolio management, and ultimately, capital. Each of these categories is likewise subdivided into its key elements, which

2 Two organizations, BDB and Loki, were closed following the discovery of massive fraud.

FIGURE 1

The Financial Institution's Hierarchy of Needs During Crisis



are also prioritized from left to right. For example, when managing confidence, clients come first, then staff, investors, and ultimately regulators. These are not hard-and-fast rules and there are certainly cases where priorities may need to follow a slightly different order, but this hierarchy should work in most cases, even where it may seem counterintuitive.

For example, after assuring immediate liquidity, the key objective of an institution in crisis is to stabilize the situation, regardless of how many bad loans it may have on the books. Once stability is achieved, an institution can start on the path to recovery, but this cannot be achieved without retaining the confidence of clients, staff, investors, and the regulator. Retaining that confidence often requires taking well-considered risks; for example, continuing to lend even when the natural reaction is to hoard and protect whatever precious resources remain. Like a ship in a storm, sometimes the safest course is to face the waves head-on, rather than trying to outrun them.

Though the different hierarchies should help in prioritizing decisions during a crisis, they also have important feedback effects. For example, maintaining the confidence of investors is crucial for institutions that need to reschedule or restructure their debt, thus ensuring liquidity. Similarly, having a strong capital position at the start will help maintain the confidence of both investors and regulators as the crisis unfolds. And sustaining an active lending program during even the most difficult months of crisis can greatly contribute to maintaining the confidence of clients. In short, although the hierarchies help prioritize the response, the inter-relationships and feedback effects between different aspects of the response should not be ignored.

The following sections will explore each of the four main categories and their components that make up this hierarchy of needs. Reading through the paper, it may be helpful to refer to Figure 1 to keep track, so to help with this, a small version is included at the top of each section, highlighting the relevant category being covered.

BOX 1

At a Glance: Scale of Crisis

The eight survivors in *WTS* represent distinct situations; however, with a couple of exceptions, all would easily qualify as having experienced severe crises. Even so, quantifying severity is not simple. The most appropriate metric would be the share of loans at their pre-crisis peak that were never collected. Unfortunately, calculating such a metric requires data that's not included in financial statements. However, using different indicators, one may be able to gain some understanding of the scale of the crisis.

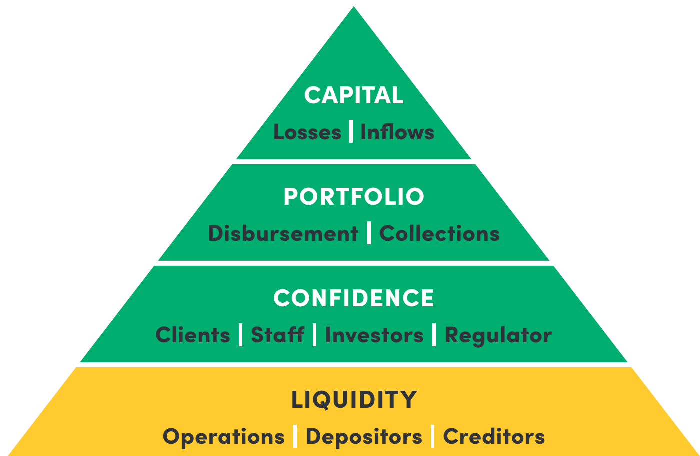
The table below uses three indicators: the highest level of PAR 90 reached in the one to two years immediately following crises. Cumulative provisions are the sum of loan loss provisions set aside during the one to five years following the crisis, including reversals. Finally, cumulative write-offs are the sum of write-offs (also including reversals) taken after a crisis, sometimes stretched over six years—and some have not yet been completed. Because provisions and write-offs are both cumulative, they are expressed as a share of the peak pre-crisis portfolio.

By various measures, it would seem that Partner and ACF probably had the mildest forms of crisis, though even that is probably excessively loose; few FSPs would see a PAR 90 of 27 percent as "mild." At the other extreme sit Kashf, Spandana, and Viator. All have at least one downright shocking indicator. Over the two years following its crisis, Kashf provisioned for 85 percent of its pre-crisis portfolio. For Spandana, the scale of pain is clear from a PAR 90 of 62 percent reported two years after the crisis, a number eclipsed only by Viator, which during its second year of crisis reported 74 percent of its portfolio as more than 90 days delinquent.

	MAX PAR 90	CUMULATIVE PROVISIONS*	CUMULATIVE WRITEOFFS*
Partner	10%	8%	11%
ACF	27%	4%	11%
Financiera Fama	13%	20%	18%
Belavoda	27%	21%	26%
Kashf Foundation	n/a	85%	n/a
Spandana	62%	n/a	22%
Viator	74%	36%	23%

* Share of peak portfolio.
Vitas excluded due to recency of crisis (2018).
Data from World Bank MIX Market and FSP annual reports.

1 Liquidity



When it comes to liquidity, three channels truly matter: funding operations (mainly staff), honoring deposit withdrawals, and having the funds to pay creditors. These likewise follow an order of priority. If an FSP cannot pay its staff, nothing else matters. Close behind in terms of priority is not being able to pay depositors seeking to withdraw; nothing kills a financial institution faster than a bank run. However, the question of liquidity towards creditors is much more complicated. Institutions facing liquidity challenges often receive agreements from creditors to reschedule or restructure their debts. In many respects, when it comes to liquidity for repaying creditors, what really matters is maintaining the confidence of those creditors, which of course means honoring whatever agreements are reached.

LIQUIDITY CHALLENGES

FOR OPERATIONS

- Rare, but can be catastrophic if not met
- Alleviated by staff missing bonus targets due to crisis
- Can be alleviated by layoffs, branch closures, etc.

FOR DEPOSITORS

- Rare, but can be catastrophic if not met
- Associated with bank runs, often triggered by monetary crisis or loss of confidence in the FSP or its peers

FOR CREDITORS

- Most common, especially for credit-only FSPs
- Aggravated by short maturity loans and technical defaults
- Can be alleviated by shrinking the portfolio; severe cases require debt rescheduling/restructuring

Liquidity for Operations

A situation where an FSP is unable to fund its operations is very rare. None of the institutions among the 16 case studies—including those that failed—came to a point where they were unable to pay staff. However, another study describes one such case: SOMED in Uganda, where field staff, after not being paid, pocketed whatever borrower repayments were still coming in, before quitting their posts altogether.[3]

One reason that operational illiquidity is rare is because FSPs can take multiple steps to delay it. The most common of these happen automatically: most FSPs have some portion of staff compensation based on a combination of growth and repayment targets. When those targets go unmet because of the low or negative growth and high levels of delinquency that define crises, it automatically results in lower operating costs. This was precisely the situation at Vitas Palestine, where the increase in PAR 30 during the crisis led to lower staffing expenses and aided the management efforts to lower costs. That said, if the variable portion of compensation is too high, it may backfire by undermining staff confidence.[4] This was the experience at Belavoda (see "Staff confidence" in the following section).

When such automatic cost reductions are not enough, laying off staff and closing branches is a common response. So is reducing disbursements of new loans. However, such actions can also undermine the organization's recovery, and should therefore be pursued as part of a larger recovery strategy, and not solely as a means to preserve cash. This was the experience at FuegoNord, where poorly executed staff layoffs and branch closures led to a loss of client confidence, triggering a bank run in some branches (see "Liquidity for depositors" below). In another example, Kashf suspended disbursements in reaction to a repayment strike, but the result both deepened and lengthened the repayment crisis (see "Client confidence" in the following section).

For this reason, it is important to maintain a sufficient liquidity buffer to sustain operations for a significant period, even when inflows from portfolio repayments are minimal. The COVID-19 pandemic tested this perhaps more than any other crisis in recent memory. Institutions operating in countries that instituted mandatory loan repayment moratoria were faced with the challenge of continuing operations for many months, even as inflows from portfolio repayments were nearly entirely stopped for multiple months. But those that had maintained a sufficient cash buffer have nevertheless been able to manage reasonably well. Most FSPs can do this—the CGAP Global Pulse Survey conducted during the pandemic in July 2020 found that 78 percent of institutions polled had cash on hand to cover at least six months of normal operating costs.[5] This is a good minimum liquidity level to ensure reasonable crisis preparedness, in addition to the specific minimums required for deposit-taking institutions.

At Vitas Palestine, the increase in PAR 30 during the crisis led to lower staffing expenses.

Liquidity for Depositors

Insufficient liquidity for depositors is rare, though when it does happen, it can be catastrophic. One reason is that deposit-taking FSPs typically must meet stringent liquidity thresholds set by regulators. As a result, they tend to enter crises with high levels of liquidity.

Looking at both the 2008–09 financial crisis and the COVID-19 pandemic shows that sudden outflows of deposits are rare. On the contrary, a crisis often tends to have the opposite effect, with more deposits flowing in than flowing out. This was the experience of First Microfinance Institution—Syria, which discovered that demand for deposits increased amid civil war, as the risk of keeping cash at home grew.[6]

3 Rozas, Daniel. "Throwing in the Towel: Lessons from Microfinance Liquidations." Self-published, 2009.

4 The Smart Campaign's Client Protection Principles Indicator 2.5.1.3 states: "If loan officer salaries are comprised of a fixed and a variable portion, the fixed portion must represent at least 50 percent of total salary and it must constitute a living wage."

