Situation of microfinance institutions and borrowers in East Africa during the SARS-CoV-2 pandemic

Content

Political stability in sub-Saharan Africa is one of the main factors influencing migration from Africa to Europe. Political stability is strongly influenced by the economic situation of citizens. In addition to military and ethnic conflicts, the SARS-CoV-2 pandemic is greatly affecting the economies of African countries and dramatically constraining the political, social, and economic wellbeing of local populations. Village savings and credit associations (hereinafter referred to as 'microfinance institutions' or 'MFIs') are established players across local economies in rural Africa and act as lenders as well as deposit managers. Rural SMEs (small and medium-sized enterprises) in particular depend on access to capital from MFIs to maintain and grow their businesses and continue to provide local jobs. MFIs precisely serve the clientele intended to be supported by German and EU funds to create local opportunities and reduce migration pressure. Because MFIs are in most cases not or only weakly regulated, they are cut off from development cooperation funding. This results in systematic misallocation since funds are distributed almost exclusively via financial and government institutions or by large NGOs. As a result, large sections of the population are neglected by these organizations. Fortunately, technological solutions are available to reach the affected population directly in a timely and efficient matter, while at the same time making the use of funds transparent.

Economic situation of Sub-Saharan African countries since 2008

Sub-Saharan Africa (SSA), and particularly poorer segments of the population, has been a major focus of German and European development policy long before the SARS-CoV-2 pandemic. In recent years, it has become increasingly clear that European and African nations are causally linked by political, economic and geographical factors.

Since the 2008/2009 financial crisis, many African economies have developed comparatively solidly in terms of gross domestic product and inflation.[1] This development has also had a positive impact on the regional and local situation of the poorer (semi-urban and rural) sections of the population, which, among other indicators, has been reflected in falling poverty rates.[2] This development is one of the cornerstones of political stability in the individual countries, which, together with socio-cultural aspects, has a direct impact on migration pressure.[3]

Despite the positive developments of the last ten years, Europe has been uniquely confronted with increasing migration from the SSA states.[4] Migration is triggered by various economic, political and socio-cultural factors both in the countries of origin (so-called "push factors") and in the countries of destination (so-called "pull factors").[5]

Role and contribution of microfinance institutions

Over the past 30 years, microfinance institutions have established themselves as reliable pillars for sustainable development and accelerators of the rural SME sector.[6] Due to their reputation as savings and credit cooperatives, they have not only an economic, but also a social bonding effect on their members. This trust

[1] *International Monetary Fund (2019), World Economic Outlook Database.*
[2] *The World Bank (2020): Poverty & Equity Data Portal.*
[3] *Gimenez-Gomez et al. (2019): Trends in African Migration to Europe: Drivers Beyond Economic Motivations; Posner, R. A. (1997): Equality, Wealth, and Political Stability.*
[4] *Schoumaker, B. (2018): African Migration: Diversity and Changes.*
[5] *Agersnap, O. et al. (2019): The Welfare Magnet Hypothesis: Evidence from an Immigrant Welfare Scheme in Denmark.*
[6] *Depending on the country, only 24% - 41% of people have a regular bank account. Source: The World Bank (2017): World Development Indicators.*

effectively counteracts migration movements. In SSA countries there are around 23,000 such microfinance institutions, which provide a total of over 90 million people with basic financial services such as small loans, savings accounts and, in some cases, crop failure insurance.[7] The credit funds are mainly used for investments for simple means of production, education for children, and job creation.

Due to the lack of regulation in the microfinance sector, the sources of microfinance institution funds are mostly limited to deposits from members of local savings and credit associations, and private investors. Nevertheless, microfinance institutions make a substantial contribution towards local economic development in the long term. Despite this contribution, they only rarely - and then, very marginally - receive funds from international development organizations.

Situation during the SARS-CoV-2 pandemic: Significant credit crunch

Since mid-March 2020, East African governments have taken stringent measures to contain the SARS-CoV-2 pandemic. In Kenya and Uganda, the central safety measures are curfews and business closures. These measures particularly affect the semi-urban population, which can no longer pursue economic activities necessary to generate income. This lack of income and minimal to no financial reserves, result in existential challenges: food cannot be bought, and rents and school fees cannot be paid.

