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Microfinance in Post Conflict Countries: What Makes it Tick? [1]

by

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[1] This paper draws heavily from the earlier papers written by the author for ILO in 1997 and in 1999.

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Examples of successful microfinance experiments have prompted its use as an intervention mechanism to enhance welfare in post-conflict situations and jump-start the crippled economy[3]. Some of the sound microfinance practices are translated from normal countries to suit the post-conflict situation. Several lessons have emerged through experiments with microfinance in post-conflict situations. This paper outlines some lessons and present some evidence to show that microfinance can work reasonably well in post-conflict situations. It is nonetheless important to not lose sight of the fact that microfinance is only one tool amongst others that contribute towards economic development in post-conflict situations. Microfinance neither can end conflicts nor can become a primary vehicle for peace building.

Conditions for intervention with microfinance in post-conflict situations

In general, several macro, micro and meso factors influence starting of microfinance activities in countries emerging from conflicts. The minimal conditions include the following: Low intensity of conflict, reasonable safety for the clients and microfinance providers, ample donor funds, re-emergence of markets, presence of NGOs willing to experiment with financial intermediation, returnees and refugees settling down, and minimal social capital. These conditions may guide interventions through microfinance after the immediate post-conflict situation.

The facilitating conditions may not be required at the start but may be essential for building institutions capable of providing sustainable financial services. These factors may not affect financial intermediation in the short run since MFOs can find ways to work around them. These may include the following:

- at the macro level: Working government, donor funds directed with long-term goals, coordinated developmental efforts, absence of hyper-inflation and other disasters, return to use of currency than barter,
- at the meso level: Bare-bone, functioning central and commercial banks, reasonably efficient support institutions (legal, supervision, property rights, information), availability of microfinance expertise in post-conflict situations, returning trust in institutions, enabling legislation to foster microfinance, and
- at micro level: A settled population, latent demand for financial services, restoration of social capital, re-emergence of informal and formal arrangements, and availability of skilled/educated local labor force. These conditions are similar to a normal less developed country.

The minimal and facilitating conditions may not be sufficient for stabilizing financial markets in post-conflict situations. The sufficient conditions are indeed similar to that of normal countries with efficient financial markets. It may include a competitive industry

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[3] There may not be an ideal and clear end to conflicts. Sporadic eruption of violence is common at least for the first five years after the peace accord. For this paper, a post-conflict situation may prevail after a peace agreement is reached or to be reached, when reasonable level of safety for the majority of the population returns, and when major demand for relief services is declining. Return of a government may not be essential to entail a post-conflict situation at initial stages.

composed of institutions with good governance, non-repressive financial sector policies, commercialization of the industry, and entry of private investors.

The facilitating conditions to nurture/develop microfinance organizations that can promote economic growth and employment is unlikely to be present in countries newly emerging from armed conflicts. But the conditions to start/initiate microfinance are few and exist after the immediate post-conflict stage. Selected programs in Bosnia, Uganda, Cambodia and Mozambique that started after the immediate post-conflict stage are prime examples. The programs started small with heavy external involvement to serve the war affected in settled areas and with flexible designs. Several of the programs are now sustainable.

Performance of MFOs in Post-Conflict Countries: How do they Compare with Normal Countries?

The performance of MFOs in post-conflict countries has not considerably lagged back compared to normal countries. Data in Table 1 compares the performance of two post-conflict countries, Bosnia-Herzegovina and Uganda, with their peer groups in Eastern Europe and Small and Medium sized MFOs in Africa, respectively.

Programs in Bosnia-Herzegovina and Uganda are slightly younger and smaller in size with a lower outreach in terms of number of borrowers but with better depth of outreach relative to the peers. They tend to use individual and group loan products to reach their clientele. Deposit mobilization is not observed to be a significant service provided by these MFOs since ample donor funds are available for on-lending. They are not profitable and yet to become financially self-sufficient like their counterparts. It is encouraging, however, to note that the MFOs in Bosnia-Herzegovina are operationally self-sufficient and close to full self-sufficiency. It is possible for the MFOs in Uganda and Bosnia-Herzegovina to reach self-sufficiency by charging higher rates of interest to cover the higher level of operational expenses compared to their peers. It is also to be noted that they tend to be less efficient than their peers due to lower staff productivity and higher staff salaries that are not aligned well with the incomes generated through the lending activity.