5 Zetterli, Peter. "Is There a Liquidity Crisis Among MFIs, and If So, Where?" CGAP. 16 July 2020.

6 Mendelson, Sam. "Resilience and Responsibility." 6th European Microfinance Award: Microfinance in Post-Disaster, Post-Conflict Areas and Fragile States, e-MFP, Luxembourg 2015.

There are two paths to illiquidity for deposits: loss of client confidence and monetary crisis.

Part of the explanation comes from the lopsided structure of most FSP deposits, where the vast majority of customers have small accounts that make up for only a small part of total deposits. Thus, even if a crisis were to push a large number of these small clients to withdraw their deposits to meet day-to-day spending needs, this is unlikely to put significant financial pressures on liquidity,[7] though honoring a high level of withdrawals may sometimes pose an operational challenge, especially during crises that reduce mobility and available staff.

Another part of the explanation is that during crisis—economic, political or some other—investment slows down, and those larger depositors who typically make up the bulk of an FSP's deposits are more likely to keep those deposits in the FSP rather than withdraw to fund spending and investments in their business, household, or major consumer goods. One important exception to this is when those depositors lose confidence that their money is safe. This may happen when there is a public loss of trust in either the institution itself or in the segment of the financial sector to which the FSP belongs. While the crucial element in such cases is to maintain the confidence of deposit clients (see "Client confidence" in the following section), when such confidence is even partly lost, it's crucial to have the liquidity to meet whatever withdrawal demands are made, thus demonstrating that the institution can be trusted and putting an early end to a bank run.

The experience of FuegoNord shows how such a situation may unfold. The institution's crisis took place in the context of the collapse of other deposit-taking MFIs in Nigeria. So when FuegoNord's former staff, laid off from branches it had suddenly closed, began telling customers that the MFI was not trustworthy, many clients quickly queued up to withdraw. And while management was able to meet just enough withdrawals to avoid an all-out bank run, the cost was very high, and the institution never recovered. It was a perfect demonstration of the feedback effects during crisis: the loss of staff confidence leading to the loss of client confidence, ultimately resulting in a severe loss of liquidity.

The other path to a deposit-driven liquidity squeeze is via a monetary crisis. While none of the *WTS* case studies experienced such a situation, throngs of customers lining up to withdraw deposits is a common feature in countries whose currency is losing value or is seen as unstable. Ironically, such situations are more likely to develop in countries with fixed-exchange regimes that too often breed complacency, for both FSPs and their clients. Deposit-taking FSPs must therefore resist the temptation of such complacency and pay particular attention to the macroeconomic trends that might make a currency crisis more likely. Should the risks of such a crisis increase, they must prepare accordingly, for example, by reducing reliance on local currency deposits or by increasing liquidity.

Liquidity for Creditors

Repaying creditors is the third and most common channel by which an institution may suffer a liquidity crisis. Luckily, it's also typically the easiest to solve, so long as the institution manages to maintain investor confidence.

In at least five cases in *WTS*, the liquidity squeeze—or the threat of one—stemming from having to repay creditors was a critical factor in the crisis. The solutions varied: some of FAMA's investors stepped in to replace those seeking to exit; Viator's investors worked together to draft an inter-creditor agreement that restructured its debts; Spandana was able to use formal corporate debt restructuring after gaining special approval from the central bank. But not all repayment crises are accompanied by a liquidity crisis; the Bosnian MFI Partner had the opposite challenge: it began the 2009 crisis with excess liquidity and had to convince some creditors to accept an early repayment.

The reason that creditor-related liquidity pressures are so common is no accident. First, nearly all debt agreements feature covenants that require FSPs to meet specific thresholds, often linked to portfolio quality, minimum capital requirements, and other

7 Rozas, D. and Mendelson, S. "Keeping the Blood Flowing: Managing Liquidity When Clients Need Deposits." April 20, 2020, covid-finclusion.org.

BOX 2

Are Women Better at Managing Crises?

Among the 16 case studies in *WTS*, most leaders were men. And yet, among the survivors, half of the leaders are women. Indeed, all women-led institutions survived, including the three most extreme cases of survival—Spandana, Viator, and Kashf. Is there something that makes organizations with women leaders more likely to survive extreme crises?

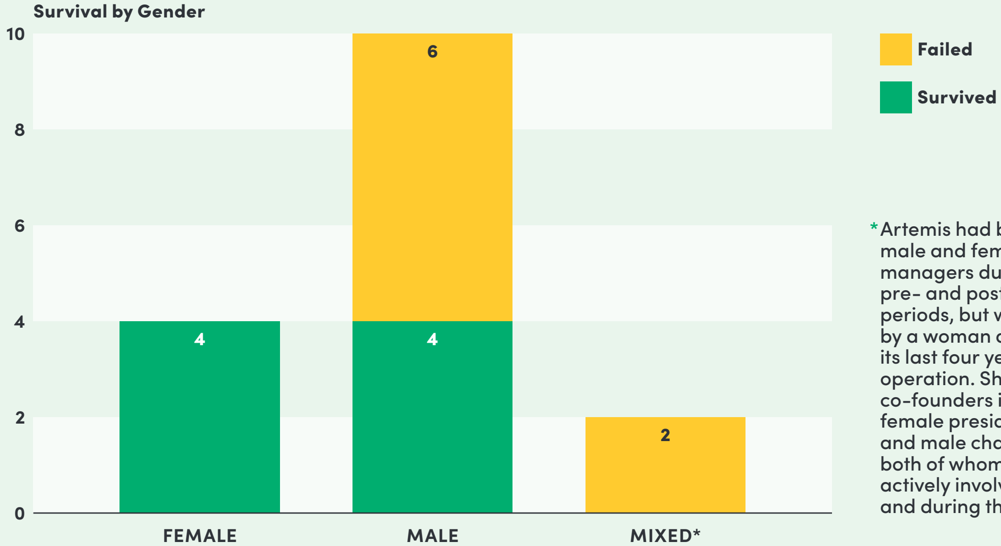
Put differently, are there qualities among male leaders that make them more likely to fail? After all, among the male-led failed MFIs, several were not so different from the survivors. Phaethon suffered losses approaching 30 percent of its peak portfolio, but it had lots of well-trained and motivated staff, and a large portion of its operations were sound. Was its leader too preoccupied with becoming #1 in the country, and subsequently unable to acknowledge his errors and make the necessary changes needed to survive?

FuegoNord's situation going into crisis was not catastrophic, but it floundered for two years, unable to implement a crisis management strategy. Its leader had insufficient experience, but was he also unable to recognize that and bring in a manager who might have been better placed to implement a turnaround?

What about PADME, which was brought down not by its operations, but by its founder's failure to recognize—or at least act to avert—the growing dissatisfaction that its political overseers had with the MFI's plans to transform into a for-profit entity?

This isn't a critique of male leaders. The heads of Partner, FAMA, Vitas, and Belavoda all showed traits that were similar to those of their female counterparts in other case studies. Nevertheless, even this small sample suggests that at least some male leaders are less able to acknowledge their mistakes or recognize inadequacies—crucial ingredients for an institution struggling to survive a crisis.

Survival by Gender



*Artemis had both male and female managers during its pre- and post-crisis periods, but was led by a woman during its last four years of operation. Shorebank's co-founders included a female president/CEO and male chairman, both of whom were actively involved before and during the crisis.

financial performance indicators. Because they are meant as early warning indicators, even a mild crisis is likely to breach many of these covenants, often in the first few months. This is magnified by the nearly ubiquitous cross-default provision, which holds that a default to any one creditor is equivalent to a default to all. These defaults, in turn, give creditors the legal right to accelerate their loans and demand immediate payment.

Inability to pay creditors is both the most common source of illiquidity, and also the easiest to resolve.

And it's not just the technical defaults that are at issue. It's very common for FSPs to have loans from multiple creditors, most featuring relatively short maturities. Indeed, the average maturity of debt from foreign investors to FSPs is 22 months,[8] meaning that more than a quarter of these loans must be repaid every six months. Typically, investors issue a new loan once a loan is repaid, but if a crisis causes investors to pause such relending, an FSP can easily be pushed into illiquidity even without breaching any covenants.

These two features of FSP debt—rapid turnover and the presence of covenants—imply two main paths through which creditor-linked liquidity pressures are likely to impact crisis-stricken institutions.

The first path is quick deleveraging and debt reduction, accompanied by a similar decrease in portfolio size. This was the scenario faced by Partner in Bosnia, which, after recognizing early on that the country's microfinance market was entering a phase of decline, repositioned itself for reduced lending volume and proceeded to prepay several lenders to avoid the cost of excess debt that was no longer generating income. Ironically, Partner received some pushback from one social lender reluctant to absorb the prepayments and which needed some convincing.

