This document is part of the Microenterprise Best Practices (MBP) Project's series of Technical Briefs on post-conflict microfinance, available at www.mip.org. The series discusses whether and how to use microfinance in post-conflict settings. The first seven briefs are designed primarily for microfinance practitioners. The final brief (#8) is designed for relief organizations considering microfinance for the first time. While experienced microfinance organizations are unlikely to find new information here, they may share this brief with non-microfinance organizations experimenting in this technical area.

Searching for Differences: Microfinance Following Conflict vs. Other Environments

Since 1997, significant energy has been devoted to the question, "What is unique to microfinance operating in immediate post-conflict environments?" From papers to workshops to virtual conferences, kernels of information have emerged, which are captured in this brief. These findings are organized as follows. First, the brief discusses the aspects of microfinance that are the SAME in a post-conflict environment as in any other environment. This list is designed to help both microfinance and relief organizations alike to plot a common course that leads to long-term microfinance success. Second, the brief lays out those elements that are *different*, either in approach or magnitude, in a post-conflict environment. This section is designed to help microfinance organizations entering post-conflict settings to set realistic expectations for their programs and staff.

Before beginning, a note on what is meant by "post-conflict microfinance." This term involves much more than giving loans to poor people to get them back on their feet economically after a conflict ends. Rather, it embodies the creation of a permanent institution that will provide on-going financial services to an ever-wider clientele, and that will remain in operation past the crisis period to become part of the long-term economic development strategy of the country. This definition of microfinance is described in Brief #2, which presents the development of a microfinance industry in Cambodia after 30 years of conflict.

And how long does the "post-conflict" moniker remain relevant? Clearly, many countries spend decades dealing with intermittent conflict even after a political solution is achieved. Throughout these periods, the unique conditions described below are likely to hold true.

But in other countries, “post-conflict” is not an permanent condition. Instead, at some point (as political stability returns, economic activities accelerate, and domestic institutions and infrastructures are rebuilt), microfinance institutions find themselves working in environments that look like developing countries elsewhere. In these situations, “post-conflict” can no longer be used as an excuse to call for any of the special exceptions discussed below.

POST-CONFLICT MICROFINANCE: SIMILARITIES TO OTHER ENVIRONMENTS

Even in the most conflict-ridden environment, experience has shown that the core principles and practices of microfinance are the same as those found in other environments, with some relatively minor adaptations in terms of the practice of microfinance.

These similarities are the five basic “principles of financially viable lending” (the first four of which are taken from and given more detail in the 1995 USAID microenterprise development brief of the same name), described below. These principles—and the practices derived from them—all apply in post-conflict environments.

1. **Offer Services that Fit the Preferences of Poor Microentrepreneurs.** As with all businesses, MFIs must offer a service that people want . . . and are willing to pay for. In practice, this means:

    - Short-term loans that are compatible with the businesses, markets, and income/expense patterns of microentrepreneurs;

    - Small and repeating loans (or “stepped lending”, where each step involves a slightly larger loan); and

    - Service provided where clients live and/or work. While microfinance tries to adopt many of the business-like aspects of commercial banking, MFIs don’t *act* like banks in many ways. They go to the clients and are “customer friendly” to people whom most commercial banks wouldn’t serve.

2. **Streamline Operations to Reduce Unit Costs.** MFIs must find ways to deliver quality services in the most efficient manner at the lowest possible cost. This not only will affect institutional viability but will help reduce costs charged to clients in the form of interest rates. In practice, this means:

    - Standardized and simplified processes for delivering credit and savings services.

    - Modest buildings and vehicles. Just as MFIs don’t act like banks, they don’t *look* like them either.

    - Front-line staff (credit and savings officers) who are close to their clients in terms of education (and hence salaries).

3. **Motivate Clients to Repay Loans.** Provide clients incentives to repay. Make it in their own best interest to pay their loans rather than to walk away from them. Practices to achieve this include:

- Repeat and "stepped lending," as mentioned above. There may be no greater repayment incentive than that of having continued access to financial services.

- Mutual-guarantee groups, which provide peer pressure and peer support to repay.

- Discounts for prompt and full repayment, penalties for delinquency, and other financial incentives and disincentives.

- An image of being a serious, permanent MFI. Temporary microfinance *projects* which are not serious about loan collection, cost-containment, and even revenue earning[1] will quickly be seen by clients as relief organizations to whom repayment is not needed.

4. **Charge Full-Cost Interest Rates and Fees.** To become a permanent institution, an MFI must cover its long-term costs. While losses are expected and often subsidized by donor start-up funding for a year (and usually longer in a post-conflict environment), they cannot continue indefinitely. This is not a license for MFIs to charge rates that cover inefficient, wasteful operations. Principle 2 above, "reducing unit costs," must be followed concurrently. In practice, charging full-cost interest rates and fees means:

- Recognizing that the unit costs of delivering one hundred $50 loans will be higher than delivering one $5,000 loan. Thus, a basis for comparison is *not* the interest rate charged by commercial banks for the latter.

