Introduction To Microfinance In Conflict-Affected Communities

by
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INTRODUCTION TO MICROFINANCE IN CONFLICT-AFFECTED COMMUNITIES
Foreword

Conflict leaves loss and devastation in its wake. Refugees and displaced people often return to situations of fragile peace, where the socio-economic infrastructure is badly damaged, and where they have difficulty reintegrating into their communities. Such environments can easily become breeding grounds for further conflict.

Given the right opportunities, however, refugees and displaced people can make a vital contribution to rebuilding peace in their countries. The human capacity to survive and adapt to changing environments can give rise to new forms of creativity. Refugees and displaced people do not need to be treated as passive recipients of humanitarian assistance. With the right tools, they have the skills and resources to contribute to their own development. People with an entrepreneurial spirit can create employment for themselves and for others.

Humanitarian organisations are often the first to provide protection and assistance to populations affected by conflict. In many cases they do not remain in a country long enough to rebuild the social and economic infrastructure, but they can play a catalytic role. Microfinance is one way in which they can provide direct assistance in the short-term. Development agencies can then assume responsibility for building on these foundations.

Since microfinance aims at both a short-term and a long-term impact, it offers a suitable field for cooperation between humanitarian and development organisations. In the past, these two sets of organisations have operated in somewhat separate realms, often to the unintended detriment of the populations they are trying to serve. By cooperating in microfinance, and working together with the government of the country concerned and local civil society, they have the potential to change this.

In a joint research project, ILO and UNHCR have found that despite all the lessons learned, there is still an inadequate exchange of information and experience between humanitarian and development organisations. Sound practices have been implemented in some parts of the world, but there is much scope to widen the spread of these practices.
ILO and UNHCR have decided to jointly focus on ensuring increased access to microfinance for communities affected by conflict. Since no training courses currently exist for organisations working with microfinance in conflict-affected communities, ILO and UNHCR have translated some of the existing knowledge into this training course. We hope this will reinforce the skills and knowledge of humanitarian and development actors in working closer together for the benefit of conflict-affected communities.

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Coordinating organisations

The ILO Social Finance Programme, based at ILO headquarters in Geneva, coordinates ILO work on financial sector issues. It has developed an innovative portfolio of research and advisory services on microfinance, and more generally on the social dimension of finance. The objectives of the Social Finance Programme are to enhance the capacity of policymakers, social partners, private sector organisations, microfinance institutions and other institutions, to develop and implement policies and activities that optimise the social benefits of finance and address poverty concerns. Through its cooperation with UNHCR, the ILO Social Finance Programme has been moving into the area of relief-based operations initiated during immediate post-conflict situations.

The UNHCR Reintegration and Local Settlements Section is part of the division of operational support at UNHCR headquarters in Geneva. It supports the UNHCR mandate to protect refugees through a focused approach to self-reliance and empowerment, and the establishment of partnerships. UNHCR sees the creation of durable solutions for refugees as important for consolidating peace and preventing the recurrence of displacement. Socio-economic empowerment recasts refugees as agents of their own long-term development. Refugees who have socio-economic interaction with local communities are more likely to integrate locally, or rebuild their own societies sustainably when they return. UNHCR believes that catalysing development assistance to refugee-hosting and returnee-receiving areas will foster a long-term enabling environment for both refugees and returnees. UNHCR works with development actors and host governments to promote the socio-economic rights of refugees.

The UNHCR and ILO partnership designs interventions for refugees, returnees and hosting populations from a combined humanitarian and development perspective.
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Introduction

The programming cycle

Microfinance programming follows the programming cycle used for all humanitarian and development activities. This process is not linear, because learning is ongoing and reviews and revisions are part of the cycle.

The process usually starts with an initial assessment and analysis of findings. This leads to programme design. Then the programme is put into practice (the implementation phase). Ongoing monitoring and periodic evaluation help to adjust design and implementation.

In an existing programme, the cycle can begin with additional market research, or an evaluation that re-assesses the existing design or implementation strategy. The important thing is that there is ongoing learning and adjustment throughout the cycle.

Programming cycle

- **Assess and analyse**
  - Gather information for supply and demand analysis
  - Module 3

- **Evaluate and follow-up**
  - Evaluate programme and clients for programme impact and revisions
  - Module 7

- **Design**
  - Set objectives, identify partners, define methodology, determine inputs and outputs
  - Module 4 and 5

- **Monitor**
  - Track programme and clients, using key indicators
  - Module 7

- **Implement**
  - Deliver products and services, provide technical assistance, manage the activities
  - Module 6
About this training course

The purpose of this course is:

- to understand the main issues of implementing microfinance in conflict-affected communities;

- to help participants decide when microfinance is appropriate for a population affected by conflict, and how such programmes should be implemented. Other livelihood creation activities, that can be promoted as an alternative or supplement to microfinance, are also presented;

- to know how to analyse the demand for microfinance in conflict-affected communities;

- to know how to proceed in designing, implementing, and managing a sustainable microfinance programme;

- to identify and develop other livelihood programmes.

Target audience

This training workshop and manual is directed at:

- field managers and field programme staff of NGOs and microfinance institutions;

- international organisations and donors involved or interested in supporting microfinance and livelihood creation activities for communities affected by conflict;

- government staff responsible for planning and coordination of such programmes.

It is not geared towards people with no exposure at all in microfinance principles. Trainees should have had at least some exposure to microfinance principles and/or some experience of microfinance in conflict-affected communities. Donors and implementing agencies attending the course are assumed to have a long term commitment to link relief operations and development operations.
Structure of the course

The course is divided into three parts. The first section, Modules 1 and 2, helps participants find out more about what microfinance is, what a conflict-affected environment is and whether microfinance is the right tool for the contexts in which they operate.

The second section, Modules 3 to 7, covers the design, implementation, monitoring and evaluation of microfinance programmes. This section draws on mainstream practices of microfinance around the world, and highlights how these are applied in conflict-affected communities. Module 4 applies specifically to donors, since it focuses on the selection of implementing agencies. Yet this module also provides relevant information for implementers. A better understanding of selection criteria will help them to improve their applications for donor funding.

The third section, Module 8, describes some other interventions which can be used in addition to microfinance, or instead of microfinance.
Successful microfinance in conflict-affected communities

This module introduces the concept of microfinance, and its scope and limitations in conflict-affected communities. It also shows how success in microfinance can be measured in conflict-affected communities, and how such environments differ from “mainstream” environments. Has microfinance been done successfully following conflict, and what are the lessons learned? These questions will be answered in this module.

Learning objectives

By the end of this module, participants will be able to:

- describe how microfinance draws on the two worlds of relief and development work, and commercial and humanitarian work;
- define success in microfinance;
- define outreach in microfinance and its various components (including sustainability);
- understand microfinance’s impact goals at various levels;
- discuss the characteristics of conflict-affected communities;
- identify some success stories and lessons of microfinance institutions in conflict-affected communities.

1.1 Definition of microfinance

Let us begin with a definition of microfinance.

Microfinance is the provision of financial services in a sustainable way to micro-entrepreneurs or any people with low incomes who do not have access to commercial financial services. Put simply, microfinance is banking with the poor.

Microcredit and microfinance are the provision of products and services to the poor. Micro-enterprises are usually the recipients of these services (very small
Microcredit is usually meant to include only credit (loans) whereas microfinance includes a broader array of financial products and services, such as savings, micro-insurance, micro-leasing and remittances (micro-money transfers).

In this course we use the term microfinance to mean credit and savings only, with the primary focus on credit. In recent years, some microfinance institutions have started adding other types of financial services, such as insurance, leasing, and remittance services.