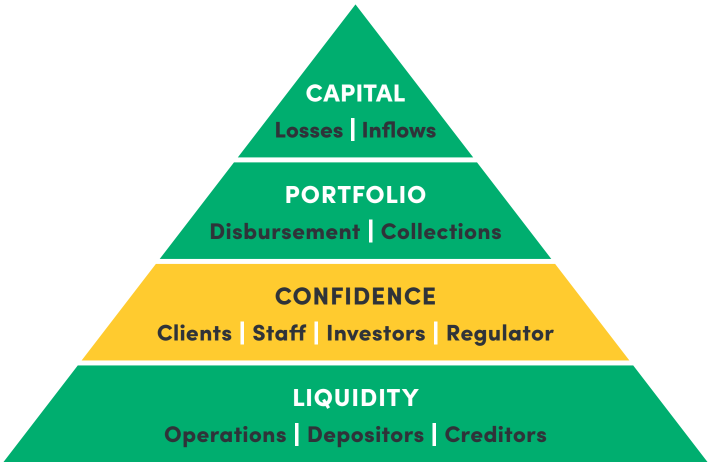
This scenario is probably more common than would appear from the *WTS* case studies. This is because the case studies are drawn from a sample of especially hard-hit institutions. Partner's situation was relatively mild, at least compared to many of its peers in Bosnia, many of which suffered far greater losses, and some of which didn't survive the crisis at all.

The second path is usually more drawn out and typically involves some type of debt rescheduling or restructuring. Most deep crises with multiple investors present involve such a scenario. Among the *WTS* case studies, Belavoda, Viator, and Spandana all went through such a process. The smallest of these, Viator, saw its 11 foreign investors come together within nine months after the full onset of the crisis to sign an inter-creditor agreement that not only extended Viator's debt maturities, but also substantially reduced its interest payments. Given the depth of Viator's struggles, its investors had little choice; less than a year into the crisis, 47 percent of its loans were overdue. However, the inter-creditor agreement allowed the company to stabilize and laid the foundation for the eventual, albeit drawn-out, recovery.

Five years earlier, at the outset of the Andhra Pradesh crisis, Spandana—at the time the second-largest MFI in India, with assets just shy of $700 million—faced a similar situation. Following a move by the Andhra Pradesh government that effectively shut down microfinance operations in the state, its portfolio there, comprising almost exactly half of its total lending, went from sub-1 percent delinquency to sub-1 percent repayment. As with Viator, Spandana's 48 creditors, mostly local banks, were left with few options. Harder still was its regulatory status, which did not allow for a formal corporate debt restructuring (CDR) process. Nevertheless, Spandana's two largest creditors, a major commercial bank and a state development bank, led a successful lobbying effort with the central bank to allow the CDR, while simultaneously negotiating a deal with the other 46 creditors. With the central bank's approval, the CDR was signed 11 months after the onset of the crisis, comprising a mix of loan extensions and a convertible note. Despite the seemingly insurmountable scale of Spandana's portfolio losses, the CDR ensured the company's survival and eventual turnaround.

8 2019 Symbiotics MIV Survey: Market Data & Peer Group Analysis. Symbiotics, 13th edition, Sep 2019.

2 Confidence



Liquidity is only the first and most immediate challenge facing FSPs in crisis. Maintaining the confidence of key stakeholders—clients, staff, investors and regulators—is not only urgent, but must be sustained for the months and years that follow. Confidence is also a complex factor; unlike liquidity, portfolio quality, or capital, it cannot be quantitatively measured.

Maintaining confidence must also be seen in the context of the crisis in which the institution is operating. If there's a country-wide financial crisis and hardly any institutions are offering loans, then doing even a little lending and with far stricter requirements than normal will inspire plenty of confidence among clients. If the economy is in shambles and job losses are rampant, staff will be happy to have their jobs, even if their pay is cut. If investors are watching their portfolios turn red and CEOs of other investees avoid sharing bad news, then the institution that's transparent about its problems will gain investor confidence. And if multiple

SUPPORTING CONFIDENCE

OF CLIENTS

- Retain confidence of depositors by paying extra attention to large accounts.
- Make withdrawal access easy for small savers—thus ensuring confidence that "money will be there when needed."
- Provide payment flexibility to struggling borrowers and always be ready to lend to reliable clients.

OF STAFF

- Ensure salaries are predictable and reasonable for a crisis environment.
- If layoffs are needed, one large round is better than multiple small ones.
- Expect to adapt staff roles and offer appropriate training.

OF INVESTORS

- Always be transparent about the challenges—and your plans to meet them.
- Don't show preference for some investors over others—especially when it comes to honoring commitments.

OF REGULATORS

- Communicate with regulators via sector association or strong investors.

financial institutions are on the brink, then regulators are likely to focus on maintaining stability and exercise greater forbearance with institutions that fail to comply with certain regulatory requirements but have reasonable plans to return to compliance in the future. In short, maintaining the confidence of key stakeholders does not mean having perfect performance, but requires instead levelheaded crisis management and transparency that recognizes the seriousness of the situation.

Client Confidence

In the middle of crisis, maintaining client confidence should be parsed into two main areas: deposits and loans; though between the two, meeting depositors' needs certainly gets priority. For depositors, the only question that really matters is whether their money is safe. For borrowers, it can mean different things: showing understanding and flexibility towards borrowers facing challenges in making repayments, continuing to maintain active collections with those who are able to pay, or continuing to provide loans to trustworthy clients who need credit and have the ability to repay.

As described in the "Liquidity" section above, crises rarely feature large levels of deposit withdrawals, but when depositors' confidence is shaken, it's crucial to ensure that those clients' withdrawals are promptly honored. However, whenever possible, it's better to act before things get to that point, especially with respect to the large depositors whose accounts comprise a meaningful share of the FSP's total deposits. This is the lesson from Artemis, where the managers responsible for stabilizing the institution proactively reached out to its largest depositors, giving them the "VIP treatment" as a way of ensuring that those funds remained in place. Indeed, during its turnaround period, Artemis not only managed to maintain its deposits, but succeeded in increasing them.

Prioritizing the confidence of savers doesn't mean the FSP can neglect the confidence of its borrowers. After all, it is the borrowers who ultimately provide the income and cash flow crucial to surviving a crisis. One key message that flows through the *WTS* project is the importance of continuing to lend in crisis. The reason this is so critical is that a key incentive for borrowers to repay is the expectation that they will be able to borrow again, especially when there is no collateral involved. And although having collateral weakens the importance of this incentive, it doesn't eliminate it. After all, while losing collateral may provide a disincentive to default, the expectation of being able to borrow again is what provides the incentive to repay.

The example is best epitomized by the experience of Kashf. When in the face of an organized repayment strike, Kashf suspended its disbursements, and in doing so, discovered the full cost of losing the confidence of its clients. After all, the repayment strike was not uniform, and some clients—especially those with only a few installments remaining—had much to benefit from repaying, as they would then qualify for the next cycle loan. So when Kashf failed to disburse those new loans, it not only disappointed the clients who had just repaid, it also strengthened the position of the leaders of the repayment strike and lent credence to the rumor that the lender's founder had died. Once it realized its error, Kashf resumed lending and eventually managed to recover, but at a high cost. At one point, over 80 percent of its portfolio was delinquent. It is very possible that, had Kashf responded immediately by emphasizing its commitment to clients and rapidly disbursing new loans to those who had repaid, it may have significantly mitigated the crisis.

A very similar situation occurred in the unpublished *WTS* case study, where the organization faced with a false rumor of the founder's death responded by reducing disbursements to nearly zero, thus confirming the very rumor they were trying to dispel. Though it too resumed lending, unlike Kashf, it never recovered. Indeed, among the eight *WTS* survivors, only Kashf ever stopped lending—even if temporarily.

For depositors, the only question that really matters is whether their money is safe.

An MFI never lends—its loan officers do. That's why maintaining their confidence is so crucial.

Borrower confidence can't be built by lending alone. Collections are just as critical a part of the client relationship. Collections are described in more detail in the portfolio management section below, but from the client perspective, the challenge during crises is that what ails the lender is also likely to be ailing the borrower. Dealing with borrowers with understanding and flexibility is therefore crucial to maintaining their confidence. That doesn't mean simply letting go of collections outright, and not only because of the financial consequences that would follow. Maintaining serious collections sends an important signal to clients that, crisis or not, the institution is there to stay.

Finally, there is the confidence from simply maintaining the relationship, checking in on clients, hearing their stories and complaints, and being their institutional support network. This was the role adopted by Vitas Palestine when the economy in the country was going through a severe shock. Its loan officers and supervisors would contact each client, find out if they needed any additional support, and referred them to NGOs or other local programs if required. They avoided asking about payments in the first call but assessed their situation during their conversations and segmented the clients based on their ability to pay. Moreover, recognizing their essential role in maintaining client relationships, Vitas focused on training its front-line staff to handle difficult conversations with clients. Such person-to-person relationships are what sets client-centric FSPs apart from the crowd and are especially valuable in a time of crisis.

Getting the balance right between lending, collections, and repayment flexibility is as much art as science, but it is a crucial part of a successful crisis response.

Staff Confidence

An MFI never lends—its loan officers do. That is precisely why maintaining staff confidence is so crucial. It only so happens that the hardest time to do that is during a crisis, when layoffs loom, compensation is squeezed, and the future is at its most uncertain. So it's not surprising that all eight *WTS* survivors found one way or another to sustain their staff's commitment.

For some, the biggest challenge is maintaining staff confidence through layoffs and attrition. For example, Viator used layoffs to cut its staffing costs by half in just one year. But by doing it quickly and retaining high-performing and experienced staff, Viator was able to reduce costs while also instilling confidence among those who remained.