- Recognizing that microentrepreneurs have relatively high rates of marginal productivity of capital—even in post-conflict settings. In other words, they are able to achieve rates of return on capital that are much higher than those of bigger businesses. Thus, whereas a large business could not pay the interest on a 3 percent per month loan and be profitable, microenterprises can and regularly do. Outside of microfinance, they even pay rates of 10 to 20 percent per month and more to informal moneylenders, and yet have modest profits afterwards.

5. **Achieve Scale.** MFIs could fulfill the first four principles and yet lose money if they are working off a small base of clients. Thus, scale is necessary not only to achieve breadth of outreach—that is, to help *many* people—but also to achieve sustainability. In a post-conflict setting, scale may be limited by level of economic activity, initial levels of trust, or compromised financial or infrastructure systems. However, it remains an important principle to incorporate in post-conflict planning, monitoring, and implementation.

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[1] According to Peter Kooi, one of the principals involved in the founding and development of
ACLEDA in Cambodia (see Brief #2), "Our repayment rate improved dramatically in the early 1990s when we significantly *increased* our rates. Our clients told us "Now we know that you're serious and will be around for a long time." Source: personal conversation with the author, February 1999.

POST-CONFLICT MICROFINANCE: DIFFERENCES FROM OTHER ENVIRONMENTS

The above list is striking in that it shows that global sound principles and practices of microfinance apply even in the most challenging environments. Differences appear in the types or magnitudes of operational challenges that emerge in post-conflict environments, and that affect specific aspects of microfinance practice. Differences also appear in terms of how rapidly microfinance goals—such as financial sustainability or program scale—are achieved. Finally, differences appear in what microfinance may contribute beyond the economic sphere. The most significant of these differences are described below.

1. **Human Resource Limitations.** In times of conflict, people are killed, lose opportunities for education, and flee. These three factors combine to deplete the human resource base. When combined with competition for skilled personnel from relief agencies, costs of recruiting and retaining sufficiently skilled staff is significant, not only for middle and senior level positions, but also for loan officers. MFIs may choose to substitute expatriate staff for positions that would otherwise be filled by local employees. In either case, personnel costs are likely to be higher in a post-conflict environment than elsewhere.

2. **Challenge in Assembling Local Board.** For the same reasons, it is difficult to assemble a qualified Board of Directors to guide and govern an MFI. While new institutions in other environments often start only once a Board is assembled, a post-conflict setting may see Boards assembled significantly (even years) after an institution is operational, despite the long-term challenges—such as building local ownership—that such a decision implies.

3. **Advocacy and Education Tasks.** Surrounded by new governments, relief-oriented donors inexperienced in microfinance, and first-time microfinance practitioners, experienced MFIs in post-conflict settings are often drawn into advocacy and education of others on the basic principles and practices of microfinance. This is often motivated by enlightened self-interest: if a competing organization follows poor practices, the results can damage other MFIs operating in the same market. These activities often require significant time investments by MFI's senior management, thereby increasing the overall costs of operation.

4. **Additional Attention to Security.** As discussed in detail in Brief #6, MFIs in post-conflict environments must give increased attention to security of staff, clients, and funds. These precautions require significant time and system investments, which imply increased operational costs.

5. **Higher Costs.** For all of the reasons above (high cost of labor, investments in advocacy, and security precautions), costs of operation can be significantly higher when operating in post-conflict environments. In addition, costs may be driven up by limited infrastructure and markets. As an example, the purchase price of MFI vehicles may be twice as high, and due to poor roads, may last half as long, in a war-torn environment.

6. **Timeframe for Sustainability.** All of the above factors combine to slow down the institution's achievement of two types of sustainability: (1) financial sufficiency—the ability to cover costs from revenues; and (2) institutional sustainability—the ability to operate and govern itself. The precise equation for achieving these goals depends on the context. For example, while higher costs may make financial self-sufficiency more difficult to achieve, positive factors—such as rapid economic growth—may mediate this somewhat. This was the case with Besëlidhja/Zavet Microfinance in Kosovo, as described in Brief #3. In general, however, donors and practitioners alike must expect slower achievement of sustainability goals relative to other environments.

7. **Intangible Benefits of Microfinance.** In addition to the core microfinance values of breadth and depth of outreach, impact, and sustainability, microfinance may play a real (albeit intangible) role in social and political reconciliation. This may occur through encouraging inter-ethnic economic activities, or by building trust through multi-ethnic community banks or solidarity group lending. These goals are enhanced by the success of microfinance—in terms of longevity and scale—and in the increased economic wellbeing that conflict-torn communities experience due to microfinance's availability.

CONCLUSION

In all, post-conflict microfinance requires the same skills and same vision as microfinance in any setting. In addition, post-conflict microfinance requires a willingness to face higher costs and higher risks, and to innovate continuously in a changing environment.