# LITERATURE REVIEW: MICROFINANCE IN POST-CONFLICT AND POST-DISTASTER AREAS

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# Microfinance in Post-Conflict and Post-Disaster Areas

1. **Microfinance in Post-Conflict Areas**
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## 1. Microfinance in Post-Conflict Areas

**Source:** CGAP Donor Brief, Supporting Microfinance in Conflict-Affected Areas

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.
- 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.
- 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.
- 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.

**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 conflictaffected 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.
- 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.
- 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.

**Source:** Microfinance Research in Conflict Environments: State of the Art and the Road Forward, http://www.microlinks.org/ev_en.php?ID=8148_201&ID2=DO_TOPIC

Critical lessons can be drawn from the experiences documented so far.

- Microfinance works in post conflict environments. Micro-credit is likely to reach the poor and un-banked in a sustainable and efficient way if, as in non-conflict environments, a demand-driven approach is followed.
- Few environmental conditions are required for initiating microfinance in post-conflict settings. An early start is crucial to quickly transition from relief to development.
- Microfinance best practices can and should be adopted from the start of a given intervention to ensure sustainable outreach to the targeted clientele. This particularly applies to market pricing of financial services, rigorous and transparent credit appraisal, and strict loan collection efforts.
- Standardized products used in normal conditions need to be adapted to suit the post-conflict situation. This requires a clear understanding of the capabilities of microfinance and the realities of the post-conflict environment, such as damaged physical infrastructure, broken social ties and trust, and populations accustomed to quick relief, short-term gains and grants.
- There are no shortcuts in designing appropriate products for conflict areas. Insightful market research is more crucial in conflict settings relative to normal situations.
- Group loans are effective, but individual loans also work in post-conflict settings. Individual loans, however, involve higher risks and costs, and re-quire close follow-up, guarantees, support of community leaders and the incentive of future loans to encourage repayment.
- Security of staff and funds matter. Damage to a society’s structure and decreased rule of law can affect the physical safety of MFI staff and cash on hand. Thus, adequate physical security must be in place to safeguard staff and cash. Internal control, good management and transparency in operation are also essential for assuring the safety of capital.
- Qualified staff is crucial for success. Personnel, management and field staff with experience in microfinance should be hired from the start whenever possible. If experienced candidates are not available, training is required to help develop skills in designing and delivering micro-

finance products and in effectively managing and monitoring operations. Incentive may be required to motivate staff to re-main focused on the target clientele and to ensure a high portfolio quality.

- Initial start-up and operating costs are high in conflict environments. The costs are especially high due to salary and security expenses. Relative to normal areas, loan losses may also be high in situations immediately following conflicts, at least in the short-run.
- Sustainable operations are possible. It is not uncommon, however, for MFIs initiated in early post-conflict settings to require a little more time to attain financial sustainability compared to similar MFIs in non-conflict situations or post-conflict areas in their late stages.
- Microfinance is only one of the development tools for rebuilding a war torn society and should be used with care. To facilitate the development of a post-conflict society, non-financial services may be required to precede and/or support financial services provided through innovative and competent institutions. In-deed, there are situations in which it may be more appropriate to use grants rather than microfinance.
- Say “No” to subsidized financial services and a loose repayment culture. Governments and donors should avoid pushing MFIs to directly subsidize the clients through cheap financial services. This can potentially undermine the microfinance sector for a long period of time. Also, MFIs must be strict on loan collections from the beginning and must clearly educate their clients on the differences between grants and loans.

**Source:** Conflict and Post-Conflict Environments: Ten Short Lessons To Make Microfinance Work (Progress Note No. 05), http://www.seepnetwork.org/files/2059_PN_5FINAL.pdf

**How can microfinance work in a conflict/ post-conflict situation?**

This progress note explores the key ingredients to the success of microfinance programs in conflict and post-conflict environments, and comes up with the following ten lessons for making microfinance work in these difficult environments:

- Focus on the client’s security: Safe and secure savings programs assist communities in building and protecting their assets.
- Work with trusted institutions: Microfinance institutions (MFIs) should work within the surviving or emerging structures that have the trust of the population. .
- Provide a range of services: There should be a clear distinction between relief services and financial services.
- Adjust product design and delivery: Product design and delivery must allow for general instability and potential economic interruptions.
- Separate microfinance from relief operations: Relief, development and peace-making activities must be separated from microfinance activities.
- Share, cooperate and collaborate with stakeholders: Sharing information with other practitioners, as well as donors and local leaders, on issues like security, product terms and conditions is mutually beneficial in an unstable environment.
- Think long term: Practitioners should work with donors to design funding mechanisms that permit continued development of the microfinance program after the emergency funding has expired.