Retraining and reassigning staff was another challenge. At Viator, several of the staff who remained had to receive extensive training on past-due collections that had not been a significant focus before. FAMA introduced an entirely new position of "loan promoter," who took over the responsibility of bringing in potential customers from loan officers, allowing the latter to focus on assessments. Artemis had a particularly innovative solution: after slimming down operations and selling a dozen cars, it solved the problem of excess drivers on staff by training them to be promoters of its savings products, which in turn helped maintain, and even expand, its deposits.

Assigning and retraining staff is important, but it won't instill confidence without appropriate compensation. At Belavoda, following the initial crisis in 2009, staff had to contend with the pre-crisis compensation scheme that heavily emphasized bonuses, but whose targets were far more difficult to achieve than they had previously been. The situation dragged on for five years, and with staff morale depressed, annual turnover started to approach 50 percent, holding back Belavoda's recovery. Indeed, while it managed to survive and function following the crisis, Belavoda did not meaningfully start recovering until 2015—six years later—when newly appointed management revised the staff compensation scheme and increased base salaries.

But perhaps the biggest change—and vote of confidence in staff—happened following the bailout merger of Phaethon with its erstwhile competitor, Eridanos. Despite the gross mismanagement and eventual collapse of Phaethon that had led to the merger, its new owner recognized the high skill level and motivation of many of Phaethon's staff, whom it brought on board. Several of these former staff were subsequently promoted to the top ranks of Eridanos' management team.[9] It's a testament to how, even during the depths of a crisis, an institution can recognize and encourage the best staff, building crucial confidence throughout the ranks of the organization.

Throughout all these different staff changes, a key element is management's communication with staff regarding its crisis management strategy. Staff are well placed to be aware of many of the challenges the institution is facing and will seek to learn the rest by talking to their colleagues. Trying to hide problems will only lead to more damaging rumors. Similarly, when layoffs or pay cuts must be made, it's best to do them quickly and all at once, rather than dragging them out. The latter will only lead to more anxiety and mistrust, as was the case at FuegoNord described earlier, where multiple rounds of layoffs created anxiety and led staff to undermine clients' confidence in the institution.

BOX 3

Ten Years On: Kashf Foundation, Pakistan

In *WTS I*, Kashf Foundation (anonymized as Hestia), was going through an exceptionally severe crisis, which began in 2008 as a politically organized repayment strike. During the first 18 months of the crisis, Kashf provisioned for nearly all of its outstanding pre-crisis portfolio, wiping out its sizeable equity (36 percent capital-to-assets ratio immediately before the crisis) and even sliding into insolvency. However, with the help of a one-year grace period on payments extended by its largest creditor, the Pakistan Poverty Alleviation Fund (PPAF), Kashf was able to make all other scheduled payments to creditors while increasing its overall liquidity. These difficult financial decisions early on allowed it to focus on recovery, a process that required Kashf to completely reinvent its business model.

Like most South Asian MFIs, Kashf had been a group-lending operation. To break the repayment strike promoted by many of its group leaders, Kashf switched to individual lending. This, combined with the effort to reach out to every single client to understand their situation and produce a cash flow forecast based on the estimated likelihood of repayment, put it on a path towards collecting detailed information on clients and their needs. And a better understanding of those needs led Kashf to integrate a host of microfinance-plus initiatives into its core operations: providing business development, gender empowerment, and health and education services to its clients. Along the way, the 2009 launch of Kashf Bank focused on serving SMEs and middle-income clients allowed the Foundation to refocus exclusively on the low-income women that were at the heart of its mission.

Kashf Foundation now stands as a leading MFI in Pakistan, globally recognized for its client-centric business model that uses detailed data on its clients to develop and deliver the services that respond to their real needs. Its sister company, Kashf Bank, was bought in 2013 by a consortium of investors and is now known as FINCA Bank, itself a major actor in the country's financial inclusion sector. These successes all stem from the recovery path that Kashf undertook in the early days of its crisis response, when its goal was far more modest: to survive.

9 Author's interviews with "Eridanos'" leadership in 2013–14, five years after Phaethon's collapse.

Investor Confidence

For most FSPs active in the financial inclusion sector, investors are the primary source of funding. As discussed above, debt investors are both the most likely source of liquidity pressure for crisis-stricken institutions, and also the most solvable one—typically via a debt rescheduling or restructuring agreement. However, the foundation on which such agreements rest is investor confidence.

It is, of course, possible to secure liquidity without investor consent—by defaulting on the debt. In the short run, it may even be easier than negotiating a restructuring. However, once the point of no return has been reached, the chances of recovery narrow greatly. Not only will such an action likely invite a legal process that will follow the organization for years (and which may ultimately doom the institution once it wraps up), it's likely to destroy any opportunities the

BOX 4

Ten Years On: Belavoda, SE Europe

WTS I left Belavoda in mid-crisis, with its investors having just managed to agree to a debt rescheduling agreement. But the crisis was hardly finished. Between 2009–11, Belavoda had to write off 26 percent of its peak pre-crisis portfolio.

The debt rescheduling helped Belavoda to put off the bulk of debt its payments for a year. During 2010, it paid off roughly one-third of outstanding debts. That same year, it also received a substantial equity injection from its largest shareholder, adding to capital it had received just before the crisis, in 2007–08. Together, these investor supports helped Belavoda stabilize both its liquidity and solvency.

But stability isn't recovery. Until 2015, Belavoda's loan portfolio remained about 25 percent below its pre-crisis peak, with PAR 30 hovering around 10 percent. In part, this was a result of ineffective management, which had replaced the founder in 2012, after the worst of the crisis had already passed. It was only with the arrival of a third manager in 2015 that things finally began to change.

The new team started with a focus on staff, whose low morale was resulting in turnover of nearly 50 percent. In response, the new management fundamentally changed the compensation scheme, raising base salaries and reducing bonuses, while shifting the latter from individual to team-based incentives. The result not only decreased turnover, but also allowed for major changes in its operations. With Belavoda's largest competitor simultaneously moving upmarket and leaving the microfinance segment behind, the turnaround began in earnest. By the end of 2016, PAR 30 had come down to 2 percent while its portfolio finally surpassed the pre-crisis peak eight years earlier. But 2016 did not only mark the end of the crisis; it was also the beginning of a new phase of remarkable growth. During the three years that followed, the company grew its portfolio by nearly 500 percent and its clients by 300 percent.

The crisis of 2008 had become a distant echo.

defaulting organization may have to receive future investment, without which recovery is almost impossible.

One cautionary example is the unpublished *WTS* case study. This crisis-stricken MFI was badly in need of debt rescheduling and possibly restructuring. However, poor communication with its investors led to a situation where the MFI defaulted on the debts of some investors even as it continued making payments to others. This irreparably damaged trust among the slighted investors, ultimately leading to a long-running lawsuit. Since then, the institution appears to have closed its doors, with the lawsuit still listed as pending nearly a decade later.

Another example is the case of FOCCAS, Uganda. In that instance, the international network that helped manage the institution lost the trust of several local creditors, resulting in a chaotic liquidation with different teams of liquidators acting on behalf of different investors. While it's an open question whether maintaining investor confidence would have saved the struggling institution, it likely would have led to a smoother closure, potentially even a merger that could have preserved some of the clients, staff, and existing operations. However, the distrust and infighting among the creditors prevented such an outcome.[10]

When it comes to maintaining investor confidence in crisis, one strategy stands out above all: transparency. Of the case studies in *WTS* that delved into the institutions' investor relationships, every one of the survivors emphasized transparency and did so proactively. For example, in the early days of the Bosnian crisis, Partner's CEO drafted a lengthy memo to all investors outlining the situation, the covenants likely to be violated, as well as the crisis management plan he was in the process of implementing. Because of the extensive data included in the document, the memo also served as a de facto reporting template, which Partner used for subsequent crisis reports to its investors, thus avoiding the added reporting burdens that would have come by waiting for each investor to request their own ad hoc reports.

The key to maintaining investor confidence during crisis is transparency.

In Azerbaijan, Viator's CEO went a step further. On the advice of one of its investors, she hired a crisis management consultant to help implement critical crisis management operations (described in the next section). On top of this work, the consultant also produced a report for investors, outlining both the very real challenges and the path forward for Viator. This included a cash flow forecast that the investors used to draw up their debt restructuring agreement, and then relied on to monitor how well Viator was performing over the subsequent months.

As both Partner's and Viator's experience shows, being open about the full scale of the crisis when communicating with investors is critical, along with a realistic strategy for surviving and eventually recovering from the crisis.

Regulator Confidence

The most likely scenario in which a regulator becomes involved is when a deposit-taking FSP puts its customers' deposits at risk. In such cases, regulators are likely to step in and mandate action such as replacing management, forcing a merger, withdrawing the institution's operating license, or even directly overseeing a wind-down of the institution. On rare occasions, a regulator may also take action involving a credit-only FSP. The *WTS* case studies include examples of regulatory action for both types of institutions.

10 Rozas, Daniel. "Throwing in the Towel: Lessons from MFI Liquidations." Microfinance Gateway, Sep 2009.

Maintaining regulator confidence isn't solely a strategy for avoiding bad outcomes.