There are many terms in the fields of microfinance. The whole area of microfinance development is an umbrella for a variety of services. The following graph gives an overview of terms used in microfinance development. These terms will be introduced and explained later on in this course.

The microfinance umbrella

- Individual lending
- Group lending
  - solidarity group lending
  - village banking
  - other group lending variants
- Other financial services
- Business development services
  - training
  - marketing assistance
  - association building
  - creation of market chains
  - other business development services
- Business grants
- Welfare grants
- In-kind lending
- Income-generating activities
Important as it is to understand what microfinance is, it is just as important to understand what it is not. Microfinance is not the following:

- **grants** - either business grants or welfare (consumption) grants. Since we define microfinance as the provision of sustainable financial services, grants are not part of microfinance;

- **in-kind lending** - assets are lent in kind, and to be repaid later to the lending programme or to a third party. An example is the gift of a cow on condition that the recipient gives their neighbour the cow’s first-born calf. In-kind programmes may contribute to self-reliance, but they are not part of microfinance;

- **business development services** - such as training, marketing assistance, assistance with legal matters. These services are often provided in addition to microfinance, but they are not microfinance;

- **charity** - microfinance may have a similar goal to charity, which is to help poor people, but its means of accomplishing this are quite different. Microfinance, unlike charity, aims for long-term sustainability for both the microfinance programme and the people being helped.

**Microfinance is not a panacea**

Microfinance is not a panacea for peace and prosperity. It is a tool that can contribute to the goals of relief and development. Like any tool, it is designed for particular purposes. Used correctly, it can be very effective. Used improperly, it can waste resources and even do great harm.

**Two worlds**

Microfinance seeks to draw on two vastly different worlds - the humanitarian world and the commercial world. It seeks to create a new world - one that takes the best of these two.

In summary: microfinance is banking with the poor. It is a tool that uniquely blends the strengths of international relief and development work with the advantages of business and banking.
1.2 What is success in microfinance?

**Did it really work?**

“It worked.” “We achieved our goals.” “Our project was successful.”

Such statements have been made about microfinance programmes which have lost most of the money lent, which closed down after only a year, which had little or nothing to show at the end, or which did damage to other microfinance programmes by “poisoning the environment”.

Every organisation, from a sporting club to a multinational corporation, asks “What is success?” The same question can be put in other ways: “What is our goal?” “What are we trying to accomplish?” “Where are we trying to go?”

If you are given instructions to shoot, your first question will be what the target is. You need to know what you are aiming for before you can start a programme.

For a sporting club, success may be a combination of competitive achievement and other kinds of rewards for the players, like camaraderie, or development of the mind, or winning the match. For corporations, success is easier to define. In a word: profitability.

In the world of relief and development, success is more difficult to pin down. Sometimes donors and NGOs claim “we succeeded” without ever having had a clear idea of what they were trying to accomplish in the first place. It is as if they shot an arrow wildly and drew a bulls-eye around the target afterwards.

In microfinance there is a fairly clear standard of success. This standard may be expressed in various ways, and there have been some valid challenges to it from those who have taken microfinance into conflict-affected communities. Nevertheless, a fairly strong consensus remains:

**Success in microfinance is:**

(1) enabling significant, lasting improvements in the lives of many poor people by

(2) developing permanent, sustainable entities that enable such change.
This definition can be expressed as four core values, which are the measurable aspects of success:

**Parameters for success in microfinance**

- **depth of outreach**
- **breadth of outreach**
- **permanence/sustainability, or length of outreach**
- **impact**

**Depth of outreach - How poor are the people served by microfinance?**

Microfinance does not try to make a difference in the lives of the middle class or the rich. It serves those who are very poor, yet potentially economically active. The term depth of outreach conveys the concept of how poor the people are whom microfinance seeks to assist.

Poverty is a multi-dimensional phenomenon that is impossible to quantify with a single measure. It has been measured by income, expenditure, household assets (including the nature and condition of a dwelling) and educational indicators (such as literacy or grade levels). If you imagine a line going downwards, representing depth of poverty, this line would be fairly short for an average Westerner. It would be longer for a poor person in the West. It would continue down further for an average person in a middle-income country like Costa Rica. It would continue even further for a poor person in Liberia, and a whole lot further for a Liberian woman whose husband and two children were killed in the fighting and who now struggles to provide for her remaining family of five.

This imaginary line shows how depth of poverty is not only about lack of income and assets. There are other factors, such as gender. In general, women bear a disproportionate share of the world’s suffering and have fewer opportunities and rights. A microfinance programme is therefore regarded as deeper in outreach if many of its clients are women. Likewise, assistance to people suffering from the effects of conflict is seen as deeper outreach than assistance to people in more stable, peaceful situations.

Depth of outreach is an important component of the success of a microfinance programme. It recognises the
development challenges of reaching poorer and more disadvantaged people. The worse off the communities being served, the greater the depth of outreach.

**Depth of outreach – an example**

The three vertical lines below indicate depth of outreach of three microfinance programmes, all operating in the same country. Some parts of this country have been severely affected by a civil war. The per capita income of this imaginary country is $1,500.

*Programme 1: Relatively shallow outreach*

Average loan size - $500. The programme operates in a peaceful, stable city and has only male clients.

*Programme 2: Moderately deep outreach*

Average loan size - $250. This programme operates in a village which has been stable and is considered to have an above-average standard of living in its region. Half of the clients are women, half are men.

*Programme 3: Deep outreach*

Average loan size - $50. This programme operates in a village which is just recovering from a recent war. All clients are women.
Breadth of outreach - How many people does microfinance reach?

The term breadth of outreach asks how many people are being served - also known as the scale, or extent, of outreach. Breadth of outreach is always important, because there are many poor people who need the help that microfinance can provide.

Some people might object to quantitative comparisons. They think along the lines of “if we only saved one life, it was worth it. A life cannot be quantified”. Microfinance institutions counter this argument with measurable efficiency, effectiveness, and output per input analysis. Rather than saying “it was worth spending $1 million to save the life of that child,” implementing agencies, donors, and governments should ask: “In an era of increasingly limited aid resources, how many people can be reached by an effective and efficient programme?”

Saving the life of one could mean that resources are not available for efforts that would have saved dozens or even hundreds.

According to the World Bank, 1.1 billion people in the world earn less than $1 a day. Not all of them are potential microfinance clients. Some are too young, too chronically ill or too old to work. Some may not want to be involved in micro-business activities, preferring to earn their living through agriculture or by working for someone else. Even so, it is estimated that about 200 million families worldwide would benefit from microfinance services, and that 15 to 20 million people are being reached by microfinance institutions across the world.

As an exercise, how much would it cost to do this? Let us assume it would cost $500 per family to bring each of these 200 million families to self-reliance. To reach them all, microfinance institutions would need $100 billion. There is not that much donor money in the world. And that sum would only cover people earning less than $1 a day. To reach all the severely poor or disadvantaged would cost two or three times that amount. There are not enough donor dollars to go around. Microfinance programmes therefore must be selective and focus their funds on what is most effective.
The number of people reached – breadth of outreach – is therefore very important. Programmes that serve 30 or even 300 people are good to visit, and one can see that every single person counts. But, as the USAID micro-economic development office once put it: “Programmes...that do not attempt to achieve large-scale outreach are simply not making a dent in the global problem.”

**Length of outreach - how to make microfinance sustainable?**

The fourth and final core value of microfinance is sustainability, or permanence. Sustainability can be viewed as a form of outreach. It asks “how long can the programme serve people?” So it is also known as length of outreach.