- Develop human resources and ensure staff safety: Microfinance programs can benefit from bringing in one or more expatriate teams to train local staff; MFIs should also ensure staff safety.
- Ensure access to staff and systems: MFIs should safeguard their records and make them available from remote locations. Management must develop a communications strategy in emergencies.
- Maintain portfolio quality: This requires a strong information system that provides timely and accurate information and enables the staff to monitor payments on a daily basis.

**An interesting article on Congo**: When, Where and How: Donor Struggles in Congo's Microfinance Recovery, source: http://www.uncdf.org/english/microfinance/newsletter/pages/mar_2004/news_congo.php

…In the face of such complexity, microfinance donors and investors are confronted with three simple questions: when, where and how to support the sector?

The questions of when and where to support and implement microfinance projects applies to those areas where peace is still very fragile, and where, for instance, international forces are still needed to stem any outbreaks of violence. Microfinance's function of lubricating economic flows proves useless if the foundations for economic life have yet to be built: disarmament, population settlement, infrastructure, and trade opportunities. Otherwise, microfinance institutions will run into a series of obstacles that include reaching inaccessible clients, demanding payments from gun-toting ex-combatants, keeping track of those that are settling in or relocating outside of the region. All of these elements will put severe strains on the institution's ability to control delinquency and will severely affect the long-term prospects for developing a healthy number of financial intermediaries.

To support an environment better suited to the effective functioning of MFI's, donors may consider postponing the introduction of microcredit components until other initiatives yield the better conditions. Such initiatives within the development repertoire include quick cash disbursement in the explicit form of grants to capitalize local communities, labor intensive programs to rebuild infrastructure, generate employment and thus increase the incentive to drop arms, and stabilize population flows. The objective is to set the groundwork for interventions, such as microfinance, to become more effective and permanent.

In the case of the DRC, where eastern provinces still experience recurring instability and where the infrastructure remains in shambles, does this mean that microfinance should be completely shelved until the entire country receives a diagnosis of stability?

In a country like Congo, the immense territory offers an opportunity to create "islands" of economic recovery and financial development in stable regions such as Kinshasa, the Bas Congo and Katanga, even if tensions linger in other, more remote, areas. Donors can have a staggered, regional approach and start focusing on cities and provinces where relative political stability and renewed economic activity present more fertile grounds for microfinance to make a real contribution. Kinshasa, for instance, is home to more than 6 million people. A lot can be accomplished now, and many institutions could achieve scale and reach in Kinshasa alone, or in Lubumbashi in the south, even while MONUC pacifies the eastern provinces.

In such pockets of recovery, donors can indeed play a major role in assisting microfinance institutions to rebuild their internal capacity and resume the provision of financial services to their clients. The challenge is to determine how to go about it. The development of a microfinance industry has been well analyzed and well documented yet most models that describe the sector's natural or anecdotal growth assume certain environmental features that are absent in post-conflict contexts such as the DRC. Beyond the theory, the DRC offers an immediate, concrete challenge: where more or less everything needs to be rebuilt, should one start by creating the right political and legal framework, by directly supporting institutions, by training the donors themselves, by training practitioners or by strengthening the Central Bank? There are many options on the menu, and the donors' understanding of where to begin is for the moment, very limited.

Ideally, all of these ”pillars” would be developed simultaneously. In a context of limited donor and investor resources, the challenge is how to prioritize. Some may argue that political and legal frameworks should wait for institutions on the ground to grow and offer evidential material upon which policies, laws, and regulations can be designed. In post-conflict settings however, the need for action on this front may be required as the inflow of international aid often leads to misguided direct government and donor credit schemes designed, albeit altruistically, to provide relief and spur hope for the future among a war weary population. This overzealous desire, on the part of various ministries to promote large subsidized credit programs also stems from a desire to shore up popular support in periods of political transitions and with elections in the offing. The difficulty lies in identifying, among the many policy and legal issues, those which require immediate attention and for which immediate attention would probably be counterproductive. In the case of the DRC, where knowledge of the sector and of its actors remains low, in part due to the inaccessibility of certain regions, laws on microfinance would appear premature. Not only would laws fail to incorporate realities on the ground, but also the inability to enforce and monitor any provisions would render them useless. At the same time, countries emerging from conflict often have inadequate or restrictive legal frameworks that hinder the development of a local financial industry. A modicum of financial liberalization in the DRC has proved instrumental in spurring interest from international financial intermediaries such as FINCA and IPC, thus paving the way for increased provision of financial services to the Congolese population.

