Enterprise Development and Microfinance, 33:3, 182–191
<https://doi.org/10.3362/1755-1986.21-00020>

Lessons for African microfinance providers and regulators in the aftermath of COVID-19

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Abstract: *This paper is concerned with microfinance in Africa post Covid-19, a crisis from which the continent is still recovering while new crises such as climate change challenges emerge. The resilience of the microfinance sector to crises must not only address operational weaknesses revealed by the pandemic, but also exploit the post-crisis potential to build resilience in areas such as digitalization and smallholder agriculture. New rules and regulations should target microfinance providers (MFPs) and enable them to quickly comply with new rules and those normally in force. This paper calls for the inclusion of all forms of MFPs, allowing for customized applications of policies and regulations. Moreover, measures for regulators include re-defining post-COVID-19 target groups, enhancing liquidity and MFP risk-based management, ensuring sustainability and best practices, activating prompt monitoring of the sector, and ensuring a consultative and coordinated culture. Measures for MFPs include increased micro-saving, avoiding subsidies, unlocking the full potential of smallholder farmers, a strong movement towards inclusive digital finance, product development, and partial movement towards crises-resistant, non-interest types of lending in countries with Muslim minorities.*

Keywords: COVID-19, resilience, microfinance providers (MFPs), digitalization, microfinance institutions (MFIs), smallholder farmers, food security, regulatory framework

THIS ARTICLE AIMS TO REVIEW the status of microfinance in Africa before and during COVID-19 and to set out principles for crisis recovery and the re-building of microfinance providers (MFPs) and regulatory policies.

The state of microfinance in Africa prior to the COVID-19 pandemic

Microfinance offers financial services worldwide to a population with limited access to conventional financial markets. According to the Microfinance Barometer 2019, pre-COVID, the gross loan portfolio of worldwide microfinance institutions (MFIs) was estimated to be US$124 bn, with 140 million active borrowers, of whom 80 per cent were women and 65 per cent were rural borrowers. Worldwide, the average annual growth rate of lending was 11.5 per cent over the five years ending

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www.practicalactionpublishing.com, ISSN: 1755-1978/1755-1986

in 2018. The growth rate of credit portfolios in 2018 was +8.5 per cent compared to 2017. At the same time, the average growth rate of borrowers worldwide continued to increase (albeit at a much lower rate than the nearly 20 per cent of the previous decade), recording an average annual growth rate of 7 per cent since 2012. In 2018, 140 million borrowers benefited from the services of MFIs, compared to just 98 million in 2009, while the proportion of women and rural borrowers had remained stable over the previous 10 years.

Africa was, and continues to be, the most unbanked continent in the world. Poor infrastructure, vast distances and remote areas that lack modern facilities and infrastructure, high rates of illiteracy, lack of identity documents, low population density, and acute poverty have hampered the development of fully fledged commercial banks that serve the poor. Nonetheless, microfinance indicators in Africa demonstrate significant growth. According to the Microfinance Barometer 2019, the total outstanding amount of African MFIs increased by 56 per cent between 2012 and 2018, while the number of borrowers increased by 46 per cent over the same period to reach 6.3 million people in 2018, with 73 per cent female clients and 79 per cent rural borrowers (Convergences, 2019) Moreover, deposits continued to be the largest source of funding for financial service providers in Africa – 71 per cent in 2017 (MIX Market, 2018). In Africa, many aspects of the microfinance sector are quite promising, such as its ability to offer a high quality of service. Sub-Saharan Africa is the only place in the world where there are more savers than borrowers (Daniel, 2016). In addition, the majority of the most advanced economies in Africa, such as Ghana, Kenya, Nigeria, Ethiopia, and Senegal, have also witnessed the strongest growth in the microfinance sector. Despite this, market penetration in general remains low in comparison to the number of potential clients, and microfinance activities are largely concentrated in urban areas, where there is a risk of limited outreach and over-indebtedness.

