



MODULE 4: MICROFINANCE IN LIVELIHOOD RESTORATION

Summary

Objectives

Following completion of this module, participants should understand:

- modifications an MFI might make to its standard products in response to a disaster situation, such as loan rescheduling and loan refinancing
- new products an MFI might consider in response to a disaster situation, such as special loan products and leasing arrangements, and
- how MFIs can engage positively with relief agencies that offer financial interventions such as cash grants and cash-for-work.

Topics

1. Introduction to Livelihood Restoration Activities
2. Microfinance Products for Post-Disaster Contexts
3. Post-Disaster Product Modifications
4. New Post-Disaster Microfinance Products
5. Other Post-Disaster Financial Products
6. Summary



TOPIC 3

Post-Disaster Product Modifications

Loan Product Modifications

As a general rule, MFIs should not make blanket changes to the structure of loan products following a disaster. However, it will sometimes be advantageous to offer temporary concessions, as it is better to forgo some income for the sake of maintaining the goodwill of clients and protecting against loan default.

Rescheduling - extending the term of the loan or relaxing the schedule of required payments.

Refinancing - paying out a (problem) loan by issuing a new loan. This allows clients to begin making the loan payments again and, it is hoped, to continue until the loan is paid.

Loan forgiveness - a de facto grant to indebted clients. Loan forgiveness has a number of negative impacts. First, it benefits different people to different degrees (those with larger loans receive greater benefit) and this can cause disharmony among clients. Second, experience has shown that forgiving loans is likely to cause 'repayment apathy' on future loans. Third, forgiving many loans can cause serious decapitalisation of the loan fund. Loan forgiveness should not be considered.

However, demanding repayment in a disaster situation when clients are simply not able to repay is to induce more pain in vulnerability - while ultimately still not receiving the money back. Sensitivity is needed from the MFI. But if client support is needed, the MFI should seek to assist in ways other than loan forgiveness.

Changes in lending methodology - Group-lending methodologies were designed to discourage borrowers from deliberate default, but not to cover unforeseen disasters and tragedies. While group-lending methodologies can result in high repayment rates under normal conditions they can also serve to magnify losses in times of widespread economic stress.

MFIs can consider changes in lending methodology in a post-disaster context. For instance, an MFI may allow members to switch from group-based liability to individual liability following a disaster, so that any individual default does not affect loan group members. In the post-disaster context, this may contribute to reducing default risk.

Loan Product Modifications

- **Rescheduling:** extending the term of the loan or relaxing the schedule of payments
- **Refinancing:** paying out a (problem) loan by issuing a new loan. This allows clients to begin making the loan payments again and, it is hoped, to continue until the loan is paid.
- **Loan forgiveness:** a de facto grant. Loan forgiveness benefits different people to different degrees, it may cause 'repayment apathy' on future loans, and can lead to serious decapitalisation of the loan fund.
- **Lending methodology:** While group-based lending results in high repayment under normal conditions, such a program can also serve to magnify losses in times of widespread economic stress.

SLIDE 8 of 20 - MODULE 4: MICROFINANCE IN LIVELIHOOD RESTORATION

Slide 8 - Loan Product Modifications

TOPIC 4

New Post-Disaster Microfinance Products (1)

New Post-Disaster Microfinance Products (2)

New financial products post-disaster could include:

- **Emergency loans** - may be offered for the purpose of restoring productive assets and essential household assets. The decision to offer an emergency loan should be based on a detailed assessment of the client's asset loss. Standard cost structures should apply.

Slide 11 - New Post-Disaster Microfinance Products (2)

- **Reconstruction loans** - designed to help clients re-build, repair and replace damaged assets following a disaster.
- **Microleasing** - see notes for slides 12 and 13.

Brainstorm

- Ask participants: 'In terms of the client's ability to service new debt, what are the considerations for an MFI with respect to offering asset-replacement loans or reconstruction loans?'
- If the asset being replaced is an income-earning asset, then the debt can be serviced by income earned. However, if the asset is not income-earning, (and this applies to reconstruction loans), then the client needs to have an existing income stream in order to service the debt.