Sustainability is the key to breadth of outreach and to achieving the other core values. Sustainability ensures that investments in microfinance do not “go up in smoke”. It is a shame when money and efforts are spent to help some people for a limited time, and then disappear with no long-term benefit. Only with sound development of institutions can there be true sustainability.

Sustainability has been talked about in the development sector for years, but in reality very few programmes, methodologies, or organisations are actually sustainable. Very few NGOs and humanitarian organisations function without continuous external financial injections. By contrast, many microfinance institutions have already reached sustainability.

Sustainability is the only way of reaching the vast numbers of people who need microfinance. A microfinance institution that achieves sustainability will, in time, be able to serve more and more clients. The hundreds of millions of people who need credit will not be served by projects that come and go. Only permanent institutions that reach a significant scale can do this.
Sustainability is also the key to impact. Few micro-entrepreneurs are able to break out of the cycle of poverty with a one-time loan, let alone a grant. People are best helped out of long-term poverty with a series of steadily increasing loans and mechanisms for savings.

To end this session, let us return to the definition of success in microfinance. You will see that it embodies the four core values – impact, depth of outreach, breadth of outreach, and sustainability.

**Success in microfinance means:**

- enabling significant, lasting improvements in the lives of many poor people, by
- developing permanent, sustainable entities that enable such change.

Now that we have looked at outreach (breadth and depth) and sustainability (length of outreach), we almost get the full picture. Yet we still have to look at one key element: the impact that the programme had on its clients. If a programme reaches many poor people over a long period of time, yet it does not improve their lives (or worse, if it deteriorates their lives), the programme has not been successful.

**Impact - how much of a change does microfinance make?**

It seeks to contribute to children eating better and going to school. It aims to empower women, enhancing their self-worth and helping them enjoy greater influence in household decision-making. It encourages greater social cohesion, reconciliation between differing cultures and groups, and greater community pride and spirit. It reduces the economic vulnerability of people in conflict-affected communities and increases their standard of living.
Beyond teaching to fish

We’ve all heard the well-worn phrase “Give someone a fish and they eat for a day, teach them to fish and they eat for a lifetime.”

Microfinance goes beyond this. It recognises that most people already know how to fish. They know how to repair bicycles, or tailor clothing, or sell vegetables in the market. They don’t need to be given fish nor do they need to be taught how to fish. Rather, they need a fishing rod, or a bicycle to take their fish to a market.

Are these things easy to measure? No. But they can be measured. Later in this course, when we discuss monitoring and evaluation, we will explore the issues of measurement. The microfinance community has struggled for years to develop instruments to track changes and find methods that are credible and cost-effective. Major developments in measurement have come about in recent years, although much remains to be done.

2.1 What are conflict-affected communities?

Conflict-affected communities are:

- countries or parts of countries, which have been directly affected by conflict and violence. Examples in recent history include Afghanistan, Tajikistan, Kosovo, Liberia, Sierra Leone, Rwanda, Mozambique, East Timor, Palestine, Bosnia and Sri Lanka;

- countries which have been severely affected (indirectly) and/or are hosting refugee populations. Applying this definition requires some judgement and may vary according to different people. Pakistan, for example, is a country affected by the war in Afghanistan, and has hosted a large number of refugees from Afghanistan.

By conflict-affected we mean post-conflict. Bringing microfinance to countries and communities still experiencing war or conflict is outside the scope of this training course.
Some characteristics of conflict-affected communities

- **psycho-social.** Death of or geographic separation from relatives and friends. Loss of trust in others, loss of self-esteem. Trauma. Tensions between different groups (ethnic, religious, local versus displaced). Feelings of entitlement due to the losses incurred. Ongoing feelings of insecurity. Difficulties in planning for the future;

- **economic.** Loss of household and business assets, from physical (houses, furniture, livestock, infrastructure, means of transportation, tools) to financial (loss of savings). Loss of jobs and other means of making a living. Change in traditional roles of family members. Loss of family breadwinners through death, or through diminished capacity due to physical or mental injuries. Sometimes increased economic opportunities (business opportunities) created by the conflict. Lack of trust in the financial system. A distorted economy fed by international aid money;

- **services.** Loss of access to health care, schooling, water and sanitation;

- **institutions.** Loss of access to media, information, banking, government, rule of law, courts, police.

2.2 What is success in traditional relief assistance?

Let us compare the objectives of traditional relief assistance with objectives of microfinance. Some objectives that relief assistance shares with microfinance are:

- **impact.** Also expressed as helping the poor, poverty alleviation, increasing incomes, creating jobs;

- **breadth of outreach.** Helping many people;

- **depth of outreach.** Helping very poor people, particularly vulnerable people.
Other objectives are different on the surface, but their underlying purposes are actually compatible with the objectives of microfinance. These include:

- **extreme depth of outreach.** A primary objective of relief is to reach vulnerable people, also known as extremely vulnerable individuals or EVIs. Extremely vulnerable people who cannot earn an income through a business activity, cannot be helped directly by microfinance. But they can be effectively helped indirectly, by providing microfinance services to the helpers who care for them;

- **length of outreach / sustainability.** Although sustainability is not a primary objective of relief, it is the key to achieving other relief goals. To achieve high degrees of impact and breadth and depth of outreach, the relief organisation must become a permanent one in order to help people beyond the short time in which the relief agency operates.

Some relief assistance objectives, however, are not compatible with microfinance objectives, and may require adjustment when microfinance is introduced. These include:

- **timing.** Many relief objectives put a high priority on achieving change in a very short period of time – quick-impact projects. Microfinance is not of much help in such short time-frames. Its impact comes when people begin to support themselves over time;

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**Helping the helpers**

“Vulnerables, vulnerables, vulnerables!” grumbled the African deputy representative of a UNHCR mission in an African country, at a workshop. This workshop was attended by mostly young westerners who had just outlined their organisational plans for assistance during a crisis in that country.

“You only think about the ten percent of the population that is vulnerable. Don’t you realise that we Africans take care of our vulnerables - our elderly, our sick, our people who cannot work or otherwise take care of themselves? If you really want to help us, help our helpers - those who are not vulnerable, who can work - to put our skills and energies to productive use. Then, with our increased income, we will help our vulnerables - far better than you ever could!”
short-term breadth of outreach. Although reaching many people is a goal shared by both relief and microfinance, again in the timing they have different objectives. Relief wants to help tens of thousands now. In relief work, help may mean the distribution of 2000 blankets in a single day. In microfinance, help means providing credit to build up economic activity in a slower but more lasting way.

Summary of what was discussed so far:

- the aim of microfinance is to have a positive, long-term impact on the lives and communities of poor people;
- microfinance is a tool that is suited to some applications but not to all;
- the three dimensions of successful microfinance are the following: breadth - how many people are reached, depth - how many of the poorest people are reached, length (or sustainability) - to what extent institutions are sustainable and services are available in the long run;
- there is considerable overlap between the objectives of traditional relief aid and microfinance, such as alleviating poverty and empowering people.

3.1 Introduction

This session examines some cases of what actually happened when microfinance work was attempted in conflict-affected communities. Some of the cases are considered successful. It also provides some lessons from microfinance institutions that have operated following conflict.

