microNOTE #24

Early and Broad Sectoral Interventions for Rapid Microfinance Development: Evidence from West Africa

I. Abstract

While clear lessons have emerged to develop successful microfinance institutions (MFI) in post-conflict environments, learning on how to quickly develop vibrant microfinance sectors in these challenging environments is still elusive. In the past, many microfinance (MF) donors and practitioners[1] have advocated a conservative and narrow approach to the sector's development. They have counseled waiting for peace to be consolidated before investing in the sector and have suggested sequencing activities, beginning with micro-level investments in a few promising retail MFIs before broadening efforts to macro-level engagement with the government and developing networks and performance standards at meso levels.

Unfortunately, while waiting for the right time to begin microfinance and then focusing on institution building, less experienced government and relief actors entered the fray and implemented poorly performing programs that were unsustainable, sowed confusion among clients, and wasted resources. In response, MF donors and practitioners are now promoting earlier and broader interventions that have the potential to reduce the number of poorly implemented programs

SEPTEMBER, 2006

This publication was produced for review by the U.S. Agency for International Development. It was prepared by Tim Nourse of American Refugee Committee, with edits by Geetha Nagarajan and Sherry Sposeep of Chemonics International, Inc.

[1] For the purpose of this paper, MF donors refers to both specialized MF donor agencies (e.g. UNCDF) or generalist donor agencies that are advised by strong MF technical units within their organizations (e.g. USAID missions supported by its Microenterprise Development Office,). Similarly, MF practitioners, refers to specialized agencies (e.g. Accion) or multipurpose agencies advised by strong technical units within their organizations (e.g. CARE).

and reinforce best practice initiatives. Sierra Leone and Liberia, two countries emerging from conflict, highlight the weaknesses of these past approaches in many circumstances and the promise of more recent and improved practices.

II. Post-conflict Microfinance – Past Approaches to Development

There is broad agreement among MF experts that MF programs can be initiated in post-conflict contexts once the essential preconditions of security, market activity and population stability are met.[2] Experts also agree that interventions at the micro, meso and macro levels are necessary to develop vibrant MF sectors that serve a large number of low income households (see Box 1).[3] The consensus largely ends there. Each agency's analysis of the post-conflict context and tolerance for risk influenced when they felt preconditions had been met and how interventions should be phased.

Often, in immediate post-conflict environments, many MF donors and practitioners encouraged conservative and narrow intervention strategies as a precaution against volatility of the environment, inexperience of a new government, and limited in-country microfinance capacity among international and local institutions. They often advised that broad microfinance activities wait until after peace had been consolidated, (i.e., two to three years after the cessation of hostilities), and that donors focus on micro-level investments in a few retail MFIs. Afterwards, once institutions had demonstrated positive results, MF donors and practitioners could broaden the approach, and turn to macro-level engagement with government and supportive meso-level activities.

BOX 1: INTERVENTIONS AND PHASING

INTERVENTION LEVELS

Micro – support retail financial intermediaries

Meso – strengthen facilitative bodies like collateral registries, auditors, raters, credit bureaus, networks, and trainers

Macro – engage government on microfinance policy and regulations

PHASING STRATEGY

Narrow – Micro, followed by Meso & Macro level activities

Broad – Two or three levels simultaneously

This narrow focus on the micro-level investments often ignored the dynamic nature of post-conflict environments. As one experienced donor puts it, "nature abhors a vacuum" - if microfinance donors or practitioners do not provide services to or leadership for the sector, others will fill the gap. Relief-oriented donors and NGOs,[4] already present on the ground, act first. They perceive the need for financial services and respond by funding or initiating credit activities, but frequently do so without having the capacity or experience to engage in sustainable microfinance.

At the same time, inexperienced local government agencies often become involved in lending or premature regulation of the sector, leading to poorly designed and implemented activities that impede the sustainable delivery of financial and the sound development of supportive structures. At worst, they limit the growth of strong retail institutions and spoil the "credit culture."