COVID-19 threats to microfinance

Although the WHO maintains that the prevalence of COVID-19 in Africa was 97 times higher than reported, affecting 65 per cent of the population, most cases were asymptomatic (WHO Africa, 2022). Nevertheless, microfinance went into lockdown several times in countries like Rwanda, Kenya, and Uganda, which were affected more severely than other economies that chose partial lockdown, such as Zambia, Ethiopia, Sudan, and Tanzania. Opting not to adopt complete lockdown policies partially reflects the weak social welfare systems in most African countries, where a full lockdown would have had dire consequences, especially for daily wage earners in informal sectors and small producers. For these workers, strict lockdowns would have resulted in the loss of livelihoods, finance, and inability to access markets. Irrespective of the type of lockdown, most African MFPs were subject to staff exposure, liquidity shortfalls, a high credit risk, new stringent regulatory directives on rescheduling, and a moratorium on loans.

The effect of the pandemic on the microfinance sector and the decrease in funders' activities as a result of government measures resulted in an increased portfolio at risk. Moreover, liquidity was affected by poor repayment and withdrawal of clients from voluntary savings, in addition to the delay or non-request of new wholesale financing lines. The liquidity situation of MFPs became volatile, and there were many signs of providers having some trouble meeting cash needs for withdrawals, as well as a run on clients' deposits. In general, when loan collections are suspended under a freeze (voluntary or otherwise), while new lending slows down, this further constrains income of MFPs. At the same time, MFPs struggled to retain staff, service debt, and cover savings withdrawals. Commercial banks faced similar pressures and curtailed credit lines to MFIs. Moreover, the crisis threatened the issuance of new loans to new clients or existing clients who had paid off earlier loans, when repayment is normally incentivized by making it a prerequisite to qualify for subsequent loans.

In sum mary, the COVID-19 pandemic disrupted both the client and the capital sides of microfinance simultaneously, threatening the existence of MFPs. That is, MFPs suffered from both reduced repayments and a lack of access to capital and liquidity from funders as well as from clients' savings. Moreover, on the microenterprise level, COVID-19 impacted microenterprise sales, household income, and loan repayments.

The response from the microfinance sector during the COVID-19 pandemic

MFP and regulator measures

The African microfinance sector took many initiatives to mitigate the impact of COVID-19. MFPs with group lending changed methods for solidarity group meetings, increasing clients' savings, reducing average loan sizes and loan disbursement rates, adopting a policy of early collection of premiums with incentives, stopping funding in areas with significant rates of late payment, and working with emergency food support or cash transfers to low-income households or the unemployed. For example, AGFUND's banks in Sierra Leone, Sudan, and Mauritania developed integrated plans managed by emergency committees, which were created to analyze the movement of health activities; determine liabilities and communicate with partners; manage financial resources required during the crisis (technical support and wholesale financing) and their uses (projects, time period/margins, financing costs and expected profits); reschedule the granting of additional parallel financing to good clients who were unable to pay; finance good former clients and projects compatible with the conditions of the crisis; and defer payments for some faltering cases after studying each case separately. As for product design, employees, and portfolios, some MFPs added additional incentives for finance officers and the design of new products to cope with the pandemic; modified the characteristics of some of the current products to suit conditions; geographically redistributed employees; laid off employees and reduced wages temporarily; rationalized liquidity in specific projects; and reduced operating expenses. Some MFPs actively worked to ease the terms of new wholesale contracts and opened additional long-term emergency financing lines with better terms, while others appealed to the regulatory authorities to form national emergency portfolios.

Because of clients' continuing expenditures, which depleted reserves and reduced their ability to meet debt obligations and liquidity needs, several African regulators took steps to change prudential standards and repayment schedules upon the approval of the regulator, or left it voluntarily (including suspension/relief/loan holidays in which repayments were optional); cut or delay interest; remove or prohibit fees for crisis-driven loan restructuring; and permit MFPs to distribute emergency relief funds (if available). Regulatory measures adopted during the crisis also included allowing MFPs to collect loan instalments during the lockdown; prohibiting MFPs from making dividend payments or bonus payments to front-line staff; reducing collateral requirements and provisioning for microcredit; reducing risk-weighted assets for microloans; and relaxing the deadlines for selected prudential norms (capital adequacy ratios, reserve requirements, liquidity ratios, leverage ratios, and minimum paid-up capital).