In the case of deposit-taking Artemis, the Bank of Ghana, concerned by Artemis' financial soundness and the threat it posed to depositors, fired the management team, forced the replacement of the Board of Directors, and appointed one of its own staff as a conservator. The conservator in turn appointed an experienced crisis management consultant as interim CEO, tasked to turn the institution around, a task that was largely successful and kept the institution operating for the next nine years.

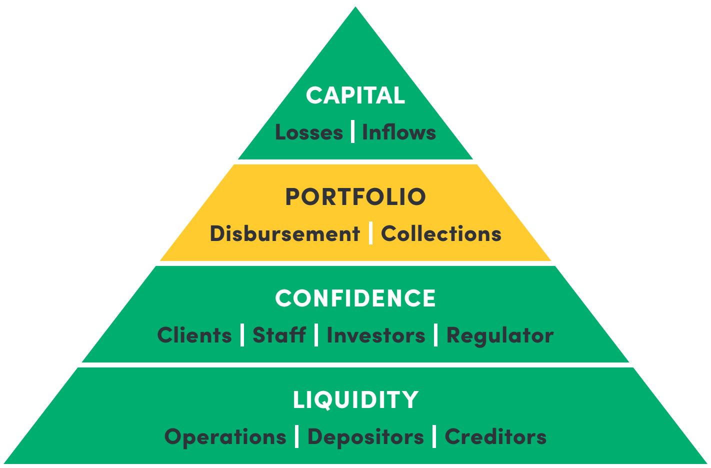
Something similar happened with Bank Dagang Bali (another deposit-taking FSP), where, after discovering a massive case of fraud committed by a close relative of the bank's founders, Indonesia's central bank revoked the bank's license and appointed a liquidator to wind down the institution.

The third example of direct action by a regulator is the case of Phaethon in Morocco. Unlike Artemis or Bank Dagang Bali, Phaethon had no deposits. However, it was Morocco's most prominent MFI, and following a period of breakneck growth, it was spiraling out of control, with widespread defaults and rampant fraud. Given Phaethon's size and prominence, there was real concern among its competitors that its public collapse would spark a far larger crisis than the one the sector was already experiencing. To head off that outcome, the country's central bank engineered its takeover by Eridanos, a leading MFI that was affiliated with a major bank, and thus had the operational and financial wherewithal needed to absorb Phaethon. While it did not end the sector-wide crisis, the merger certainly helped contain it.

These three cases—Artemis, Bank Dagang Bali and Phaethon—are all examples of FSPs losing the confidence of their regulator, thus inviting attention that no manager wants to receive, even if, as in the case of Artemis, it was to the institution's benefit. But regulators don't just play the role of enforcers or undertakers whose attention is best kept at bay. Sometimes they can provide much-needed support.

When Spandana was faced with a massive liquidity shortfall towards its creditors, it found that the regulations governing non-bank financial companies (which it was) did not allow for a corporate debt restructuring available to banks. However, Spandana, together with its leading investors and other microfinance institutions impacted by the Andhra Pradesh crisis, was able to effectively lobby India's central bank to allow non-bank financial companies (NBFCs) like itself to avail of the CDR process, which Spandana formally entered 11 months after the onset of a crisis. Indeed, India's central bank didn't stop there. Spurred by the Andhra Pradesh crisis, it created a new regulatory class of institutions—the NBFC-MFI—along with a set of rules that helped stabilize the situation for the microfinance sector in India and laid the groundwork for the next stage of its development.

3 Portfolio



During a crisis, the loan portfolio can be both the cause of an institution's demise and the path to its recovery. Indeed, both forces can be playing out at the same time, and which of the two will win may not be clear for months or even years.

Managing a portfolio during a period of crisis requires navigating the fine line between increased risk tolerance and recklessness, underpinned by a strong operational mindset and a robust monitoring capability. It also requires balanced attention to both disbursements and collections, without excessive emphasis on either. Above all, it requires accepting change, including, when necessary, reducing the size of the outstanding portfolio.

Indeed, substantial portfolio shrinkage should be an expected outcome for crisis-hit MFIs; every *WTS* survivor's portfolio shrank by at least 35 percent. The most drastic case is Viator, which, over three years, shrank its current portfolio by 87 percent from its pre-crisis peak. The shrinkage may well be long-lasting, but most of the *WTS* survivors eventually recovered and surpassed their pre-crisis peaks.

The path during and following crisis depends greatly on the broader economic context as well the resources available to the institution. One of the reasons for Partner's partial recovery is that over 2008–15, Bosnia's economy continued to struggle, contracting more than it grew. It took

MANAGING (LOAN) PORTFOLIOS

DISBURSEMENTS

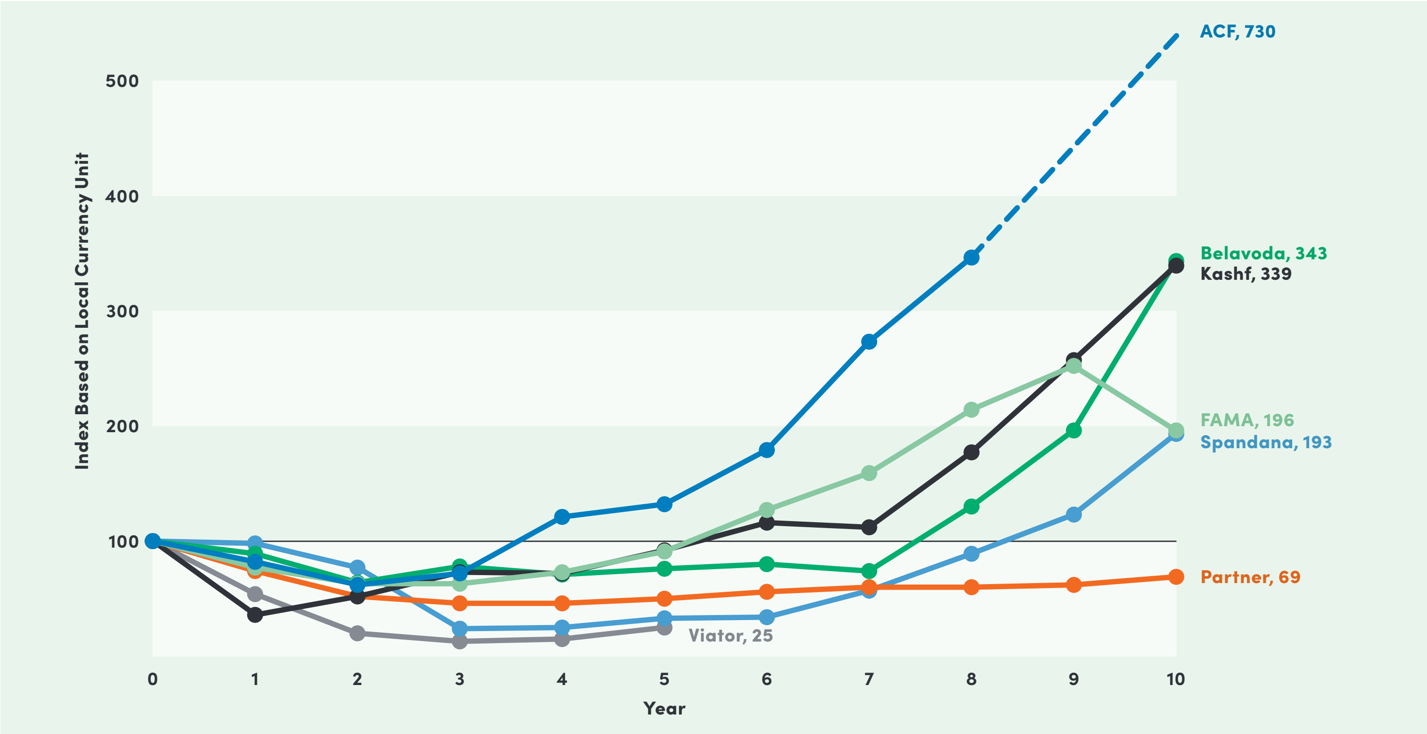
- ↗ Always continue lending to reliable clients, even during the worst periods of crisis.
- ↗ Actively seek out new lending opportunities that emerge in fast-changing crisis environments.
- ↗ Avoid "growing out of crisis" by continuing business-as-usual disbursements.

COLLECTIONS

- ↗ Ensure past-due collections operations are fully functional, supported by good monitoring and trained staff.
- ↗ Segment customers based on how much their finances were affected by the crisis.

FIGURE 2

Net Loan Portfolio (Excluding Past-Due Loans; Year 0 = Pre-Crisis Peak)



SOURCE World Bank MIX Market, FSP annual reports

a full decade, until 2018, for the country's GDP to get back to its 2008 level. Given this anemic economy and the necessary credit contraction following the massive credit bubble that had developed in the runup to the crisis, it's hardly surprising that credit demand a decade later remained lower than during the peak set in 2008.

On the other hand, the rapid recovery in Kazakhstan, with the economy growing by 7 percent in 2010 and averaging 4.5 percent over the next decade, presented ACF with real growth opportunities, especially given that the microfinance market had been largely underserved at the time of the crisis. During the first two years of crisis, ACF contracted its portfolio by 38 percent, but by year four it had already surpassed its pre-crisis peak, and by the end of 2020, thirteen years after the onset of the crisis, its portfolio stood more than fifteen times larger than its pre-crisis peak. It stands as the most remarkable recovery in *WTS*.