Once the MF donors and practitioners become more broadly involved in the sector, robust MFIs generally begin to emerge, however their arrival is often delayed by well-meaning but less than effective early initiatives (see Box 2 for examples of donor interventions and results).

[2] Doyle, Karen, Microfinance in the Wake of Conflict, DAI, USAID 1998.

[3] Building Inclusive Financial Systems, CGAP/World Bank, 2004.

[4] Relief oriented donors and NGOs includes general donors that act without support from their internal technical units and multipurpose organizations that are managed by relief staff, rather than MF support units.

BOX 2: LESSONS LEARNED IN
MOZAMBIQUE AND BOSNIA-HERZEGOVINA

In Mozambique and Bosnia & Herzegovina, a narrow focus on micro-level institution building without developing the supportive environment through macro and meso-level activities led to much uncertainty in the microfinance sector. Subsidized credit programs undercut sustainable focused institutions, while relief donors and NGOs confused clients with mixtures of grants and loans ("Groans"). In post-conflict Mozambique, the sector lagged for five years before donors and MF practitioners met and put forth guidelines for MF initiatives, finally paving the way for the dynamic growth of the sector.[1] In Bosnia & Herzegovina, the future of the sector was uncertain until funding dried up for the weakest programs and the World Bank supported a broad, sector wide development program.

III. Liberia and Sierra Leone – Evidence for the Importance of Early and Broad Interventions

A. Liberia's first attempt at microfinance – MF donors and practitioners intervened too little and too late. During Liberia's first attempt at peace between 1996 and 2001, MF donors and practitioners waited on the sidelines for the peace to be consolidated while relief-driven donors, NGOs, and government initiatives dominated the microfinance sector. Unfortunately, the results were less than successful.

In 1997, the Liberian peace agreement and presence of UN peacekeepers helped establish the basic preconditions for microfinance. The UNDP, which at the time had little MF technical capacity in Liberia, sponsored the first major microfinance program. The program supported seven mostly low capacity, charity-focused, local NGOs with capital and very little technical assistance (TA) or operational support (roughly 75% capital; 25% TA and operational support).

The implementers performed poorly, recording high arrears rates (reaching 67% at one point), limited outreach (only 7,800 clients served over the 6 years of funding), and numerous cases of fraud and mismanagement.[5]

A similar initiative was funded by two other relief donors – the United Nations High Commission for Refugees (UNHCR) and the US State Department's Bureau of Population Refugees and Migration (BPRM). They chose an international relief NGO - the American Refugee Committee (ARC) - to serve as the umbrella agent through which low capacity, local NGOs were provided with capital funds but little technical assistance. This program had results similar to those of the UNDP program. Unable to cover more than 35% of its operating costs and suffering from 33% of its portfolio in arrears, the program briefly served 4,602 clients, but then collapsed, depriving its clients of further services.[6] The last program was a government initiative involving the Liberian Bank for Development and Investment (LBDI), a commercial bank partially owned by the government, and the National Investment Commission (NIC), a government department. Through a tripartite agreement between the borrower, LBDI and the NIC, small enterprises were lent between $1,000[7] and $5,000. After serving approximately 50 clients, this program failed because the loans were perceived as government money and not repaid. (See Table 1 which summarizes the high and low periods during the first decade of the microfinance sector development in Liberia.)

5 *Microfinance Development in Liberia, An Initial Assessment.* UNCDF, 2004.
6 Interview with former ARC MF program and HQ staff.

