DONOR BRIEF No. 21
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Helping to Improve Donor Effectiveness in Microfinance

SUPPORTING MICROFINANCE IN CONFLICT-AFFECTED AREAS

Supporting microfinance in devastated and fragile communities can be successful when donors work in concert, select qualified partners, are patient, are willing to take risks, and are prepared to pay higher costs. Effective microfinance can create the foundation for a fully integrated financial sector and fuel reconstruction.

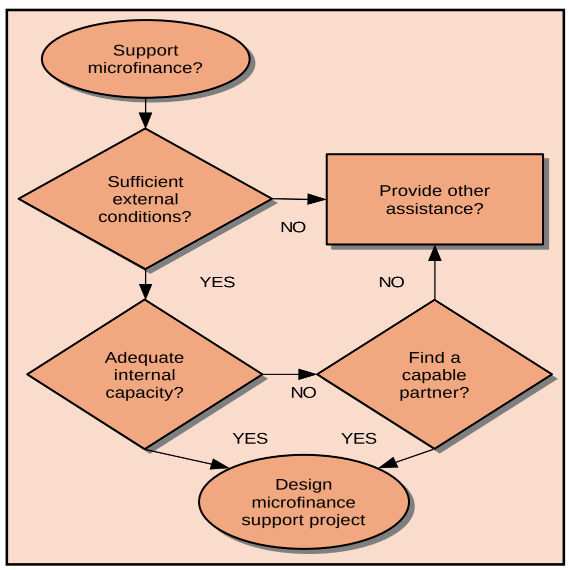
What are some characteristics of conflict-affected areas?

Psycho-social	→	Loss of trust; death or geographic separation from families; difficulty in planning for the future; feelings of entitlement; fear of violence
Economic	→	Loss of household and business assets; lack of trust in financial systems; distorted economy fed by aid money; small pool and high cost of skilled human resources
Infrastructure and services	→	Damaged and neglected physical infrastructure and loss of access to basic services, such as schooling, sanitation, health care

What are the essential conditions to start microfinance operations?

External Environment

- *Minimum political stability.* Microfinance is not a conflict resolution tool. Program areas must offer a reasonable degree of security and safety for clients and microfinance institutions (MFIs) to carry out their activities. In the Democratic Republic of Congo, USAID and CIDA focused microfinance efforts on pockets of stability while other areas of the country remained inaccessible.
- *Stable population.* Maintaining timely loan recovery is difficult with mobile populations. Most programs focus on residents, internally displaced people, and returnees, rather than refugees—unless refugee communities are de facto semi-permanent. The American Refugee Committee (ARC) provided Sierra Leonean refugees quick access to credit upon their return home by certifying qualified entrepreneurs in the quasi-permanent refugee camps in Guinea.
- *Sufficient economic activity and a cash economy*. Microfinance allows clients to take advantage of economic opportunities—it does not create them. People need access to productive resources, be able to trade, and carry and use money for microfinance to work.



Internal Donor Agency Capacity

- *Sufficient, qualified staff.* Agencies should have a person in-house, with experience in sustainable microfinance in conflict-affected areas, to provide inputs in early program design, select good partners, and conduct performance-based monitoring.
- *Patient, long-term perspective.* Donors may expect institutions to take longer to become sustainable relative to lower-cost, non-conflict settings. They should commit to three years or more. Donors constrained by short funding cycles should coordinate with others to ensure long-term access to funding.
- *Flexible, longer-term funding mechanisms.* Whereas relief operations require large amounts of funding disbursed quickly, microfinance requires smaller amounts disbursed over time at higher administrative cost. Donors should offer grant funding without restrictive or rapid disbursement conditions—even in the face of political pressure.

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What are the guiding principles for donors?

Donors can play an instrumental role by following the principles below, and leaving operational decisions to strong financial service providers.

- ***Apply good practices.*** Microfinance good practices do apply to conflict-affected situations. Core principles, such as maintaining high portfolio quality, applying market interest rates, and planning for full cost-recovery, should not be compromised. Donors and their partners must understand client needs and their capacity to use financial services. Providing credit to someone who cannot repay only creates greater vulnerability and insecurity. Other services, such as savings and transfers, may be more appropriate.
- ***Ensure separation between relief services and microfinance.*** Donors working in the early stages of post-conflict should agree with their implementing partners on when and where to offer grants for relief activities to clients versus offering them financial services. This approach can help minimize damage to the credit culture. Areas completely dependent on relief operations are difficult for microfinance.
- ***Select experienced partners.*** Donors should pick implementation partners that have experienced staff and a track record in microfinance in conflict-affected areas. Preferred partners include local financial institutions (commercial banks, credit unions, NGOs) and specialized international NGOs. Where none exist, donors can support organizations with in-depth country knowledge to acquire microfinance expertise. In southern Sudan, USAID worked with Chemonics, a consulting firm with microfinance experience, to establish a local MFI which is managed by Sudanese and clearly distinguished from internationally-staffed relief organizations.

Microfinance Is Not Always the Answer: A Range of Donor Interventions

- Investments in infrastructure, e.g., market centers, wells, and electrical or stand-alone generators
- Employment services, including food for work projects and vocational and skills training
- Business development services
- Economic development grants

- ***Avoid targeted programs.*** Forcing unsuitable clients on good practitioners will lead to poor results. Donors should not dictate that MFIs serve exact numbers or percentages of particular populations. High risk groups, such as youth or ex-combatants, might be better served by other non-credit services or grants.
- ***Take measured risks.*** Incentives and accountability mechanisms should strike a balance between promoting risk taking and ensuring sound performance. Still, donors should be prepared for occasional failures and high costs for staff, security, and transport.
- ***Collaborate with stakeholders.*** Donors should engage relief agencies, local leaders, practitioners, and other donors to exchange information on programs, establish joint principles to support microfinance, and avoid undermining each other. CGAP and the World Bank designed the Microfinance Investment Support Facility in Afghanistan to combine diverse donor funding (DFID, CIDA, USAID) and goals into a single, flexible funding and institution-building support mechanism. Over US $20 million has been invested following good practice performance and transparency standards.
- ***Be responsive to the local context.*** Volatile situations require donors to tread lightly and be sensitive to political tensions that could have a serious impact on the success of a program. Donors may have to work in areas not controlled by traditional authorities.

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Where to get more information: Tillman Bruett, "Conflict and Post-Conflict Environments: Ten Short Lessons to Make Microfinance Work," SEEP Progress Note No. 5 (Washington, DC: SEEP, September 2004), www.seepnetwork.org/content/library. Dave Larson et al, ed., *Microfinance Following Conflicts Technical Briefs* (Bethesda, Maryland: Development Alternatives, Inc./Microenterprise Best Practices, 2001), www.microlinks.org. John Tucker et al, "Recapitalizing Liberia: Principles for Providing Grants and Loans for Microenterprise Development," *Forced Migration* 20 (May 2004):13-15, www.fmreview.org. Geetha Nagarajan and Michael McNulty, "Microfinance Amid Conflict: Taking Stock of Available Literature," Accelerated Microenterprise Advancement Project (Washington, DC: USAID, August 2004), www.microlinks.org. Timothy Nourse, "Refuge to Return: Operational Lessons for Serving Mobile Populations in Conflict-Affected Environments," MicroPaper, no. 4, Accelerated Microenterprise Advancement Project (Washington, DC: USAID, May 2004), www.microlinks.org. International Labour Organisation, *Introduction to Microfinance in Conflict-Affected Areas: Trainer's Handbook* (Geneva: ILO, 2002).