Post conflict environments present donors and investors with the difficult task of choosing among institutions that have all gravely suffered from the crisis. Faced with weak capacity across the board, should donors and investors support institutions created ex-nihilo or should they strive to build upon what currently exists? The due diligence required before deciding on these options is a complex and time-consuming exercise. In the Congolese context, this difficulty is compounded by the absence of any records, any census, and the inability to reach, physically, many of the institutions. Yet, immediate support to just one or two institutions is critical. In a country that combines a deeply rooted distrust of the financial sector with an immense need for financial services, the growth and sustainability of demonstration models that provide quality services to the population are essential in restoring the public trust, reinvigorating its cooperative tradition, and attracting additional international investments.

Based on these observations, one could argue that donors and investors have accumulated a fairly good understanding of when and where to support microfinance. The question of how (or where to begin) remains problematic. Our understanding of the appropriate timing and sequencing of microfinance initiatives remains weak. Evidently, as we all recognize the importance of local contexts, most of the learning will come by doing, through a trial and error process. However, certain guiding principles have emerged from the experience of various post-conflict countries.

By looking at the recent history and the current climate of the DRC, we can arrive at the following conclusions:

- Long-term commitment: in a context of political, economic and social recovery, the development of the microfinance sector and of all its pillars will take time. Donor commitment and patience are required. Proper due diligence, a perennial weakness on the part of donors, is even more essential in this context. In the DRC, given the immense task at hand, the expected time frame for the development of the sector should be longer than what other countries have experienced.

- Judicious restraint: microfinance should not be a priority, nor should it always be included in recovery programmes when conditions for a meaningful and sustainable contribution are not ripe. In such areas, labor-intensive projects, quick and temporary grant disbursement and peace building measures such as disarmament should be the priority.

- Judicious engagement: in areas that are no longer at risk, donors and investors can support the development of the microfinance sector, thereby creating pockets of growth that can expand nationally as the country achieves greater stability.

- Recognition of local dynamics: during conflicts, people develop their own survival mechanisms at the local level, including informal financing methods. Efforts to rebuild the financial sector should, in part, rely on and add to the existing mechanisms. In the DRC, the long and successful history of the cooperative movement provides an appropriate basis.

Given the size of the market and the demand, this last principle does not mean that other models and delivery mechanisms should be promoted and supported. A clear indication of a successful political, economic and social recovery will be when clients themselves are able to determine which model best fits their needs. At that point, microfinance in the DRC will no longer be post-conflict.

## 2. **Microfinance in Post-Disaster Areas**

**Source:** CGAP Brief, February 2005, Sustaining Microfinance in Post-Tsunami Asia

### Key Principles for Microfinance

Maintain a commitment to sustainable operations. Where possible, MFIs should work with dedicated agencies and donors that specialize in emergency relief rather than providing relief directly. In the absence of dedicated relief agencies, established MFIs often have to provide relief assistance immediately after disasters. But this period of postdisaster assistance must be well-defined, and should be followed by a return to unsubsidized loans in the rehabilitation and reconstruction phases.

Customize solutions according to clients' needs. Some clients may be severely affected by the tsunami, others less so, and a few fortunate ones not at all. MFIs should be able to provide each household with the appropriate menu of services depending on its circumstances. For those hit hardest, emergency relief would be a better first intervention than financial services. To make customization work, staff must have the training to assess the situation and the authority to make on-the-spot decisions. Specific criteria should be defined for loan officers to make decisions about rescheduling and providing grants.

Be realistic about MFI role. MFIs should consider where they can contribute best in disaster response and avoid embarking on activities beyond their capacity and mission.

**Guidelines for Microfinance Institutions**

Relief Efforts**.** MFI participation in relief efforts should usually be limited to locating clients, linking clients and other community members to on-going relief operations or by transporting these people to locations where they can receive services. However, MFI field staff can play a vital role in transmitting public health messages, such as the importance of consuming only clean water. Coordination with relief organizations is essential. Where relief providers are not present, an MFI may temporarily conduct relief but should ensure that clients recognize its role as being, fundamentally, a financial services provider.