7 All figures are shown in US dollars.

TABLE 1: LIBERIA MICROFINANCE SECTOR DEVELOPMENT: 1995-2006 During the first phase, relief donors and the government agencies intervened at the Micro and Meso levels with unsustainable results; afterwards, MF donors first restricted relief and government interventions and then began to support the growth of sustainable MFIs.			
YEAR	MAJOR MILESTONES	DONOR INTERVENTION LEVEL	# OF CLIENTS SERVED BY MF PROGRAMS
1995-1997	Peace agreement and peacekeepers	Micro — Various relief donors	4,500
1997-2002	National elections, temporary stability	Micro– Various relief donors Meso – MF network created by MFIs	12,000 (at Height)
2002-2003	Return to conflict	———-	1,000 (at end of 2003)
2004	Peace agreement and peacekeepers	Micro — Relief and MF donors Macro — Policy paper	2,000
2005-2006	National elections and government organization	Micro –- Mainly MF donors Meso – MF network re-started by MFIs with encouragement of MF donors Macro –-Government capacity building by MF donors	6,355 (July 2006)

Source: UNDP program report (2001); UNCDF country study (2004); MFI self reported figures (2005-6)

The one successful outcome of these largely micro-level initiatives was the Liberian Enterprise Advancement Program (LEAP), an MFI that in addition to UNDP funding, enjoyed financial and technical support from World Relief, a more experienced MF practitioner. At its height in 2002, LEAP was continuously serving 5,800 clients, covering 72% of its costs and maintaining low arrears (on average less than 5%). While successful considering the context, its relatively small outreach after 5 years of operations are testament to the difficulties of operating in or influencing a poorly supported sector. For example, LEAP staff recount how they competed with other donor supported projects that used food donations as an incentive for clients to take and repay loans.[8]

After five years, Liberia had little to show for these three programs' roughly $10 million investment in microfinance. Although conditions in the country were challenging, the absence of MF donors and practi-

[8] Interview with acting LEAP manager, January 2006.

tioners allowed relief donors and NGOs and the government to implement mostly narrow micro-level initiatives, unhindered and unadvised. The lack of success of these relief programs not only restrained the growth of LEAP, the one MFI supported by a more experienced MF practitioner, but created a poor credit culture. This legacy has challenged new initiatives during Liberia's second attempt at microfinance.

B. Earlier and broader interventions meet success. Liberia's conflict returned in 2001 and ended abruptly in the summer of 2003 with a siege of the capital. This time, MF donors and practitioners learned from the past and pursued an earlier and broader development strategy. As the essential preconditions were being established, UNCDF along with MF specialists from ARC, World Relief (WR) and World Hope International (WHI) developed guiding principles for the use of loans and grants that were circulated to all major donors, NGOs and contractors. This meso-level activity clearly differentiated sustainable microfinance from short-term subsidized income generation programs.

At the micro level, WR and WHI joined together to support LEAP with an advisor on the ground, while ARC created *Liberty Finance*, a new MFI based on a successful ARC program in Sierra Leone. LEAP and *Liberty Finance* recognized the importance of meso-level associations for information sharing, and restarted the moribund Liberian Microfinance Network (LIMINET), as a forum to promote best practices and restrain relief agencies from initiating credit programs. UNHCR and BPRM, learning from some of their mistakes in the past, have become more flexible, allowing their implementing partners WR and ARC to conduct programs that would meet their refugee support objectives, while not compromising MF best practices.

UNCDF, UNDP and Cordaid created an investment fund for microfinance styled on MITAF in Sierra Leone. The fund, initially capitalized at $3 million, has provided LEAP and *Liberty Finance* with a combination of capital and technical assistance appropriate to small developing MFIs (majority TA and operating grants, limited capital). These donors have also engaged the government with external training and encouragement to create their own microfinance policy.

These early and broad actions from MF donors and practitioners have supported the expansion of two best practice institutions and equally important, helped prevent the funding of poorly designed programs by other relief donors or NGOs or the government. As of December 2005, LEAP and *Liberty Finance* had cautiously expanded to 5,000 clients. While these results are modest compared to the 12,000 clients reached during the first phase, greater levels of client screening and slower growth are necessary to overcome poor repayment discipline among clients from past unsuccessful programs implemented by institutions with low capacity. Moreover, if the country remains stable, the foundation for a dynamic microfinance sector appears to have been laid.