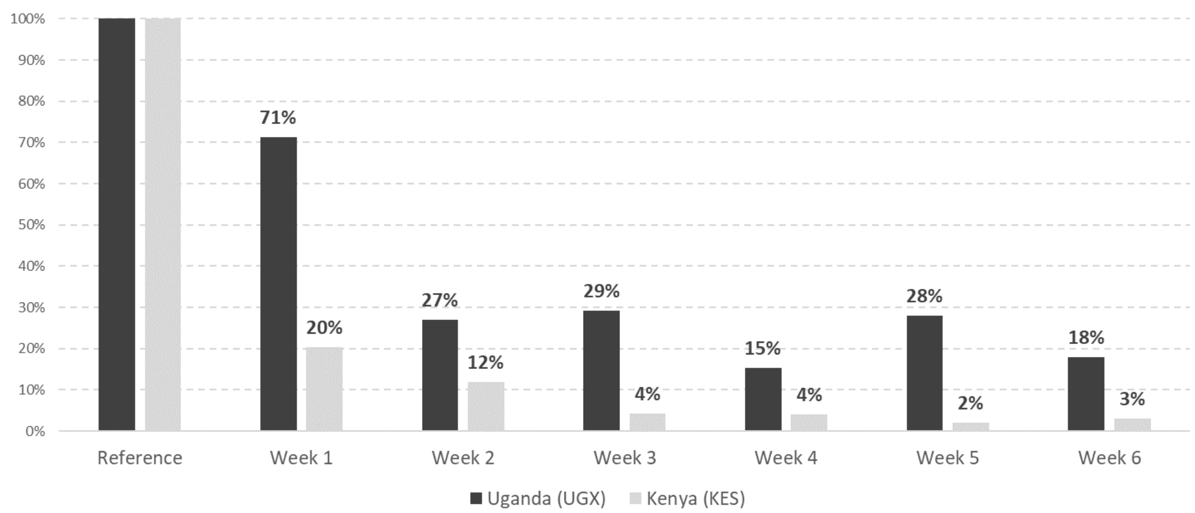

Figure 1: Lending (volume in local currency KES/UGX) in the period 19.03.2020 (week 1) - 29.04.2020 (week 6). Reference: 05.02.2020 - 11.02.2020.

To understand the scope of this crisis, awamo has analyzed credit data of its clients. awamo offers a fully digital core banking system for microfinance institutions in Kenya and Uganda, and serves more than 400 MFIs. These provide basic financial services to around 3 million people.[8] Before the SARS-CoV-2 pandemic began, a monthly credit volume of around EUR 2 million was made available to borrowers via the software. From a total of 27,663 credit data sets, awamo calculated the changes in credit supply and recorded decreases of up to 98% (cf. fig. 1).

When looking at the use of loans, it can be noted that a large proportion of loans (88.3%, cf. Figure 2) are typically taken out in order to finance small and medium-sized enterprises, for self-employed persons, and

[7] *Source: The World Bank (2014): Jean-Loïc Guièze, Financial inclusion in sub-Saharan Africa; population growth extrapolated to 2020.*

[8] *awamo serves about 700,000 end customers with its software platform. The average household size in Uganda and Kenya (weighted) is just under 4.4 household members. Source: United Nations (2017).*

for "other" purposes. "Other" uses include school fees and funds for bridging seasonal income fluctuations (e.g. through seasonal cultivation and sales of agricultural goods).

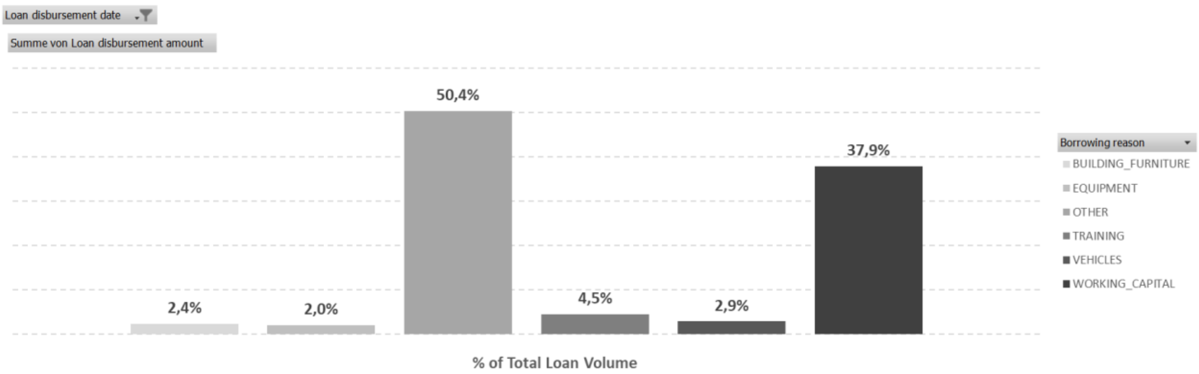

Figure 2: Use of credit funds as a percentage of total credit volume in the period prior to the SARS-CoV-2 measures (01.01.2020 - 18.03.2020).

Complementary options for the allocation of funds in development cooperation

The reason for historically distributing funds via financial and government institutions and large NGOs is in large part due to the transparency over how these funds are used. Nevertheless, the donors are aware that despite the preference for institutions, these funds cannot always be used for their intended purposes, and at times do not reach the funding's target group. In addition, there is a long delay from the allocation of funds in Germany / the EU to their eventual disbursement on the ground.

A complementary option to the existing approach would be to consider (non-regulated) microfinance institutions - which have direct access to targeted beneficiaries (semi-urban and rural populations) - as distributors, provided they can ensure sufficient transparency on the use of funds.

awamo is one of several companies that offer MFIs the ability to create greater transparency through a digital core banking system. In recent years, a large number of companies - some of them based within the EU - have become involved in the digitization of African economies and have developed considerable outreach (e.g. Oradian, Musoni Systems, Ensibuuko, Savings Plus, Loan Performer).

Due to the nature of their business models and, in some cases, their headquarters or branches within the EU, these companies might also be able to allocate funds directly to MFIs and make their use sufficiently transparent to the donors.

It is advisable for the measures described above to be integrated into the existing system of fund allocation. These measures would greatly improve the political discussion and the resulting implementation in development cooperation in the future.