Managing Client Savings. MFIs should lift compulsory savings requirements in affected branches until the emergency stage has passed and clients have begun reconstruction. This gives MFIs the opportunity to rebuild branches and locate clients, and ensures that clients retain as much cash as possible to cope with the crisis. When considering the opening of deposit accounts to clients for withdrawal, MFIs should consider their liquidity position and any prior promises made to clients about the availability of savings during emergencies.

Rescheduling Loans. Rescheduling loans on a case-by-case basis can help MFIs avoid losses and defaults on their loan portfolio, and ensures that any cashflow earned by those hardest-hit stays in the household.

Reconstruction Loans. Reconstruction loans are most effectively given once the emergency stage is over and MFI staff can assess the damage to property, and the credit standing, of clients. Repayments on these loans must be monitored carefully, particularly if they are used to finance homes or latrines, which don't generate regular cash income.

Going into New Areas. MFIs considering entering unserved areas to provide emergency financial assistance should plan their long-term presence in these areas carefully. Clients without prior knowledge of an MFI's commercial rates and commitment to sustainability may initially view the organization as another relief agency or temporary donor program.

Managing Micro-insurance Claims. Insurance claims should be processed as soon as possible to afford clients access to emergency cash. Care should be taken to screen out false claims and to ensure the sustainability of the micro-insurance program. Emergency loans can be provided against approved insurance claims if there are delays in disbursement.

**Guidelines for Donor Support**

Donors must understand the options available to MFIs in post-disaster situations as well as the corresponding constraints. In general, donors should:

Be responsive to the local context. It sounds obvious, but in many communities, the success of microfinance hinges on a hard-earned trust between lender and client. By collaborating with local stakeholders — community leaders, microfinance practitioners, nongovernmental organizations, and other agencies — donors can help microfinance institutions balance the immediate needs of their communities with the long-term need to remain sustainable.

Ensure separation between relief and microfinance. MFIs are not relief agencies. While the imperative of the situation may force some MFIs to conduct relief activities immediately in the

post-disaster phase, donors should ensure separation between relief and microfinance as soon as possible.
Stick to microfinance good practices. Donors and their partners must understand clients' needs and their capacity to use financial services. But where these services are feasible, donors should encourage microfinance institutions to restructure, rather than forgive, loans.
Avoid setting disbursement targets. Donors should avoid setting a target number of 'clients served' for microfinance institutions, as this may encourage some to take on clients who are unable to repay debt.

**Source:** Microfinance Donors: Preparing for Natural Disaster, What are the roles and responsibilities of donors in risk-proofing the microfinance industry against large-scale natural disasters?
http://www.microlinks.org/file_download.php/rapid_onset_brief_8.pdf?URL_ID=7464&filename=11202847541rapid_onset_brief_8.pdf&filetype=application%2Fpdf&filesize=69685&name=rapid_onset_brief_8.pdf&location=user-S/

In order that donors may respond most effectively to rapid-onset natural disasters faced by MFIs, they require good information and thoughtful policies. This technical brief outlines four ways in which donors can take appropriate action both before and during critical times of crisis for MFIs.

- Even in the face of disaster, promote microfinance sound practices. This includes not asking MFIs to forgive loans, or pressuring them to act as social safety nets for communities
- Prepare a Natural Disaster Response Policy for MFIs
- Clear policies including terms and conditions for disbursements of disaster funds and a standard format are essential for when a crisis hits
- Provide Disaster Preparation Support to the MFI Industry
- Donors can invest in preparedness activities such as early warning systems, duplicate records safekeeping, or staff training
- Develop a Consensus on Disaster Response in the Microfinance Industry. Topics for discussion include appropriate reserve requirements and the support and management of disaster loan funds.

Overall, policy dialogue on these four points should take place on an ongoing basis, not just during and following large disasters

More info:

- *MicroLinks* organized a discussion group on Using Microfinance to Mitigate the Effects of Natural Disasters (facilitated by Geetha Nagarajan)**.**

In case you would like to have a look, a full summary of this event is available here: http://www.microlinks.org/file_download.php/MF+%26+Natural+Disaster+SC_Final.pdf?URL_ID=8566&filename=11295762491MF_%26_Natural_Disaster_SC_Final.pdf&filetype=application%2Fpdf&filesize=433252&name=MF+%26+Natural+Disaster+SC_Final.pdf&location=user-S/

- FYI: Another relatively recent paper (World Bank and UNCDF, February 2005)

Surviving Disasters and Supporting Recovery: A Guidebook for Microfinance Institutions
http://www.proventionconsortium.org/files/disasterguidefinal.pdf