C. Sierra Leone - Broader interventions for better results. Sierra Leone initially followed a similar path to Liberia. Once a peace agreement and peacekeepers helped establish the basic preconditions for microfinance in 2001, an inexperienced government ministry jumped into the sector. With funding from the African Development Bank, the government worked through local chiefs and scores of local NGOs and Community Based Organizations (CBOs) to provide one-off loans through a group lending structure, with little training or technical assistance. Results were unimpressive. The government program which used the local chiefs provided single loans to 24,000 individuals, but only achieved 70% eventual recovery after three years.

The program with the NGOs and CBOs served 3,500 clients with an unsustainable repayment rate of 85% by the end of 2002. Outside the government, three relatively inexperienced NGOs began microfinance programs with BPRM, UNHCR, Christian Aid and private funds: ARC and WHI, two international agencies, and the Association for Rural Development (ARD), a local NGO. In addition, unsupported by their technical units, the local USAID mission and Christian Children's Fund (CCF) began a credit component for ex-combatants as part of a "reintegration" program. In short, the Liberia experience was on its way to being repeated.

However, a combination of early MF donor interventions and broader focused activities, along with improved NGO implementa-

tion steered microfinance industry development in the right direction. In 2002, soon after the government began its forays into the sector, the World Bank sponsored a delegation of government Finance Ministry and Central Bank officials to an intensive microfinance training course.[9] The World Bank followed up the training by sponsoring a conference on microfinance in Sierra Leone that laid the foundation for a government policy statement approved in 2003. This policy statement proscribed the government's role in microfinance to technical support and set forth sensible microfinance regulatory guidelines.[10] UNCDF then convinced UNDP and KfW, donors who were considering investments, to develop a joint strategy to develop the sector. These donors created the Microfinance Investment and Technical Assistance Facility (MITAF) in 2003, whose goal is to accelerate microfinance sector growth through concerted support at all levels – MFIs, support institutions, Bank of Sierra Leone, government, donors/investors, and the broader microfinance community. UNCDF, UNDP and KfW pledged an initial $9 million to MITAF's operations and contracted a microfinance consultant firm to manage the facility. The government, though not a funder of MITAF, was engaged in the process and chairs (without a vote) all MITAF investment meetings.

MITAF began operations in late 2004 and was joined by the Dutch funding agency, Cordaid, in 2005.

On the retail side, outreach grew slowly from 2001-2003, as the NGOs implemented uneven programs that were hindered by relief donor (UNHCR, local USAID mission) requirements to work in returnee areas or with special populations, i.e. ex-combatants, refugees, or internally displaced persons (IDPs). Performance improved once they increased internal technical support to their programs and accessed MITAF's effective training and flexible funding. MFIs and MITAF negotiate the appropriate mix of technical assistance, operating grant, and loan capital funding on an annual basis according to specific MFI needs.

ARC helped its affiliate MFI *Finance Salone* become the leader in Sierra Leone (40% market share; one of two operationally sustainable MFIs with more than 13,000 clients), while WHI's affiliate *Hope Micro* recorded impressive advances, reaching over 11,000 clients by June 2006 (see Box 3 for MFI statistics). ARD and CCF have attempted to turn around their programs during this time period and have been successful in increasing outreach but are still trying to reduce arrears (currently PAR>30 days is 13%) to acceptable international standards

Box 3: Leading MFIs in Sierra Leone

MFI	*Finance Salone*	*Hope Micro*
Founded	2003	2002
Affiliation	ARC	WHI
Active Clients	13,462	11,854
Outstanding Portfolio (USD)	$1,155,281	$391,374
Average Loan Size (USD)	$86	$33
PAR > 30 days	2.8%	3.14%
OSS	115%	120%

Source: MITAF, June 2006

[9] The three-week *Boulder Microfinance Training Program*, then hosted by Naropa University in Boulder, CO, USA.