Despite these vast differences, what both Partner and ACF have in common is that their post-crisis growth was driven by the level of credit demand in their respective markets and not by a lack of resources. The opportunities in Kazakhstan allowed ACF to bring on board a new equity investor that provided it with the capital needed to fund its rapid growth. This is a crucial distinction because decline and growth may just as easily be constrained by internal factors, such as insufficient capital or excessive caution. In such circumstances, it is possible for an FSP to shrink too much and stay smaller and for a longer period than warranted by local market opportunities.

For example, Spandana shrank its portfolio by 76 percent over three years, then took another six years to return to its pre-crisis peak. At the time of the crisis, Andhra Pradesh accounted for half of its portfolio, so a large shrinkage was inevitable. But perhaps with fewer resource constraints, it could have been less than

76 percent, and rebuilding could also have been faster. After all, during the six years of Spandana's recovery (2012–18), India's economy was booming, averaging 7 percent annual GDP growth. And other FSPs in the country, with much less direct exposure to Andhra Pradesh than Spandana, averaged significantly higher growth during the same period. None of this is to imply that Spandana's recovery was any less impressive, but it does suggest that its recovery was held back by the constraints of low capital and the CDR under which it was operating. An earlier capital investment and inflow of fresh funding could have allowed Spandana to bounce back faster (see "Capital inflows" in the following section).

Portfolio: Disbursements

What all these examples emphasize is the importance of lending, even in the middle of a crisis. To focus all attention on collections, deferring new lending until the risks and uncertainties have passed, is not a conservative approach; it is, simply put, wrong. That does not mean that continuing to lend implies continuing business as usual. Adaptation to changed circumstances is crucial.

The type of lending will depend greatly on the context and the institution's situation. However, in all cases, priority should go to current clients who need credit and have demonstrated the capacity to repay. While that may be a relatively small subset of existing clients, they cannot ever be ignored or forgotten; such clients represent arguably the best spokespeople for the institution and treating them with loyalty and trust will be repaid in kind.

But that is the bare minimum; lending exclusively to a small coterie of unaffected customers is unlikely to be enough. Most crises last years, and without new lending, institutions will simply shrivel into irrelevance. To avoid that fate, FSPs must be innovative and look where they can for new lending opportunities. In some cases, this will mean expanding existing business lines. That was the case for FAMA, which recognized that the crisis was impacting mostly larger customers and SMEs, and so FAMA refocused on its core market of microenterprise clients, many of whom had been left behind by other FSPs in their rush to grow during the pre-crisis years. Partner in Bosnia took a very similar approach, focusing its post-crisis lending on lower-income clients.

Institutions facing severe crisis must be innovative and look wherever they can for lending opportunities.

Other cases may well require greater changes. For Viator, this meant using a relatively new product—a loan backed by gold collateral, usually jewelry—as a way to lend to customers while keeping risks modest. The product was a natural fit for a market hit hard by currency depreciation, which inevitably drives people towards gold as the "safe" asset. It also aligns with Azeri cultural traditions that feature gifts of jewelry for weddings and other family celebrations. Thus, when Viator began offering these loans to customers that needed to monetize their family's gold, they found a ready and willing market, especially when many of its competitors had scaled back their lending.

Rolling out a new product in crisis can be especially challenging, and Viator needed to refine its operations to ensure that it could effectively sell the collateralized jewelry in the event of default. But those new loans proved a crucial source of cash flow and income when its pre-crisis portfolio stood at 77 percent delinquency, with most of that more than 12 months overdue. Without the new jewelry loans, Viator is unlikely to have survived at all.

But perhaps the biggest change was executed by ACF. Prior to the crisis, ACF had been a "missing middle" lender, focused on SMEs in urban areas and using real estate as collateral. Many of its loans were meant specifically for housing. Unfortunately, this was also the sector perhaps most devastated by the 2008-09 financial crisis, and ACF's clients not only lost their business income but also suffered large losses in the value of their homes and real estate. Realizing that this was not a segment likely to recover anytime

Lending during a crisis must be done with extra caution and care, and with eagle-eyed watchfulness for the first signs of trouble.

soon, ACF made a 180-degree turn, shifting to group lending in rural areas that were much less deeply affected.

To do this, ACF opened two new branches in rural areas adjoining the city where their two original branches were operating. It retrained existing staff and hired some new staff who could better relate to rural clientele. And then it started lending. At the start of 2008, on the eve of the crisis, ACF's group loans were a tiny pilot, accounting for 1.1 percent of its portfolio. But as the first wave of the crisis appeared early that year, ACF embarked on a massive breakneck scaling up of this segment. By year's end, group loans accounted for 19 percent of the portfolio; a year later, it was 52 percent; and by year three, it stood at a whopping 87 percent. In just three years, during the biggest economic crisis in a generation, ACF managed to shift its entire operation from urban SMEs to rural group clients. And the cash flow and income that this new group loan portfolio generated not only allowed ACF to survive, but also set it on a new growth path that took it far beyond its pre-crisis peak.

These examples of lending while a crisis is raging should not be misread. If there is one thing worse during a crisis than stopping lending entirely, it's continuing to lend—or even increasing lending—as if nothing happened. While none of the *WTS* cases exhibited such a tendency, there are anecdotal accounts of lenders trying to "grow out of a crisis." After all, nothing looks so impressive, and so deceiving, as growing the portfolio while everyone else is contracting, with the added benefit of an artificially lower delinquency rate created by that same growth.[11] That way lies tragedy. The key to successfully surviving a crisis is adapting to the changed circumstances. Lending during a crisis must be done with extra caution and care, and with eagle-eyed watchfulness for the first signs of trouble.

That caution and care were exhibited by all *WTS* survivors. Viator faced significant operational obstacles when implementing its jewelry loans. ACF also had significant growing pains, watching PAR 30 on its freshly disbursed group loans hit 3.4 percent, at levels that were already understated because of massive growth. However, ACF persisted, making the necessary adjustments along the way, and eventually brought PAR 30 down to just 0.1 percent by the end of 2010. While it took patience—it was nearly two years until group lending was finally running smoothly—ACF's management recognized that group lending was its path out of crisis and proceeded to adapt everything to get it right: the products, the staff, and the training.

Portfolio: Collections

While lending is a crucial part of survival and recovery, it's just as critical not to neglect collections. By definition, crises entail high levels of delinquency and default. Collecting on those overdue loans not only helps to provide additional cash flow, but also helps retain scarce capital. After all, every dollar collected on an overdue loan is a dollar that can be counted as equity, whether it means moving it back out of loan loss provisions or keeping it from being moved there in the first place.

Beyond the balance sheet, effective collections also help build confidence for both investors and regulators and can be important for maintaining the confidence of clients as well, by signaling that the institution takes borrowers' promises to repay seriously.

Maintaining effective collections during a crisis requires segmenting clients. The segments typically reflect the specific nature of the crisis; perhaps geographic regions or economic segments that may be less or more affected, or product features (for example, loans

11 Since PAR 30, the go-to measure of delinquency, is expressed as a share of the total portfolio, rapid growth has the effect of reducing PAR as bad loans are added to the denominator as soon as they are disbursed, but usually take a few months (or at minimum 30 days) to be recognized as delinquent.

denominated in foreign currency) that make them more susceptible to delinquency. When such high-level segmentation is not possible, one can rely on loan officers' assessment of the likelihood that clients will be able to repay, and how soon. No matter how these segments are drawn, their purpose is twofold: to guide the institutions' collections operations and to provide a forecast of future cash flows and probable losses.[12]

Such segmentation was a core part of the response at Vitas Palestine described earlier (see "Client confidence" in the previous section). After the onset of multiple economic shocks, its staff would reach out to clients to discuss their situations, without mentioning loan payments. Based on the clients' responses, Vitas' staff would segment them by the degree of impact that the crisis had on their household incomes, and implicitly, on their ability to repay. This response was guided by Vitas' long experience of operating in a market wracked by frequent economic shocks arising from the country's complex political situation.

However, not all institutions are likely to have prior experience in dealing with crises. When the institution has no such experience, it can be useful to bring in an outside specialist to fill this gap. For example, Viator's crisis response was to a large degree guided by the advice of a consultant who had worked at a hard-hit MFI in Bosnia five years earlier and who had been recommended by one of Viator's investors. She helped Viator develop the systems for segmenting and monitoring clients by their repayment ability and training staff on past-due collections. Some of Viator's managers were invited to visit the MFI in Bosnia to see firsthand how its collections systems functioned. For Viator, which had not previously experienced crisis, such advice was crucial in avoiding the much harder path of learning by trial and error.