3.2 Microfinance successes in conflict-affected communities

For years people thought that it was impossible to implement successful microfinance programmes in conflict-affected communities. Yet recently there are more and more success stories in this environment. Programmes like EMT (GRET), and ACLEDA in Cambodia, for example, have managed to become self-sufficient. EMT now reaches over 78,000 active clients.
Other successes include MEB (IPC), Partner (Mercy Corps), Prizma (ICMC) and Bospo in Bosnia and Herzegovina, Beselidhja/Zavet (World Relief), FINCA and KEP (ICMC) in Kosovo, Faten, UNRWA, and Asala (Oxfam, merged with CRS) Palestine, URWEGO (World Relief) in Rwanda, LEAP (World Relief) in Liberia, FCC (World Relief) in Mozambique, SEEDS in Sri Lanka, Constanta (Save the Children) in Georgia, Sitorai Najot (Save the Children) and the National Business Women’s Association (Mercy Corps) in Tajikistan and Financiera Calpia in El Salvador.

3.3 Experiences of successful microfinance organisations

**Key lessons from microfinance experience in conflict-affected communities**

Microfinance can work after conflict. It can be successfully implemented and can make a lasting change in poor people’s lives, despite the enormous obstacles that may exist.

- if designed properly, microfinance can have a long-lasting impact;
- as with any business, a demand for financial services must exist;
- relative security and accessibility are prerequisites;
- start the microfinance programme slowly and set the foundation for future growth. A rapidly changing environment calls for sound objectives and continued adjustments of operations;
- human resource development is crucial. External technical assistance and intensive staff development is absolutely necessary;
- conflict does not end after the fighting stops. Microfinance initiatives should remember this reality when designing their operations;
- internal controls and NGO governance should be put in place to address potential conflict among microfinance programme staff;
- a government regulatory framework may not be needed at the onset, but will be required later on. A balance between control and laissez-faire is needed.
3.4 Lessons from microfinance in conflict-affected communities

Can the objectives and practices of microfinance and relief be bridged? They already have been, in numerous cases around the world. Here are some of the lessons that have been learned:

- microfinance does work and has worked in conflict-affected communities, but it requires specific knowledge and skills. Practitioners are advised to seek more training and to access the available resources on the subject. The basis of microfinance is knowledge of project design, project management, accounting and finance. Conflict-affected environments also require more creativity and adaptability in each of these areas of the programming process;

- adjustments must be made by microfinance institutions operating in conflict-affected communities. The tool of microfinance must be used properly or harm can be done. Relief organisations can learn about microfinance and adjust to its practice. Adjustments also have to be made in the practice of traditional microfinance to make it more suitable for the specific environments of conflict-affected communities;

- microfinance can achieve greater long-term impact on the welfare of the poor than traditional relief activities alone;

- build a solid foundation. Relief agencies (both donors and implementers) cannot stay in a country long enough after a conflict to build permanent, sustainable microfinance institutions. In countries where the human resource base was low to start with, and further decimated by conflict, it can take many years for microfinance institutions to become fully sustainable. In the past, relief agencies and development agencies have often each done their own thing – sometimes to the unintended detriment of the communities they were trying to help. Relief agencies can contribute greatly to the development of permanent institutions by thinking long-term, building foundations, and using best practice. Without changing their aim of helping people in the short-run, they can lay the groundwork for institutions that will help people for years, even decades, after they have departed. Development agencies will then be able to take over this work and build further.
Module 2

Environmental conditions for successful microfinance

What conditions have to be in place to undertake microfinance in conflict-affected communities? This module identifies essential and preferred conditions, and gives some examples on how these conditions facilitated or obstructed microfinance in selected countries.

Learning objectives

By the end of this module, participants will be able to:

- determine conditions when to use or not to use microfinance;
- classify them between essential and preferred conditions;
- apply these conditions to a conflict-affected environment.

1.1 Essential conditions for microfinance

Introduction

In 1993, when Mozambique was emerging from a long decade of war, the director of a large donor development mission concluded “There is ample evidence that formal small loan programmes will fail given the present state of the financial sector and the poverty of the people.” Clearly these were not major obstacles, because successful microfinance institutions have been working in Mozambique since that time.
Experience has shown that microfinance works in more environments than people thought possible. It seems that there are remarkably few environments where microfinance will not work.

Nevertheless, some essential conditions do exist. They are called essential because they are so important that without them microfinance should not be undertaken:

- there must be a certain degree of political stability;
- there must be a certain degree of demographic stability. Populations have to be settled, or at least relatively settled, given the conditions of refugees and conflict-affected communities;
- the client community must show sufficient economic activity and entrepreneurial spirit, otherwise there will not be an effective demand for microfinance services;
- a cash (non-barter) economy needs to be operating.

We will now discuss each of these conditions in turn.

**Essential condition 1: political stability**

Programme areas need a reasonable degree of security and safety, both for clients and implementing agencies. Businesses do not function well in an environment of chaos or anarchy. Microfinance clients must be able to carry out their business activities with some assurance that they can do so profitably. Likewise, implementing agencies must be able to operate without disproportionate danger to their staff, assets, and clients.

Political stability does not mean that there must be a total absence of conflict. The LEAP agency in Liberia, for example, showed that microfinance could be provided successfully in one area of Liberia even while conflict raged in other parts. In the prolonged low-intensity fighting that has characterised many African conflicts, microfinance and other developmental interventions may contribute to political stability, because they help to bring conflict to a close by providing people with economic optimism. Some conflicts continue for years because many people, often the combatants themselves, profit from the conflicts. Economic opportunity gives people a stake in peacemaking, an incentive for the combatants to lay down their arms and for the community to encourage them to do so.
It is difficult to determine exactly when a situation has become sufficiently stable, because it is common in conflict situations for violence to break out again after fighting seems to have ended.

Even in such situations, microfinance can be put into practice. An example of this was Urwego, a microfinance institution started by World Relief Rwanda nearly two years after the genocide of 1994. Many observers questioned whether Rwanda was sufficiently stable for microfinance, because of the insurrections in certain parts of the country. Urwego’s response was to stay away from those areas, focusing on the more stable areas of the country and moving into the conflict areas as things stabilised.

**Essential condition 2: population stability**

To make significant, lasting improvements in the lives of many poor people, microfinance programmes have to evolve from temporary projects to permanent institutions. For this to happen, loan recovery must be possible from the outset. This is hard to achieve with mobile populations who may literally walk away from their loans.

Some microfinance practitioners have concluded that an essential condition is to work with relatively stable populations. This has led, in conflict-affected communities, to a focus on returnees or internally displaced people (IDPs) rather than refugees. Refugee populations are viewed as relatively unstable, especially if their stay is expected to be temporary. However one must judge refugee situations carefully. The reality is that even short-term refugee communities can stay for long periods of time. When this is the case, it may be appropriate to provide microfinance to refugees.

In general, microfinance practitioners feel that they are more effective helping returnees to rebuild in permanent locales than assisting refugees cope with temporary, short-term displacement. They argue that it is easier to work with internally displaced people who can be followed back to their homes after fighting has ended, continuing the microfinance services there. This can be done with refugees too, although it means that the microfinance institution should be prepared to start operations in the new country.
What is true, is that a relatively stable population is best for microfinance. A stable population means more repeat customers, higher repayment rates, and a longer period over which to spread fixed costs. Population stability also helps the clients. 18 months is sufficient time for clients to not only break even, but reap the benefits of their businesses. Practitioners agree that microfinance should be provided for displaced people only if the population is likely to remain in the area for at least 18 months.