[10] The policy is available on the Government of Sierra Leone website - http://www.dacosl.org/encyclopedia/3_strat/3_2g_fin.htm.

TABLE 2: MICROFINANCE SECTOR DEVELOPMENT IN SIERRA LEONE: 2001-2006 Early intervention by MF donors first reduced relief donor and government interventions, then later led to the rapid growth of the sector.			
YEAR	MAJOR MILESTONES	DONOR INTERVENTION LEVEL	# OF CLIENTS SERVED BY MF PROGRAMS
2001	Peace Agreement and Peacekeepers	Micro only – various relief donors	1,000
2002	Organization for and holding of National Elections	Micro – relief donors Macro – World Bank	7,000
2003-2004	National government organized	Micro – relief donors tapering off Macro – MF donors (MITAF)	14,000 (end of 2004)
2005-2006	Organization for and holding of Local Elections	Micro – MF donors (MITAF and USAID) Meso – MF donors (MITAF) Macro – MF donors (MITAF)	41,000 (June 2006)

and reach operational sustainability. The government programs, in conformity with the policy paper and encouraged by the MITAF donors, reduced its microfinance program, cutting the number of partners and transitioning out of funding MF directly. Combined, these developments created a microfinance sector that by June 2006, served 41,000 clients (39,122 served by MITAF partners), boasted a number of specialized MFIs, and was attracting commercial funding.[11]

[11] Examples of commercial funding include ARC's negotiations with a local commercial bank for equity ownership in Finance Salone, Procredit's decision to create a bank in Sierra Leone and EcoBank's decision to enter MF in Sierra Leone.

IV. MF sector development in post-conflict environments – Lessons Learned

While it is still premature to declare that Sierra Leone and Liberia have successful microfinance sectors, early results indicate that both countries are moving in the right direction. From their experiences, a number of lessons learned can be gathered:

Start early: Microfinance can begin once the essential preconditions are in place in at least the country's capital. Although these initiatives are risky and grow slowly at first, MF donors and practitioners should consider implementing at this early point in order to create a foundation for later MFI growth and to influence development of the sector.

Intervene broadly: A narrow and micro-level focus on building retail institutions without supporting broader macro or meso-level activities may not create the enabling environment necessary for the sustainable long-term growth of microfinance. Combining investments in retail institutions with education for government and support to MF associations can both prevent misguided initiatives from starting and reinforce best practices at the micro-level.

Encourage collaboration among stakeholders: While effective partnerships and collaboration are difficult in practice, they

are important and possible in post-conflict countries to advance the sector's development. There are several ways to collaborate. Agreeing to standards for the provision of grants and loans can clarify the appropriate use and timing for both activities. Joint funding mechanisms can be effective, especially for agencies without technical staff on the ground, if they are structured flexibly, keep the government informed, and have conservative targets. At the least, MF donors should promote collaboration and information sharing between the national and/or local government, relief donors, and other MF practitioners to prevent poorly designed programs from being implemented.

Utilize MF expertise: Strong MF expertise is often scarce in post-conflict countries. Donors and international NGOs or contractors tend to be more relief-focused and local organizations generally have limited capacity. As a result, MF strategies often don't succeed unless outside or specialized expertise is utilized. Local organizations can be involved, but can't be solely relied upon to lead the sector. MF practitioners should be tapped to establish new institutions or build the capacity of promising local MFIs.

Donors and implementers should coordinate between their head and field offices to maximize internal technical units and expertise for assistance in designing MF strategies.