Most of the microfinance providers used mobile or digital devices (point of sale (POS), mobile phones, tablets) to offer existing services (e.g. customer registration, loan application, money transfer) and to digitize processes to increase efficiency. The use of mobile devices allowed MFP field staff to perform daily operations (replacing paper forms with digital ones), provide new services (e.g. savings collection), and use mobile agencies (mobile branches, tablets) instead of physical branches. Measures already in place in digital ecosystems were expanded to remote services in the short term. These measures were made to ease access to digital services (information systems and electronic payments) by simplifying customers' due diligence for certain accounts (opening an account in bulk individually without the requirement to sign a contract), reducing or waiving fees, raising transaction limits, and making greater use of mobile wallets and agents for loan repayments and disbursements.

MFP initiatives for resilience, recovery, and rebuilding post-crisis

It is now well recognized that COVID-19 is not only a health crisis; it is also an economic crisis, a humanitarian crisis, a security crisis, and a human rights crisis (United Nations, 2020a). It has affected us as individuals, families, and societies. The crisis has highlighted fragilities in the microfinance sector and in the ways MFPs are operated.

African microfinance activities needed new pathways to be resilient during a crisis, and to recover and rebuild after COVID-19 and other crises. Moreover, MFPs needed support to comply with the requirements of the path from crisis to recovery and afterwards. Immediately after COVID-19, MFPs had to alleviate the negative impacts of the crisis and enable the microfinance sector to play its central role in the medium-term economic recovery in Africa. This included helping viable MFPs to survive and retain the confidence of their clients, to begin lending again, and to encourage the repayment of restructured outstanding loans. However, the consolidation or exit of institutions that could not sustain themselves was necessary. There are major requirements articulated as follows:

- making additional liquidity available to MFPs from local governments and international multilateral sources (African Development Bank, International Monetary Fund, World Bank);
- revising practice measures, products, and mechanisms to achieve sustainability;
- deferring non-critical supervisory processes and going for new, post-COVID-19 regulations and measurements; and
- restructuring or liquidating troubled MFPs.

Post-COVID-19 microfinance products, mechanisms, policies, regulations, and monitoring are called to consider the following eight major principles:

1. *Include all forms of MFPs and authorize customized applications of policies and regulations*.
2. *Enhance MFPs' risk-based management culture, best sustainability, and best practices*.
3. *Activate a prompt monitoring and consultations/coordination culture among and within the MFPs*.
4. *Avoid costly, distortive, and discretionary subsidies* that prolong the lifetime of inefficient, ineffective, and unsustainable MFPs that are unable to survive without external, subsidized support and during the time of the crisis.
5. *Liquidate unviable/insolvent MFPs* (if they exist post-COVID-19). The new approach to MFPs' recovery and sustainability must ensure that MFPs elevate to higher efficiency levels to cope with similar or other crises in the future, and must go beyond a relief package, protecting small depositors and small borrowers to cover any negative impact caused by future institutional failures or a future crisis.
6. *Make additional liquidity available to MFPs* to cope with any upcoming shocks by providing enough financial resources for MFPs on a market basis, including more injection of owners' equity and clients' small savings.
7. *Transform clients' products finance in a way to cope with the post-pandemic period and be resistant to future crises*. New products are required to have a clearly defined reference, preferably in line with the United Nation's Sustainable Development Goals (SDGs), covering health, education, and smallholder finance for food self-sufficiency and exports.
8. *Fully exploit the potential of digitalization*. The provide financial services using technological innovations to reduce operating costs, share in social transfer programmes, expand access to remittances, and increase outreach, especially in rural areas.

Redefining the target group

COVID-19 stressed the need to redefine microfinance clients to include those who are vulnerable to crises and those who live off the land and in small towns and villages and have yet to be reached. Previously, success in reaching the poorest of the poor has been limited because, in general, emphasis has been placed on building healthy and profitable institutions. As a result, not enough attention has been paid by MFPs to overcome societal problems as envisaged by the SDGs and, therefore, the SDGs-related target populations were not well and specifically incorporated in microfinance.