The high costs of operation is a special challenge to MFOs in post-conflict countries. The staff provide multiple services such as counseling and education in addition to lending that reduces their time available for lending activities. In addition, considerable amount of marketing efforts is found necessary in Bosnia-Herzegovina to earn people's trust before making loans, and in product development. Also, excess demand for well trained local staff and hiring of external consultants pushes up salary costs. The high salaries, however, in part function as an incentive for the staff to work long hours and in distressed areas, and cover for inflation losses. It may be imperative to tolerate the higher than normal costs at the beginning to compensate for the challenges in establishing MFOs in post-conflict areas.

The above discussion also indicates that developing sustainable institutions in post-conflict countries is possible but may take more efforts and costs compared to normal developing countries. Currently, there are a few programs in Cambodia and El Salvador that have reached financial self-sufficiency. It is to be noted that sustainability was possible after about seven years in Cambodia and El Salvador since the launching of the program, only a little longer than that observed among best practices in normal developing countries. The programs required heavy donor involvement in capacity building for up to six years. Bosnian programs could achieve operational sustainability within about three years since their inception but they are subsidized heavily by donors.

What Makes Microfinance Tick in Post-Conflict Countries?

Clear understanding of the situation is the foremost criteria for making microfinance work in post-conflict countries. Understanding the causes of conflict, limitations of microfinance and effectiveness of donor interventions through microfinance in the wake of conflicts is paramount especially for donors who consider microfinance as an intervention tool. Post-conflict country may prefer not to revert back to the pre-conflict stage since the prior environment would have triggered the conflict. Therefore, goals for post-conflict country to become normal need to be different from the pre-conflict stage. This requires examination of alternative scenarios for the country rather than the pre-conflict stage. Not all post-conflict situations are alike. Situations prior and during conflicts matter and need to be considered as initial conditions that feed into the type of interventions after the conflicts.

Micro-finance institutions are site-specific and their design is often influenced by the local culture. Therefore, donor assistance may be required in developing local capacity and micro-finance intermediaries that reflect local culture. This may involve more donor time, money and efforts compared to normal countries. Therefore, donor support for capacity building through developing the capacity of national project teams may probably be justified for a longer time compared to normal developing countries. Donor grants may be essential for initial capitalization to build an equity base that can be used to generate investment income, build loan portfolios and leverage funds from local banks of MFOs. But continued capitalization may create a donor dependency syndrome and may reduce NGO efforts to mobilize local resources.

The MFOs that are pro-active with donors and innovative tend to make the program work well. NGOs are good in group formation but lack banking skills. However, often they are the only agents available in a country emerging from conflicts that are willing to take the risk of doing microfinance at that stage of the country. Significant training and change of mindset for these NGOs to provide microfinance is found to result in efficient MFOs in post-conflict countries. External advisors willing to train local counterparts are found to contribute towards developing sustainable MFOs in post-conflict situations (eg. Cambodia, Bosnia, Mozambique).

The prime ingredient for good performance of MFOs in post-conflict countries is observed to be the design of the program. Flexibility in design matters: Institutions that have achieved financial self-sufficiency were launched with flexible designs at small levels after the immediate post-conflict stage and later expanded. Examples of ACLEDA and GRET in Cambodia, and CALPIA in El Salvador show that these programs started small after the immediate post-conflict situation and are now expanding with new products and services to more clients thanks to consistent donor support to build equity capital and capacity, and for covering the majority of operating costs at initial stages. They are flexible programs that tend to learn by doing. However, Flexibility in design should not undermine the credibility of the organization. ACLEDA in Cambodia has modified its technology during its seven years of existence to suit the demand. The modifications have been generally in terms of financial technology that matches the local situation and demand rather than that compromises the basic principles of best practices such as charging interest high enough to cover costs, services tied to demand, and strict monitoring and enforcement of contracts.

Safety of MFO staff matters and appropriate staff incentives are essential to motivate staff to work in such risky locations. MFOs have devised several operational methods to ensure safety of their staff. Parity in the systems for procedures and resources available to expatriate and local partner staff in terms of safety and stress management is important to improve staff morale.