**Microfinance for internally displaced people**

With displaced populations, there is always an element of uncertainty. In 1995, a Mozambican microfinance institution, Fundo de Credito Comunitario (FCC), experienced within a few weeks an exodus of several hundreds of clients from its programme area in the town of Chokwe in the Gaza Province. The displaced clients had already been in Chokwe for two years after fighting had ceased. Some of them had fled from their homes 15 years before. Why did they leave Chokwe so suddenly? An investigation found that they had reached a consensus that it was safe for them to return, and a stampede had begun when people realised they had to get back before others claimed their land. This example shows how difficult it can be to estimate the stay of resettled or refugee populations.

Despite this, there was not a single loan default, even though some clients had been with the microfinance programme for a year or less. Interviews with the clients revealed that they had repaid in full so as not to harm friends and relatives who were permanent residents of Chokwe, and who had guaranteed their loans. This shows how local populations can be assisted by displaced people. Clients also said that they paid in full because they hoped FCC’s microfinance programme would follow them back to their home areas. Their attitude confirms that mobile populations are more likely to settle down if they can start or re-start their businesses.

**Essential condition 3: economic activity and the demand for microfinance**

If economic opportunities require credit, people have to be actively engaged in the cash economy. This may not be the case in immediate post-conflict environments. Displaced people can find themselves without access to productive assets and without the legal right to undertake economic activities. Returning populations may be economically inactive for some time while they assess the
security and permanence of their new situation. A rule of thumb indicator of sufficient economic activity is: if local markets are active, then the population is probably economically active enough to benefit from microfinance.

Countries that have had to make a transition to a market economy for the first time, in addition to a conflict (the Balkans typically), may be wary of microfinance. Old habits of looking at the economy caused many people to look for government subsidies, pensions and other social safety nets, rather than micro-credit. Microfinance programmes have found that people from this background need more exposure to the opportunities that come with taking a loan, before they realise how it can help them. In such cases demand for microfinance might not be immediate, but will follow after education and promotion.

**Essential condition 4: a cash economy**

Financial services by definition mean money. An environment using only barter, not cash, will not be appropriate for microfinance.

### 1.2 Preferred conditions for microfinance

In addition to these essential conditions (political stability, population stability, economic activity, and a cash economy), three other conditions have been identified as preferred but not absolutely necessary, at least in the short run:

**Preferred condition 1: commercial banks**

Commercial banks provide critical services to microfinance institutions. Among other things, they store loan funds and move money electronically within and between countries. Some microfinance institutions have been able to function temporarily without a functioning commercial banking system, but the absence of commercial banks does significantly increase the costs and risks facing the implementing agency. Banks eventually do emerge, even in the most conflict-devastated countries. When banks are not functioning, microfinance institutions can survive by taking appropriate steps and precautions, but they have to accept that there will be additional costs and risks.
Preferred condition 2: social capital

Most microfinance programmes use social capital or mutual-guarantee mechanisms. What happens when distrust has developed or been exacerbated by conflict? Can microfinance be successful in countries where internal conflict has divided communities?

Group-based social capital mechanisms have proved to be unpopular when there is lack of trust within the community. In these cases, microfinance programmes have found that it is better to shift to the use of individual loans. Distrust (low social capital) has slowed microfinance growth in some post-conflict situations, but it has not been an insurmountable obstacle. Even with individual loans, clients are able to find co-guarantors for their loans, as happened in Kosovo. Microfinance can help rebuild damaged social capital.

Preferred condition 3: macro-economic stability

A relatively steady currency and other characteristics of macro-economic stability within a country certainly make the microfinance climate easier. The reality, unfortunately, is that high inflation and foreign exchange fluctuations are often part of conflict-affected economies. Nevertheless, ways have been found, in most cases, to deal with hyper-inflation and foreign exchange risks.

One way is to use a hard currency for lending and repayments. At Besëlidhja/Zavet Microfinance in Kosovo, for example, the entire operation—along with most of the Kosovo economy—is conducted in Euros. In this case, lending in hard currency is justifiable. In other countries, lending in hard currency is not legally allowed. In the Democratic Republic of Congo, for example, the Kabila government forbade the use of the US dollar.

Indexing loans to a hard currency is another option. But this method has the disadvantage that when clients’ business activities are conducted in local currencies, the macro-economic risk is shifted on to an already vulnerable client.

If there is no social capital, no macro-economic stability and no commercial bank, microfinance will be difficult.
1.3 Conclusion

Those who argue against microfinance for conflict-affected communities say that the environmental conditions are insufficient. What is remarkable is how few conditions, both the essential and the preferred conditions, there really are. It seems that the difference between conflict-affected countries and non-conflict countries, as far as microfinance is concerned, is relatively small. Many non-conflict countries have adverse conditions, with no political stability and no macro-economic stability, even if they have not experienced a war.

In some environments decision-makers may choose not to invest in microfinance. The risks may be too high for the institution to bear, or the costs may be unacceptable. However, choices based on risk or cost-benefit calculations should not be used as arguments that microfinance cannot succeed in conflict-affected communities.

Every year, seasoned microfinance professionals find new environments where microfinance flourishes. The key to their success is not only their willingness to work in high-risk and high-cost environments, but also their commitment, and the commitment of their clients, to following sound principles and practices.

Summary: essential and preferred conditions for microfinance

The essential conditions are:
- relative political stability;
- relative population stability;
- sufficient economic activity and demand for financial services;
- a cash economy.

The preferred conditions are:
- a functioning commercial bank;
- social capital or trust;
- macro-economic stability.
1.4 References


¹The Microfinance Following Conflict Technical Brief, developed by the Micro-enterprise Best Practices Project, is the primary source for this module.
Identifying clients and influencers

Before embarking on a microfinance programme, donors and implementers should get a thorough understanding of the market for these services. How large is the demand? What products are needed? Who is providing these products? Which factors can influence a microfinance programme in a positive or negative way? These questions are addressed in this module.

Learning objectives

By the end of this module, participants will be able to:

- determine what they need to know about potential clients and suppliers of microfinance;
- determine ways of conducting an appropriate assessment;
- determine potential microfinance suppliers in conflict-affected communities;
- understand the roles of other actors (influencers) in the microfinance environment;
- assess how the macro-environment can affect microfinance programmes.

1.1 What to look for on the demand side?

Once the essential and preferred conditions have been assessed, one should take a closer look at the demand for future microfinance programmes. The following issues should be assessed:

- household size.
  During the assessment, one should find out how big the households are in the focus area, and what the family cash-flow looks like. It is also important to determine how many people are productive in the family, i.e. how many family members are income-earners. These factors will affect the spending patterns in the community;
The population density will be one of the key elements to consider when selecting the methodology;

**professional background and skills.**
Many organisations make a general assumption that refugees (or vulnerable people in general) have no resources and very limited skills. Yet very often, this is not the case. It is important to avoid making such assumptions, and instead assess their professional background, skills and resources;

**skills in the context of microfinance.**
Identify what skills are required for the clients of the programme, and assess to what extent these skills prevail among the interviewed persons. Some programmes look for more skills than what is actually needed to successfully implement income-generating activities or micro- or small businesses in a certain environment;

**population mobility.**
The location and concentration of refugees, returnees and IDPs is another crucial factor to assess. As mentioned before, a reasonable degree of population stability is an essential condition to microfinance;

**income, expenditures and poverty level.**
This gives an indication of the target population’s capacity to repay. For destitute people (those who are dependent on others to survive, or those who are already heavily indebted), microfinance can have an adverse impact. The key selection criterion here is that clients should be able to use loans productively and improve their lives (while also being able to repay these loans);

**previous experience with grants programmes.**
It is important to know to what extent the target population is used to, or is dependent on charity. It is equally important to assess the target group’s mentality towards grants and charity;

**gender roles.**
During the assessment one should differentiate between the economic profile of women versus the profile of men. Often women have no land ownership, or they may operate as “ghost clients”, having the
responsibility to repay a loan without having the power within the household to benefit from the loan;

- economic activities.