New appropriate regulation and governance measures

The pandemic exposed fragmentation in regulatory frameworks, such as inconsistency across separate regulatory domains for banks and non-bank financial institutions; and the limited reach of regulatory authorities. The latter can create situations where a few large MFPs meet regulatory criteria while many unlicensed, unsupervised MFPs do not. Moving towards a functional, graduated framework of tiered regulation may be part of the solution. Tiered regulation may be needed to meet the need for a proportionate, risk-based regulatory and supervisory framework for MFPs, in accordance with well-established guidance. Other components include regular communication and consultation with the industry and well-tailored tools and high-quality data that enable proactive monitoring of providers.

In the post-COVID-19 era, wholesale finance needs to be reorganized to allow for restructuring of commercial bank loans to other MFPs. Loans to MFPs that qualify as small and medium enterprises would also benefit from lower risk-weighting in capital regulatory frameworks. Measures to ease bank liquidity, such as release of capital buffers and reduction of reserve requirements of commercial banks, may enable commercial banks to provide more credit to MFPs. CGAP identified five key steps at the regulation and policy level during COVID-19 that are also suitable for recovery: 1) enable MFPs to operate safely; 2) provide relief to microfinance clients; 3) make additional liquidity available to MFPs; 4) restructure or liquidate troubled MFPs; and 5) balance urgent rescue against longer-term values such as legal certainty, risk-based regulation, and sustainability (CGAP, 2020).

Finally, apart from the prevailing lack of regulation and supervision, most MFPs in Africa are suffering a risk factor related to a weak governance structure. COVID-19 showed that during the crisis, good and active governance played a successful follow-up and support role in quick recovery. The unclear ownership structures of NGOs and cooperative microfinance institutions (which often depend heavily on a single person who concurrently plays the role of founder, general manager, and president of the board of directors) will not be suitable to help in the recovery of the institution from crisis. Good governance is, therefore, one of the prerequisites for future recovery from any emergency.

Product development and delivery

MFPs need to amend their lending policies and introduce new products and online channels to mitigate the negative impacts of crises, while also developing a system that is resilient to crises. For example, COVID-19 disproportionally impacted the most vulnerable and marginalized groups, who lack access to essential health, education, and sanitation services. The same also applies to recovery. The more a person is excluded, the more challenging the recovery, and persons with disabilities often fall in this category. MFPs can launch a programme expanding more societal projects that are in line with SDGs in all fields, and improve delivery of loans via digital means. These projects/products aim to increase financial services available to youth, women, refugees, displaced people, rural farmers, among other marginalized groups.

Innovation in digitalization policies, facilities, and capacity building

To improve efficiency and outreach after COVID-19, microfinance institutions have to find innovative ways to conduct operations (the provision of financial services using technological innovations), increase client savings components, and avoid dependency on poor transportation systems. An encouraging signal is that mobile banking in Africa, especially in Kenya, Ghana, Tanzania, and South Africa, is clearly ahead of other regions. All these countries employ an M-Pesa-type mobile money transfer initially launched in Kenya in 2007. Digital financial services are spearheading greater financial inclusion in sub-Saharan Africa, with 338 million registered accounts in 2017 (AFI and AfPI, 2018) and one in five adults now with a mobile money account (World Bank, 2017).

The pandemic underscored the urgent need to enhance rural and remote MFP operations and to speed up the shift toward digitizing front-end services and back-end operations, making greater use of mobile services and digital platforms, expanding the role of agents, and increasing access to remittances. In addition to facilitating payments in remote areas, the extension of digitalization in Africa will lead to greater ease of payments in remote areas; enhanced credit, savings, and money transfers; lower discrimination against historically marginalized groups; improved customer due diligence; and combating the financing of terrorism/anti-money laundering.

Unlocking the full potential of smallholder farmers

A shock such as COVID-19 threatens the food security and nutrition of millions of people. More than 820 million people were already chronically food insecure, and an additional 135 million people may have suffered acute hunger in 2020 due to the impact of the pandemic, while an additional 70–100 million people may have fallen into extreme poverty (World Food Programme, 2020). In the longer term, we face possible disruptions to the functioning of food systems, with severe consequences for health and nutrition due to other crises such as climate change droughts and extreme weather events.

In order to create an enabling environment to mobilize agricultural smallholder finance in Africa, significant barriers regarding non-credit policies and measures need to be addressed, namely:

- Introduce lending quotas to micro- and small agriculture by the regulator. The set quota depends on comparative advantages and varies among countries and regions within the countries.