Conclusions

Microfinance in post-conflict countries is an evolving field. The most important lessons emerging from several experiments with microfinance in post-conflict situations are the following:

- *Microentreprenuers are highly resilient and become very active at the post-conflict stage creating a market for microfinancial services.*
- *It is possible to implement successful microfinance programs in post-conflict countries with reasonable stability: Development of sustainable microfinance institutions serving the vulnerable population such as war affected is possible with good timing and efficient designs.*
- *The conditions required to start microfinance programs after the immediate post-conflict situation are few.*
- *Pre and post-conflict environment matters in deciding the type of intervention.*
- *After the immediate post-conflict stage, a conflict-affected with few recurrent conflicts country is like a normal country, only with war memories. Therefore, building of sustainable financial institutions require facilitating conditions similar to any normal developing country.*
- *Best practices apply and work in post-conflict situations with reasonable stability after the immediate post-conflict stage. There are several lessons from normal developing countries that apply to post-conflict countries.*
- *Like in normal countries, microfinanace in only one of the tools available for economic development in post-conflict countries.*
- *There is no "one size fits all methodology" for implementing microfinance programs in post-conflict situations.*

Several issues remain to be addressed. Less is known on the informal arrangements in post-conflict situations that may offer valuable insights for developing mechanisms that can suit local conditions. For example, information on informal arrangements such as pawning, money-lending and remittance and safe keeping services provided on informal basis in refugee camps and in areas where returnees and refugees are settling down is rare. Commercial banks are emerging to provide microfinance in some post-conflict countries and stand-alone microfinance banks are also established (such as in Kosovo and Bosnia) after the immediate post-conflict stage. Less is studied on their performance to draw lessons. Role of self-regulation or supervision by an external agent is yet to be examined in detail. There are some efforts underway in Bosnia-Herzegovina in this area.

The current state of the art is less than adequate to guide us through all post-conflict situations. With well intentioned and focused efforts, however, the few successful cases may lead to a snow balling effect resulting in better microfinance activities in post-conflict countries.

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Table1. Performance of selected MFIs in post-conflict and other countries (averages)

Items	Bosnia and Herzegovina (n = 8)	Eastern Europe (n = 7)	Uganda (n =6)	Africa – Small and medium MFIs (n = 10)	All MFIs (n= 114)
Age (yrs)	2	3	5	6	7
No. borrowers	1,882	943	9,677	15,845	10,574
Total loan portfolio outstanding (mill.US$)	2.57	3.12	1.06	2.03	3.88
Average loan balance (US$)	1770	2481	119	129	581
Depth of outreach (Average loan balance/GNP per capita) - %	163	232	37	33	48
Adjusted return on assets (%)	-4.3	-2.1	-15.2	-11.6	-3.2
Operational self-sufficiency (%)	105	103	68	81	107
Financial self-sufficiency (%)	85	91	63	76	92
Real portfolio yield (%)	15.4	16.9	48.4	34.6	28.7
Operational Income (as % of average assets)	26.5	21.9	25.5	28.1	29.3
Operational expenses (as % of average assets)	30.6	22.6	42.6	42.1	33.1
Administrative expenses (as % of average loan portfolio)	25.6	17.8	85.7	57.4	31.0
Average staff salary (as multiple of GNP per capita)	9.8	4.1	16.7	7.7	5.1
Staff productivity (no. borrowers / staff)	67	48	111	190	111
Cost per borrowers (US$) (Administrative expenses / No. of average borrowers)	289	266	88	61	150

Note: To minimize outlier effect, averages were calculated after deleting observations at the top and bottom percentiles for each indicator.

MFIs included in Bosnia-Herzegovina: BOSPO, LOK, AMK, MC-SEA, SUNRISE, Microenterprise Bank, World Vision, Mikrofin; In Uganda: FAULU, FINCA Uganda, CERUDEB, FOCCAS, UWFT, Pride Uganda; in Eastern Europe: Fundsz Mikro, Inicjatywa Mikro, NOA, Nachala, FEFAD, Moznosti, NLC; in Small and medium Africa: SEF, RFF, FINCA Malawi, Wages, SAT, Pride Vita, Kafo Jiginew, Pride Tanzania, Nyésigiso, PAMECAS ; All 114 MFIs include MFIs from around the world and refer for names to *The MicroBanking Bulletin*, Sep. 2000. www.calmeadow.com.

Source: *The MicroBanking Standards Project*