BOX 5

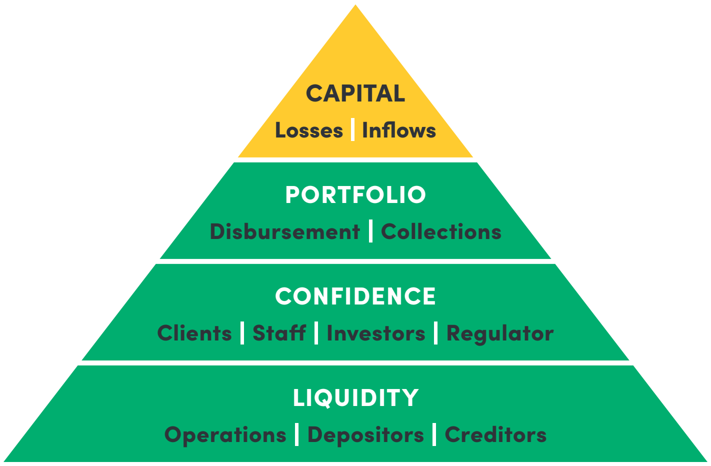
Ten Years On: Asian Credit Fund, Kazakhstan

WTS I used the name Caravela as the anonymized stand-in for ACF because the caravel ships of the 16th century were relatively small vessels recognized for their speed and maneuverability, as well as their resilience—all of which were elements demonstrated by the MFI during its crisis response. At the time of *WTS I*, ACF had already completed its rapid transition from an individual lender serving the urban, missing middle sector to a group lender focused on low-income rural clients.

Since then, ACF has flourished, growing its portfolio by 2100 percent during the following decade. The transformation is even more remarkable in terms of clients served, from just over 600 clients immediately before the crisis, to now nearly 30,000. Such growth naturally required capital, and in 2014, ACF's founding NGO, Mercy Corps, sold part of its shares to a specialized social investment fund, Base of Pyramid Asia (BOPA). Over the next half-decade, BOPA invested additional capital, becoming the majority shareholder. In late 2020, during the COVID-19 pandemic, BOPA made an additional investment of $500,000, both to demonstrate its support and confidence in the institution, as well as position it for further growth.

12 Nails, Donna. "What prior crises tell us about tackling Covid." Fireside chat. European Microfinance Week, November 20, 2020.

4 Capital



MANAGING CAPITAL

PRE-CRISIS

↗ Maintain a minimum 25 percent capital-to-assets ratio.

LIMIT LOSSES

↗ If crisis is moderate and sufficient equity is available, provision early, then focus on recovery.

↗ If equity is limited or scale of crisis unclear, don't provision more than necessary.

↗ Don't forget other sources of losses, such as currency depreciations or excessive operating costs.

MAXIMIZE INFLOWS

↗ Don't underestimate the value of past-due collections to rebuild or preserve equity.

↗ For investors: don't wait until full recovery to invest. Recovery can be slowed by lack of equity.

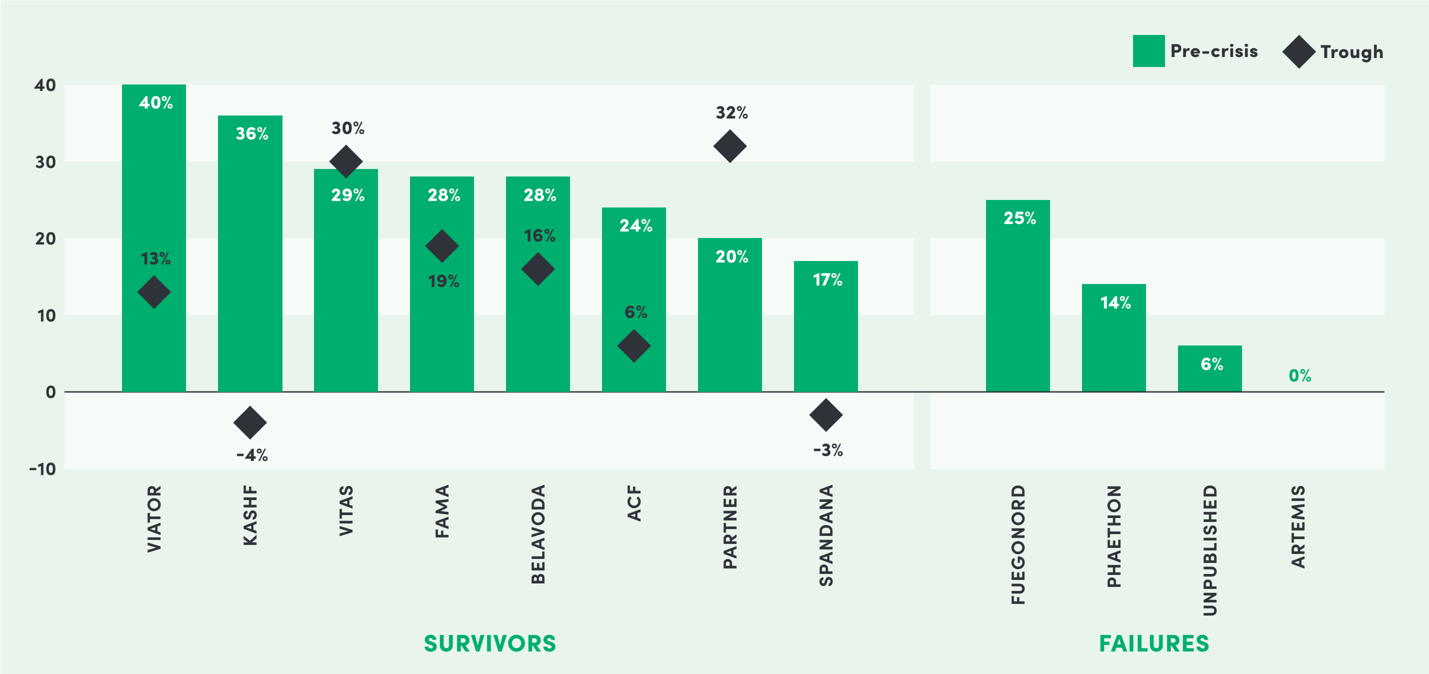
Traditionally, few parts of an FSP in crisis get as much attention as its capital adequacy and especially the risk of insolvency. After all, once insolvent, the FSP is often seen as having failed. But this is backwards. Long before insolvency, an institution may fail due to insufficient liquidity or irreparable loss of confidence of key stakeholders. Meanwhile, the process of eroding capital can take years, and along the way there are often plenty of opportunities to delay or repair the damage. This is why capital sits at the top, rather than the bottom, of the financial institution's hierarchy of needs during crisis.

That doesn't mean that capital should be forgotten or ignored. It is crucial to maintaining the confidence of both investors and regulators, and having a large cushion of capital can greatly expand the maneuvering room available to FSPs in crisis.

Three factors directly impact capital: the pre-crisis capital position, the level and speed of losses, and the amount of new capital inflow. The first is simple: the more capital an institution has, the easier it will be to navigate the crisis. Among the eight institutions that survived, five had a pre-crisis capital-to-assets ratio (CAR) above 25 percent, and only Spandana had a CAR below 20 percent (Figure 3).

FIGURE 3

Capital-to-Assets Ratios at Pre-Crisis and Post-Crisis Trough (lowest post-crisis level)



On the other hand, among the four that failed but where survival was plausible,[13] Phaethon had a CAR of just 14 percent in 2007, the unpublished case had a CAR of 6 percent, and Artemis was barely solvent, at just 0.4 percent. It's conceivable that with higher capital levels, all three could have survived and recovered. As for FuegoNord, while it had a solid CAR of 25 percent in 2008, its founder-manager was new to the sector and made serious mistakes during the crisis; without a different manager, its failure was probably unavoidable.

From here flows an important lesson: for FSPs and their shareholders, higher leverage (meaning lower capital position) can be a path to greater profitability. However, those greater profits come at the cost of greater risk—a basic tenet of finance theory. And while increasing returns through leverage may be an appropriate strategy for a diversified portfolio, it is inconsistent with the social and development premise behind financial inclusion. Judging from the *WTS* case studies, a minimum CAR of 25 percent is a sensible rule of thumb. This applies also to nonprofits, for while they have no shareholders from whom to raise capital, when it comes to crisis, they are as likely to fail as their shareholder-owned counterparts, a hard lesson learned by the founders of the NGOs Phaethon and the organization from the unpublished case study.

Capital Losses

During a crisis, capital is usually eroded via loan loss provisions, though it may also be eroded through unexpected financial expenses, lost or destroyed physical assets, as well as excess operating expenses. Some of these may be managed, while others are largely outside the FSP's control.

13 Failures not shown are from institutions with extreme levels of fraud (BDB, Loki) or result of a political takeover (PADME). Pre-crisis balance sheet data is no longer available for Shorebank.

If you have the equity, provision early, but if that's not an option, stretching out losses can be a feasible path to recovery.

Provisioning for loan losses is what typically hits an institution's financial position the most, mainly because of the scale of delinquencies. The most extreme situation among *WTS* cases was Kashf, which in a single year provisioned for 86 percent of its assets—in effect, its entire portfolio. The figures are less dramatic among other cases, though provisions of 10 percent or more in a single year are common. However, provisioning is also to some degree flexible for an FSP. Of course, accounting standards must be observed and financial statements audited, but even with that, institutions in crisis find ways to control when and how much to provision.