- Link small holder farmers to health insurance and micro-savings.
- Move small holder farmers from self-dependency to agro-business for export.
- Introduce gender-neutral credit policies, to enhance smallholder female farmers' access to credit.
- Finance innovative products for smallholder agriculture, e.g. value chain finance measures.
- Provide extension services and link farmers to markets by the government and the private sector (crop market, insurance market, etc.), provide inputs, storage facilities, and agricultural machines required for production and harvesting.
- Reduce all agricultural taxes and fees imposed inside and at export destinations.
- Provide digital finance technologies such as mobile banking and payment.
- Establish platforms and ways to reduce operating costs in reaching smallholder farmers.
- Set up solutions to reduce the riskiness of agriculture by insurance companies.

Easy access to liquidity on reasonable terms

Liquidity was the concern most frequently voiced by MFPs and microfinance stakeholders (including international donors and investors) during the pandemic. The downstream effects of liquidity shortage lead to micro- and small enterprises' inability to meet their credit needs, value chains under stress, potential shortages of food and other basic needs, and resulting setbacks to recovery. MFIs rapidly took action to avoid a liquidity crisis, although they will need financial guarantees from donors to access local credit and address the increase in demand to resume their activities.

Client savings in recovery

Low-income people's earnings are small and irregular (e.g. seasonal income of smallholder farmers, daily income of labourers and artisans). Savings help maintain consumption levels and planned investments in the face of irregular income streams and occasional upsetting events. Most studies indicate that the synchronization of loans and savings has a positive effect on financial performance and on the expansion of credit spread. Needless to say, augmenting client savings both in volume and number of accounts during a crisis recovery period will face some constraints. Financial literacy, access to formal bank accounts associated with free identity cards, digital financial services, among others, contribute to recovery. An important future analytical challenge will be to gauge the relative importance of these various approaches to build resilience and promote recovery.

Expansion of interest-free finance

Standard & Poor's Global Rating emphasized that COVID-19 offers an opportunity for more integrated and multifaceted interest-free finance growth with higher standardization, stronger focus on the industry's social role, and greater use of fintech (S&P Global Ratings, 2020). There are many reasons to introduce interest-free finance in other countries as an additional lending system. These reasons include mobilization of savings of Muslim minority groups into official channels; enhancing the provision of financial inclusion via new, universally acceptable interest-free mechanisms; and responding to the demand of Muslim minorities. Deposits can also be attracted by deposit incentives through non-interest profit-sharing formulas. In addition, interest-free microfinance is profitable for MFPs and represents a cushion in any crisis such as COVID-19.

Conclusions

The COVID-19 crisis endangers health and economic prospects across the globe. Microfinance in Africa is not an exception. This paper examined the status of microfinance in Africa during the pandemic and set out some thoughts on recovery and rebuilding for MFPs and credible regulations to achieve greater resilience and more rapid recovery after COVID-19 and other crises. The main points to consider are:

- *Address the weaknesses of the existing regulatory framework* and the gaps in payment regulations, and create a sector-wide microfinance fund for post-disaster relief or emergency liquidity.
- *Speed up the shift toward digitizing front-end services and back-end operations*, making greater use of mobile services and digital platforms and expanding the role of agents.
- *Unlock the full potential of smallholder farmers* through MFPs' alternative financing instruments, linking to health insurance, micro-savings, and crop markets.
- *Synchronize MFP loans and savings* for a positive effect on financial performance and on the expansion of credit.
- *Develop more MFP partnerships with commercial banks, donors, and financiers* in wholesale alternative financing instruments.
- *Ease MFPs' liquidity* by releasing capital buffers and reducing banking reserve requirements by the regulator, and strengthen MFPs' institutional self-sufficiency through client savings to augment resilience during any future crisis.
- *Enhance MFPs' client savings* to stabilize active poor consumption and investment during recovery periods, and to enhance financial performance and credit spread.
- *Promote a quick movement of qualifying MFPs towards full sustainable financial inclusion*, to include more products and to reduce service costs by mobile applications through completing the regulations of mobile banking applications.
- *Introduce interest-free finance* in targeted MFPs in African countries where regulators allow for this type of finance.

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