Fund MF appropriately: During the early stages of a post-conflict transition, an effective microfinance support strategy requires an appropriate mix and level of funding. In terms of the funding mix, considering low capacity levels, generally at least two-thirds of initial funding for the sector should focus on technical assistance, capacity building and retail institution operational support through grants. The rest can be used for loan capital. Funding levels should be commensurate with the absorptive capacity of the MFI and generally conservative, as having too little retail outreach is better than promoting too much and risking large loan losses or institutional failure. As institutional capacity grows over time, the grant-to-loan mix can shift more towards loan capital and increase in size, but still with a strong technical support component.

Table 3 below provides a "roadmap" for donor support to the MF sector in post-conflict environments including the level of intervention, suggested activities, and their timing. Expected outcomes for these activities have also been described, divided into immediate outcomes during the transitional and early stabilization stage and longer-term outcomes that build on the initial foundation of support. While typical of many post-conflict countries, the timeline evolution will also depend on the specific country and context.

TABLE 3: ROADMAP FOR EARLY AND BROAD SECTOR DEVELOPMENT STRATEGIES: ACTIVITIES, TIMING, AND EXPECTED OUTCOMES

Phase	Transitional (1-2 years)	Early Stabilization (2-3 years)	Late Stabilization (3-5 years)	Consolidation (5 years +)
Major Milestones	Peace agreement and peacekeepers	Organization for and holding of national elections	National government organized	Organization for and holding of local elections
Presence of Essential and Preferred MF Conditions*	Most essential; Few preferred	All essential; Few preferred	All essential; Some preferred	All essential; Most preferred
Approach Level, Actor and Illustrative Activities	*Micro:* MF donors Invest in MFIs; promote best practices *Meso:* MF donors and practitioners; Agree to MF best practices	*Micro:* MF donors; Invest in MFIs; promote best practices *Meso:* MF practitioners; Develop MF network *Macro:* MF donors and govt.; Work together to develop MF policies	*Micro:* MF donors; Invest in MFIs; promote best practices *Meso:* MF donors; Support MF networks and auditors *Macro:* MF donors and govt.; Work together to enforce policies	*Micro:* MF donors and private entities; Invest in MF *Meso:* MF donors; Support networks, auditors, and introduce raters *Macro:* MF. donors and govt.; Work together to enforce policies
Expected Outcomes	• Only limited # of relief-driven / poorly designed credit programs • Growing client base in easier to reach urban areas • Best practices followed by MFIs • Government involved in sector by developing MF supportive policies		• Growing client base beyond urban/easy to reach areas • Many retail institutions achieve steady increases in outreach, sustainability, efficiency, and capacity • Government enforces supportive policies, involved, but not intrusive • Commercial funding sources emerge	

**Essential pre-conditions are reasonable security, open market activity and limited population mobility; preferred conditions include working government, commercial banking networks, skilled workforce, enabling legislation, and absence of hyperinflation.*

V. Conclusion

Precise blueprints do not yet exist for building robust microfinance sectors in post-conflict environments, but lessons are beginning to emerge for their development. Early interventions, starting as soon as the essential preconditions are in place, are both possible and can serve to demonstrate best practices in post-conflict areas. As important, broad interventions that work to build standards at the meso-level and to educate the government at the macro-level will support micro-level investments in retail institutions and prevent well-intentioned, but disruptive relief-driven credit programs.

Clearly, each environment will require a slightly different approach. For example, before the recent peace agreement in South Sudan, macro level activities were impossible since there was no recognized national government to support. Furthermore, early and broad strategies alone will not usher in a vibrant microfinance sector. Well-designed projects can fail due to poor management or the overall environment can change for the worse due to poor governance or the resumption of conflict.

Nonetheless, the cases of Sierra Leone and Liberia indicate that earlier and broader strategies, combined with appropriate funding for MFIs, stakeholder collaboration, and MF practitioner involvement, contribute to improved quality and accelerated outreach of microfinance. A broader approach to sustainable microfinance development will certainly help to move countries devastated by conflict one step farther along the road to economic recovery.

DISCLAIMER

The views expressed in this publication do not necessarily reflect the views of the U.S. Agency for International Development or the U.S. Government.