The type of economic activities undertaken in a community will affect the design of the loan product (loan duration, loan size, repayment schedule, etc).

### 1.2 How to conduct an assessment?

There are various ways of conducting assessments. Some of the tools that can be used for assessments are:

1. **individual interviews;**
2. **surveys;** and
3. **focus group discussions.**

It is crucial to adjust the tools to the context, in conflict-affected communities as well as in other environments. It is also recommended to conduct a mix of individual interviews and focus group discussions. One can start with a focus group discussion and next conduct interviews (to explore some sensitive issues in more depth). Yet one can also start with individual interviews, and next organise a focus group discussion (to test some issues on which consensus has not been found so far).

The advantage of surveys is that they can generate representative results (provided that the sample is large enough). Yet the disadvantage of surveys is that they require quite some time and funding.

#### 1. Individual interviews

This method is clear by definition. Good interviews generate both “frontstage information” (the information mentioned openly by the interviewee) and “backstage information” (the observations, the body language). One can use matrices to record the answers to these questions, so as to facilitate data analysis.

#### 2. Surveys

Through surveys, one collects quantitative data. Questions are pre-coded, and answers can be entered into a statistical programme and analysed.
In order to analyse data, the following process should be followed:

- step 1: idea;
- step 2: develop hypotheses;
- step 3: get data;
- step 4: test and verify procedures;
- step 5: generalise and find proof.

In statistical analysis, there are two methods to prove hypotheses:

- A. Deductive:
  - develop ideas;
  - test the ideas: gather data and analyse them to draw conclusions on the ideas.

- B. Inductive:
  - gather data;
  - distil ideas of relationships between these data.

**Sampling**

When choosing a sample, one should consider the following issues:

*Selecting control groups.*

The data gathered should be compared to a control group. In the case of microfinance, a control group on credit would consist of people who are not a client. Yet this is not the only criterion. People in the control group should also be identical in terms of their lifestyles, social conditions, background etc. Since it is not realistic to find such a group, the control group is called a “comparison group”.

*Cluster sampling.*

Cluster sampling means to randomly select a certain number of sub-groups out of a larger group, and select respondents from these selected sub-groups. Data may be clustered by geographical area, education level, gender, etc. As an example, cluster sampling may imply that one randomly selects 4 out of 20 geographical areas and select respondents from these 4 areas.

*Stratified sample.*

Through this type of sampling, one can take a specific look at an under-represented segment of the population by increasing its proportion in the sampling design.
Matching sample.
One can, for example, interview one shoemaker who is a client and one shoemaker who is not a client, to get an optimal match of profiles.

3. Focus group discussions

Through focus group discussions, one can collect qualitative data on a few key issues. These groups should be composed of 6 to 8 homogeneous participants, and the discussion should be led by a moderator.

Examples:
- participatory rapid appraisal focus group;
- discussion guide

Size and composition
The rule of thumb is to have at least 40 individual interviews with different people in a community to get a representative impression of this community. When using the focus group methodology, it is important to interview at least 3 to 4 focus groups on each topic. The sample should also be as homogeneous as possible.

Assessing the demand: market size

When one refers to demand, one should be thinking of both quantity of demand and quality of demand. The quality of demand includes all of the characteristics of a potential client, whereas the quantity of demand refers to the number of potential clients, such as the number of IDPs, refugees or local population. It is important to gather quantitative data in order to assess the breadth of outreach, to generate a financial model, and to find out when the programme can reach sustainability (length of outreach).

When assessing the demand for microfinance, two key factors are the market size and potential client characteristics.

Before embarking on a microfinance programme, MFIs should try to estimate how many people are interested in microfinance services in that region. There is no exact scientific method of doing this. However, good estimates can be gathered by asking these questions:
**Step 1. What is the total population?**

Before considering microfinance in a certain area, estimate the total number of people living there permanently or temporarily. For this example, imagine an area with 100,000 people.

**Step 2. How many people per household?**

Estimate the average number of people living in a household. For this example, assume that the average household has 5 family members.

**Step 3. How many households?**

Divide the total population by the average number of family members per household, to determine the number of households in the community. In this example, this is 100,000 / 5 = 20,000 households.

**Step 4. What percentage of households could benefit from microfinance?**

This estimate is the hardest part. It depends on the degree of poverty in the community, the unemployment or underemployment rate, and the degree of entrepreneurial ability. In a very poor community, with high unemployment but with a high degree of entrepreneurship, as many as 70 percent of households may be potential microfinance clients. In a less poor community with more people employed, but where people are not very entrepreneurial, we may see percentages of 10 percent or less. In this example, it is estimated that 50 percent of households are potential clients.

**Step 5. The size of the market for microfinance?**

Multiply the percentage of potential client households by the total number of households in the region to get the total market. In this example, the market for microfinance is 50 percent x 20,000 = 10,000 clients.

Data can be obtained from relief agencies, government sources and other sources. The following data are relevant: population figures, refugee camp sizes, and demographic composition according to age, gender, and ethnicity.
Types of businesses

When starting an assessment, it is important to determine the type(s) of business(es) that are relevant to the programme. One can focus on income-generating activities, micro-enterprises and/or small businesses. These are on a continuum, and are all part of the economy.

Their profiles are different, however, in terms of skills, level of assets, and investments in the workplace.

Some microfinance programmes require that clients be economically active. This is not a fair condition to put onto conflict-affected communities, where people may only be inactive due to their displacement and consequent loss of assets, equipment, or stock. They should not be penalised for this. A better requirement would be that clients should have the capacity to be economically active.

People who cannot repay their loans, the extremely vulnerable individuals, are not helped by microfinance. They would just become indebted, and may get a bad reputation in the community. The way to help extremely vulnerable people who cannot repay loans is to focus on assisting their economically active helpers. When the helpers are helped, their aged grandmothers, families stricken with AIDS, or orphaned young siblings will benefit indirectly.

When assessing the demand it is important to find out who can use services productively and profitably.
1.3 Targeting

In marketing, the targeting strategy is called “segmentation”. It is useful to identify market segments to better adapt the products to the needs of clients in each market segment. Yet when defining these segments, one should keep in mind that segments should be:

1. measurable.
   Determine the potential number of clients for the programme. How does one say that one group is one segment or target group and the next group is another one? In a relief project, one can use age or gender as a criterion to distinguish market segments. In microfinance, a group that shares a common need and preferences in terms of financial products constitutes a segment.

2. significant.
   Be rather broad in the targeting. For instance, one would not target left-handed taxi drivers from “south-east province”, who returned to the country two years ago, as they constitute a very small group.

3. accessible.
   The Save the Children programme in Afghanistan decided that, in order to reach women, it would target carpet weavers, because that was the way to find access to these women. Save the Children thus found that women constituted a market segment that was not very accessible. Clients need to be accessible to the programme. Yet there is a tendency by donors to encourage implementing agencies to target inaccessible individuals.

The negative effects of targeting can be exclusivity and the marginalisation of non-targeted populations. This is likely to happen if organisations specifically exclude non-targeted individuals from their programmes. Rivalry and distrust can arise between targeted and non-targeted groups, affecting community integration in a negative way. As a rule of thumb, targeting should not be undertaken at the cost of community integration. It should not harm the scope of outreach, impact and sustainability of the programme.
Traditionally, women in Kosovo do not participate in commercial income generating activities. It was therefore difficult for microfinance organisations to find a critical mass when targeting women. The key was to be creative. The microfinance programmes put extra effort into raising awareness of women about the kinds of businesses they could start. The women took group-loans for very small activities. This example shows how it is essential to be creative.