For example, although its Andhra Pradesh portfolio was rendered almost entirely uncollectable following the 2010 state government action, Spandana waited until 2012 to provision for these loans, when it set aside provisions equivalent to 52 percent of its total assets. Coincidentally or not, by that time Spandana was already operating under the CDR that its lenders had signed a year earlier. Similarly, Viator changed how it was applying provisioning rules throughout the crisis. Whereas previously, it had been provisioning 100 percent for all delinquent loans, two years into the crisis, its provisions for loans overdue by more than 12 months stood at 70 percent. This way, Viator succeeded in always keeping just enough equity not to fall into insolvency.

When it comes to provisioning, the approach tends to vary. For those that are facing moderate crises or have lots of equity, early provisioning seems to be the norm, allowing the institution to put the crisis quickly behind it and focus on recovery. But when this is not an option, stretching out provisioning over several years can also be a plausible path forward.

Even if the bulk of capital losses come from impaired loans, financial and operating costs can also have a meaningful impact on capital, but with less opportunity for timing those losses. Direct financial expenses—basically the cost of debt—may sometimes add a few points to the borrowing costs of crisis-stricken MFIs, but this is not common. A bigger factor is other financial costs, especially currency-related losses. Viator lost 11 percent of its pre-crisis equity to foreign exchange losses alone, and ACF lost nearly 12 percent, a figure which doesn't even account for the additional expense stemming from a large spike in its hedging costs a year later.

Besides loan losses and financial expenses, FSPs dealing with crisis may also experience increased operating expenses, due to a drop-off in staff productivity. Part of that is the added effort needed to collect on overdue loans that under normal circumstances would use the regular, more efficient channels to handle repayments. At the same time, FSPs also experience lower productivity while implementing significant changes to their products and sales strategies that form their crisis response. While savings on staff salaries discussed earlier may offset some of these added costs, that may not always be enough to offset the lower productivity.

When building forecasts of losses and their effect on capital, it is therefore important to account not just for expected loan losses, but also for higher financial and operating expenses, too. Their effect is by no means negligible.

Capital Inflows

It is fitting that the last piece of the crisis hierarchy is capital inflows, which typically happen on the far side of crisis, often when recovery is already well underway or has been completed entirely.

But there is one part of capital inflows that can come much earlier: the recoveries that come from collections of overdue loans, many of which will have already been fully provisioned and maybe even written off. As discussed above, this is an oft-neglected part of the crisis response, but such recoveries can be an invaluable means of rebuilding capital, especially during the depths of a crisis. Nevertheless, important as such recoveries are, unless the crisis is a mild one, they will not be enough. By the same token, relying on retained earnings to rebuild capital can be a long, drawn-out affair.

Unfortunately, equity investment in crisis-stricken FSPs is rare. Among *WTS* cases, only Belavoda can be said to have received an equity injection as part of its investors' crisis response. Coming in year two of its crisis, this equity injection by Belavoda's largest shareholder increased capital by 40 percent and was crucial in absorbing the large loan losses it was experiencing. Indeed, the investment was almost exactly equal to the (negative) net income recorded during the first two years of the crisis.

But Belavoda's experience is the exception that proves the rule. While Spandana and ACF also received equity investments following their crises, both of these came more than six years after the onset of those crises, by which time the institutions had fully recovered and were well on their way to post-crisis growth. For Spandana, the investment from the private equity fund Kedara Capital provided a path to buy out the remaining CDR-holders and inject new equity into what was by then a fast-growing FSP. Two years later, Spandana held a successful IPO. For ACF, the investment by the Base of Pyramid Asia (BOPA) fund in 2014 provided an exit to ACF's founding shareholder, Mercy Corps. However, by that time, ACF had already recovered and grown its portfolio to double its pre-crisis peak. While these investments in Spandana and ACF facilitated future growth, they played no role in their recovery.

There is one other important source of capital inflows: subsidies. This was the case for Viator, which, four years after the onset of its crisis, received a grant and subsidized loan from the country's central bank as part of the government's rescue package to the sector. This allowed Viator to finally fully provision for the remainder of its crisis-hit portfolio and close the last chapter of the crisis. A similar approach was employed by Kashf, which used capacity-building grants and other subsidies to rebuild lost equity.

For most crisis-stricken FSPs, equity investments come too late to meaningfully help with their recovery.

As a coda to these scarce examples of equity injection, in November 2020, as the COVID-19 pandemic raged, ACF's main shareholder added another 13 percent to its capital. The investment was both a part of ACF's long-term strategy and a show of confidence during a time when the MFI was seeking temporary rescheduling from its creditors. However, the pandemic's impact on ACF was far smaller than the crisis a decade earlier, and this investment played at best a supporting role in ACF's crisis response.

The combined experience in *WTS* strongly suggests that there is a deficit of capital available to institutions either during crisis or their post-crisis recovery. Are those five- and even 10-year recovery periods seen in so many crisis-hit FSPs really a reflection of the time it takes to recover and rebuild? Or are they a demonstration of the resource constraints—especially equity—under which post-crisis FSPs must operate? It's plausible that a more rapid response by equity investors could jump-start post-crisis recoveries and thus provide scarce financial services in a time of need, rather than watching FSPs lose years rebuilding that which was lost. Perhaps this is an opportunity for a socially responsible vulture capital fund that would specialize in crisis-hit FSPs?

BOX 6

Former Crisis Survivors Tackling COVID-19

One of the unique opportunities offered by *WTS* is seeing how institutions that have weathered severe crises are applying their earlier experience to the COVID-19 pandemic. Unsurprisingly, they implemented many of the same responses they had learned during their prior crises.

First, there is a universal emphasis on liquidity; one of the managers stressed that as the pandemic hit, she specifically focused on increasing cash reserves, targeting 35 percent of assets to be held as cash on hand. Another mentioned that debt investors have also learned their lessons and were much more willing—a few even insistent—on rescheduling their loans. For both managers, the added cash reserve may have cost more, but it was an important source of flexibility during a period of uncertainty.

The second—and also universal—response is the focus on maintaining the client relationship, including continuing to lend. One manager even lamented that she was unable to find a way to continue operations during the first month of the initial lockdown, mainly because with remote rural clients, there was just no time to set up distance banking operations before the lockdown went into effect. The MFI resumed as soon as the lockdown was lifted and has not stopped lending since. There is also openness to respond with new products or serve new clients; one manager mentioned increasing loan sizes to vendors of food and medical products, which are experiencing increased demand.

Other issues mentioned included transparency towards investors, offering repayment flexibility to clients struggling with income shortfalls, and generally listening and reacting to client needs. One MFI manager, hearing client concerns about accumulating interest on loans under repayment moratorium, reacted by reducing interest rates on restructured loans.

One notable element that only briefly shows up in the original *WTS* case studies is the extensive coordination among MFIs via their respective industry associations when communicating with government authorities. These former crisis survivors recognize that governments are compelled to help people, including MFI clients, manage their finances in the face of an unprecedented pandemic. However, hasty government decisions can make things worse for both FSPs and their clients, and much of this lobbying has been aimed at pointing out the unintended consequences as well as obstacles that governments may not have recognized.

Conclusion

The sixteen case studies in *Weathering the Storm*—failures and survivors alike—form a remarkably rich set of lessons and experiences. But if there's one lesson to take away from them all, it's that microfinance institutions, like their clients, can be remarkably resilient. With a decent equity cushion at the start and a willingness to adapt to changing circumstances, an FSP can survive just about any crisis, no matter how severe.

When *WTS* was first published in 2011, a key message was that microfinance institutions are not immune from crises, and they and their stakeholders need to be prepared and ideally take steps to avoid them. After another decade's worth of experience and especially following the onset of the COVID-19 pandemic, few would question the possibility of a crisis seriously affecting the sector and its institutions.

At the time of this publication, the pandemic is continuing to wreak havoc around the world, even as glimmers of hope for a return to normal are becoming more visible. That optimism should be tempered with caution: *WTS* clearly shows that serious crises have long tails, with most institutions taking at least five years to fully recover. Such a timeframe would be far too steep a price to pay given the scale of the current pandemic—even if its worst effects turn out to be limited to only the hardest-hit markets. Hopefully, the experience of *WTS* survivors will inspire today's institutions and their investors to focus on averting a drawn-out recovery.

Looking further ahead, when the effects of the COVID-19 pandemic are only a memory, the lessons from *WTS* will remain relevant. One likely outcome from the pandemic is that many managers and staff of FSPs and their stakeholders will have acquired substantial crisis management experience. While this paper provides a framework for thinking through the issues one might face during a crisis, it can neither anticipate every eventuality nor describe every response in sufficient detail to be used as an instruction manual. Simply put, there is no substitute for experience. If you or a partner institution are facing your first crisis and have the possibility of consulting with someone who has been through one and seen it up close, don't hesitate to do so. The investment in time and money will more than pay for itself. This could mean a colleague, a board member, an investor, or even an outside consultant.

If that's not an option, remember that the case studies from *Weathering the Storm* hold many more lessons than are covered in the pages above. Another useful resource is CGAP's Crisis Roadmap for Microfinance Institutions.[14]

A journey through crisis is one that only the reckless would choose. Instead, it's a path for which we are chosen, willingly or not. Should you find yourself on that path, let the experience of others be your guide.

> All our knowledge begins with experience.
>
> **– IMMANUEL KANT**

14 Abrams, Julie. "Crisis Roadmap for Microfinance Institutions: COVID-19 and Beyond." CGAP, February 2021.

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