TOPIC 5

Other Post-Disaster Financial Products

Grants and Loans in Livelihood Restoration

Many disaster-affected people have existing outstanding debts. Supplying new loans in these situations may further destabilise their economic condition. Therefore, grants are often necessary to help people re-acquire assets required for income-generation. Many relief agencies provide both in-kind and cash grants to help replace lost assets.

Slide 15 - Grants and Loans in Livelihood Restoration

It is not uncommon for MFIs to be asked to provide cash grants to their disaster-affected clients, to help them restore their livelihoods. However, many MFIs fear that the provision of grants will undermine their image as a reputable financial service provider and that it may negatively impact loan repayment discipline.

Despite concerns from the microfinance community, grants are often provided to microentrepreneurs following a natural disaster. The challenge for relief agencies and MFIs is to design these interventions in such a way that they contribute positively to restoration of livelihoods, without creating dependency and without undermining efforts to provide market-based financial services on a sustainable basis over the long term. This is possible, though not easy. Certainly, a well-designed grant product is better than a 'loan forgiveness' strategy.

The overarching recommendation is that there must be deliberate and close **coordination between relief agencies and MFIs** to ensure effective interaction between grant and loan products.

Case study

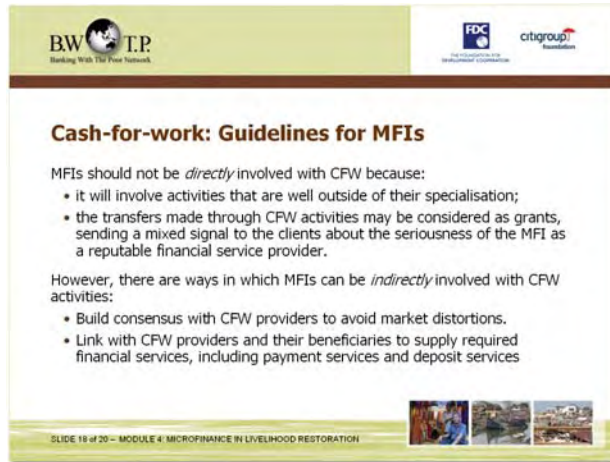
- Ask participants to read the case study in Handout 4.15.
- Ask participants to identify the key reasons for the success of the grant/loan program, and to explain their thinking.

TOPIC 5

Other Post-Disaster Financial Products

Cash-for-work: Guidelines for MFIs

As a general recommendation, MFIs should not be *directly* involved with CFW, since community-related activities invoking logistical issues that are beyond their specialisation may often be involved. Also, the transfers made through such CFW activities may often be considered as grants and safety-net measures - sending a mixed signal to the clients about the seriousness of the MFI as a reputable financial service provider.



Slide 18 - Cash-for-work: Guidelines for MFIs

However, there are ways in which MFIs can be *indirectly* involved with CFW activities. Broad guidelines include the following:

Build consensus with CFW providers to avoid market distortions

MFIs and CFW providers need to discuss how to set fair market wages, to avoid inflated wages. CFW should involve short-term interventions that do not overlap with seasonal livelihood activities such as agriculture, and that can be phased out when markets begin to emerge.

Link with CFW providers and their beneficiaries to supply required financial services

Cash transfers through CFW were provided in excess in many places. Some MFIs decided to capture the savings made from such cash transfers. One cooperative in India, LEAD in Trichy, collaborated with the relief organisation Save the Children to capture the savings. While Save the Children implemented CFW programs in LEAD operational areas, LEAD convinced the CFW beneficiaries to buy shares in the cooperative. After buying three shares they became eligible for loans worth 3-5 times the share value at a low interest rate from the cooperative. By the end of the CFW program in June 2005 it was reported that 1400 new members were added due to this effort - about 235 of them took loans using the shares as collateral, and repayments were reported at 95%. The total savings at the cooperative also increased due to new members.