The following examples show some experiences of microfinance targeting in Côte d’Ivoire, Liberia, Cambodia and Mauritania.

Targeting Liberian refugees in Côte d’Ivoire

In Côte d’Ivoire, a microfinance programme was initiated to serve Liberian refugees, whose chances of immediate repatriation were very low. After assessing the market and demand for microfinance in the refugee camps, the agency decided to target refugees who had stayed for longer than six months. This was done through a group-lending programme. The refugees could work outside the camps and several of them were provided with some skills training prior to the loans.

Characteristics of the microfinance programme were:

- small, short-term loans, since the cash requirements of refugees were generally low. Loans were increased with each loan cycle;
- loans to savings clubs and credit clubs of refugees who planned to repatriate to the same home area in Liberia. The clubs were composed of poor and non-poor, male and female, the aim being to diversify risks;
- loan repayments rates were very high. Several refugees were able to transport their savings and credit clubs to Liberia. This was easy because the clubs were made up of members who originated from the same area.
When not to target?

Former boy-soldiers in Liberia lacked basic skills to run businesses, and their “fighting skills” influenced their behaviour in a group. After the conflict, therefore, World Relief decided not to target them for their microfinance programme. The agency found that the boys first needed social skills before they could access business support services and micro-credit.

Similarly, ACLEDA, a Cambodian microfinance institution, avoided targeting demobilised soldiers. Many of the soldiers lacked business skills and preferred to return to the army. They were not a stable population. Their attitude to loans was that they considered loans as a reward for their services to the country.

Unsuccessful targeting

In Mauritania, two institutions targeting small and medium enterprises were launched at the beginning of the 1990s. Both of them were unsuccessful.

One programme, initially launched as a government programme, became a credit union offering individual loans. It focused mainly on the fishery and artisan sectors. The credit union had to respect the following quotas when disbursing loans:

* 40 percent for educated, unemployed persons;
* 30 percent for returning migrant Mauritanians;
* 30 percent for small enterprises in the informal sector.

These quotas were based on a political decision rather than an assessment of demand. This is probably why loans among the targeted clientele declined over the years and loan repayments were very low. The institution was eventually liquidated in 1999.

The other programme offered loans for specific activities. But because the target niche was so narrow, the microfinance institution encountered more and more difficulties in developing clients and recovering loans. It later stopped its lending activities.
Format for interview with community members to assess microfinance demand

- How long have you been in this refugee camp/settlement?
- How long have you been displaced by conflict?
- How long has it been since you returned to your home?
- Where were you living before you came here?
- How long were you there?
- What did you do there?

**Before the conflict/displacement:**

- What did you do to earn money?
- For how many years did you work in this activity?
- Were you able to do this work all year round?
- Did you also work at something else? If so, what?
- How much did you earn after you paid for your expenses?
- Was anyone else helping you in your business? Who? How many?
- Were you employing anyone? How many employees?
- Did you ever borrow money for your economic activity? From whom?
- How much did you borrow and for how long?
- How did you have to repay? Monthly? Weekly? Daily?
- What percentage interest did you pay?
- If you made money from your economic activity, how did you use it to make more money?
- Did you participate in RoSCAs (Rotating Savings and Credit Associations)? in credit unions?

**After the conflict/displacement:**

- What do you do to earn money?
- What are your expenses?
- Think of events in your life when you need lump sums of cash, what are these expenses for?
- Do you have expenses related to emergencies? What are they?

- Have you tried borrowing money? Why? Why not?
- If you could borrow money, would you?
- If yes, from whom?
- How much would you borrow?
- How much time would you need to repay the loan?
- How much would you be willing to pay each month?

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2.1 Identifying microfinance suppliers

Organisations undertaking microfinance programmes in conflict-affected communities vary widely in type and background. Some have a comparative advantage in microfinance, others a comparative advantage in humanitarian operations. Some organisations have no experience in microfinance but ample experience in working in conflict-affected communities. These organisations may find that there is a strong unmet demand for microfinance.

Traditionally, suppliers of microfinance can be classified as:

- formal: banks, government and donor programmes, non-bank financial intermediaries, credit unions, international and national NGOs, MFIs, formal transfer systems.

- informal: RoSCAs (Rotating Savings and Credit Associations), traders, moneylenders, and money-keepers, pawn brokers, credit and savings associations (SACCOs), informal borrowing, informal transfer systems.

Suppliers - what is different in conflict-affected communities?

After a conflict, formal financial systems, such as banks, may have collapsed. Yet there may also be a large influx of donor money, to set up new microfinance programmes.

Credit unions are generally not very common after a conflict. If a credit union culture prevailed before the crisis, it is likely that the institutions have incurred heavy losses, and it will take quite some time to re-capitalise them again.

Tools for assessing microfinance supply

Donors are interested mainly in assessing the microfinance supply at the macro level, while implementing agencies focus more on the regional and local levels. The following tools may be used by donors and implementing agents to assess the supply:

Tool 1: Assessing the formal sector.
Interviews with banks and credit unions allow the agency to assess the volume of loans made, the number of formal
sector clients, the number and location of branches, and the products offered.

**Tool 2: Assessing the semi-formal sector.**
Interviews with national and international NGOs allow the agency to assess the semi-formal sector.

**Tool 3: Assessing the informal sector.**
Informal interviews with key informants will give the agency an assessment of this sector. Informal microfinance suppliers can be found in refugee camps. They can be identified by camp organisers, relief workers, government, and traditional leaders of the local population. It may be difficult to get data on the volume of their transactions.

**Tool 4: Assessing the competition.**
This tool is for implementing agencies rather than donors. To understand the competition, implementing agents need to talk to sources to get an idea of terms and conditions on their products offered. They may need to use some specialised market research tools.

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**3.1 Key influencers**

Influencers are organisations or people who, directly or indirectly, positively or negatively, affect the environment for microfinance, or have the potential to do so. Examples of influencers are:

- government departments and related authorities, including the central bank;
- poorly designed microfinance programmes;
- donor agencies;
- financial institutions, including other microfinance institutions;
- relief agencies;
- employment generation programmes;
- credit rating agencies;
- military, rebel groups, peacekeeping forces.

Microfinance donors and implementing agencies may not be able to control most of these influencers, but they should nonetheless take them seriously. Donors and
agencies may need to explore coordinating with influencers, to create an enabling environment for the microfinance programme.

Influencers - what is different in conflict-affected countries?

Following conflict, governments are generally weak or not operational. This can provide a facilitating environment, in the sense that stringent regulations and tax regimes are absent. Yet it can also generate a climate of uncertainty, in which roles and responsibilities of government and other influencers are not clear.

3.2 Macro-environment

The macro-environment can strongly influence the microfinance programme. The key elements to assess, are the inflation, interest rate, exchange rate, economic growth rate and level of unemployment. The following non-economic factors also affect microfinance programmes: population density, population size and infrastructure facilities.

After a conflict, the macro-environment tends to change very fast, and this makes planning difficult. Besides, data on the macro-economic environment may be inaccurate, and the situation may change quite fast, affecting the potential programme design.

Based on their assessments, donors and implementing agencies can decide whether a microfinance intervention is justified, and can address the constraints identified in the assessment.

4.1 Steps for donors

- request proposals and applications from potential implementing agents (this module includes a format for applications);
- pre-select implementing agents and interview short-listed candidates;
- establish a cooperation agreement with the implementing agent, including reporting requirements, monitoring procedures, strategic objectives, logical frameworks and budget.
4.2 Steps for implementing agents

- assessing internal capacity and experience:
  - objectives - will microfinance complement, or conflict with your objectives?
  - does your agency have the skills required to implement a microfinance programme successfully, or at least the ability to acquire these skills in a short time?
  - do you currently have the necessary infrastructure – staff and fixed assets – to implement the programme? If not, can you acquire them in a short time?
  - do you have access to reliable sources of funds to implement the programme? Uncertain funding will disrupt continuity of the programme. Long delays between approval and disbursal of loans will send a signal to clients that the microfinance programme is in trouble. This will lead to defaults, because few will want to pay back loans to a programme that seems to be on the brink of bankruptcy.

- developing a proposal and application for submission to donors.
Donors and implementers entering the field of microfinance have a great opportunity to make a significant impact in the lives of many poor people. Yet in the implementation stage of the process, it is crucial that donors select the right partner organisations.

This module discusses the importance of selecting the right partner, and presents some selection criteria and tools to facilitate this selection process.

**Learning objectives**

By the end of this module donors will:

- know the pros and cons of various types of potential partners;
- know which criteria to use to select implementing partners.

### 1.1 Why is selecting the appropriate partner so important?

1. If an organisation selects the wrong partner (for example a partner that mixes grants and subsidies with microfinance or a partner with a “charity” and handouts approach) it may cause harm in a community by creating dependency. It may also provide disincentives for other agencies to work in this community, thereby reducing the benefits to the community.

2. The mistake of choosing the wrong partner is very costly in terms of time and money. The organisation will miss an opportunity to achieve something meaningful in the community.

3. If microfinance is done poorly, it can influence or even destroy the market for other providers.
1.2 The application process

A donor wanting to introduce microfinance in a conflict-affected community normally puts out a call for proposals. The applications are then assessed, and the most appropriate organisation or organisations are chosen. This module outlines the various criteria that donors can use to assess the profile, skills and expertise of an implementing agency.

The donor’s responsibility is to make the call for applications very clear. The donor should provide sufficient information on the objectives of the proposed programme, the areas where it will be implemented, and the likely duration of the funding. To ensure that the main questions are answered and that the applications are comparable, the donor can provide the application form. Tools 2 and 3 contain relevant information for such an application form.

1.3 How to compare agencies?

*One cannot generalise about the profile of the implementing agency.* Potential agencies could have a wide range of background and characteristics. They could be a credit union or an NGO, a local or international organisation, a specialised microfinance organisation or a multipurpose organisation. For each of these organisations, their experience and professionalism can vary widely. Hence, it is impossible to make general recommendations about “preferred partners”. Instead, the choice of partners should be based on a thorough, case-by-case assessment.

When understanding such an assessment, it is crucial to investigate the vision, mission and reputation of the implementing agency. Information on the latter can be obtained by consulting donors, other agencies, and communities where the agency has worked. If clients already have a certain image of an institution, it is difficult to turn this image around. Organisations that are highly regarded for their grants programmes will be at a disadvantage here, because they will be perceived by clients as more lenient on repayments than established microfinance institutions.

It is very important to get the selection process right, because once a microfinance programme has started, it is difficult, time-consuming and even damaging to clients to
change to another implementing agency. Donors specialising in relief work, should be especially cautious, not to automatically select implementing agencies they know from relief operations - they may not be the best equipped to do the job. An implementing agency for a microfinance programme requires a specific profile. Tools 4 and 5 contain information on how to assess microfinance institutions and non-financial agencies.

1.4 Selection criteria

The long-term survival of the applicant organisation is one of the most important requirements of successful microfinance. Assessing survival is a qualitative matter, but a number of areas can be looked at:

- **vision**: does the organisation have the clear vision, objectives and strategy necessary to create purpose and ownership?

- **long-term perspective**: does the organisation have a long-term orientation towards development, even if its work focuses on relief activities? Does it have a long-term strategy? Does it seriously plan for sustainability? Is it looking ahead beyond this particular funding opportunity?

- **activities**: products and services: what products and services does the agency currently offer?

- **experience**: does the agency have any experience in microfinance and/or in conflict-affected communities?

- **reputation**: does the agency have a good reputation among NGOs and international organisations? Is its reputation with communities appropriate for a microfinance programme, or does its reputation lead to expectations that it will provide things for free or with large subsidies?

- **policies and procedures**: do the organisation’s policies and procedures support its vision and its plans for sustainability? How does the organisation deal with late payment, interest rates, and loan write-offs?

- **internal controls**: how does the organisation protect itself against fraud?

- **management**: how is the agency’s capacity to manage a microfinance programme? Does the management
support the agency’s vision, objectives and strategy? How does the organisation track its funds? Does it have an effective and cost-effective management information system to manage its loan portfolio?

- **performance**: how does the organisation track its performance? How has it used donor funds in the past? What has been achieved through its past lending operations? What has the organisation achieved in other contexts in its outreach, sustainability, efficiency and impact? How much progress has been made, and over which time period? If there has been low performance in the past, how does the agency justify this?

- **outreach**: how many people does the organisation currently reach and how many is it aiming to reach, according to its proposal?

- **sustainability**: how sustainable is the organisation, and what is its timeframe for sustainability according to its proposal?

- **efficiency**: how efficient is the organisation, and how do its costs compare to its achievements?

- **impact**: what impact has the organisation had in the past, and what does it aim to achieve through its planned activities?

- **adaptability**: how has the organisation been able to adapt to the changing environment?

- **staffing**: what are the skills of the staff, and how much emphasis is placed on developing those skills? What is the productivity and turnover of staff?

- **donor support**: how many donors support this organisation, and for what purposes?

Some applicant organisations may be new to microfinance but provide non-financial services. They could have experience in the same region, in other conflict-affected regions, or in stable environments. For these organisations, one could ask additional questions:

- **what is the organisation’s track record in non-microfinance programmes?**
have these programmes attempted complementarity with microfinance?

- what is the organisation’s capacity to implement a microfinance programme?

- for multisectoral agencies, what is the agency’s capacity to track costs separately for a microfinance programme?

1.5 Sustainability

As we have seen throughout this course, sustainability is a key part of any microfinance programme, so it should be a major factor in the final selection process. Are the applicant’s operations likely to continue to reach the same communities over a longer time, even after the agency closes its operations in that area? Does the agency have a convincing plan on how to facilitate continuity after the donor phases out?

Sustainability is closely related to localisation, that is the registration under local law of a project set up by an international organisation. Donors who are committed to long-term impact should ensure that the agency has a plan to localise operations, or hand them over to a development organisation. Donors should assess the agency’s capacity to make such continuity successful.

The localisation process can be a challenge, both in the legal sense and in terms of finding the right managers. Because management is transferred to local staff members, capacity building becomes a key consideration.
1.6 What if a suitable implementing agent cannot be found?

If there is no suitable organisation to implement the microfinance programme, it is strongly recommended not to undertake it. It is better not to embark on microfinance than do it the wrong way. A possible alternative is to engage in programmes that promote non-financial livelihood activities.

Although some donors may be tempted to implement microfinance programmes themselves (in light of the absence of appropriate partners), they should refrain from doing so, for the following reasons:

- donors do not have the time, capacity or competency to run a microfinance programme;
- donor presence in a country is usually temporary. By implementing programmes directly, donors can obstruct chances of building local, sustainable institutions with long-term impact;
- direct implementation by donors, especially relief donors, is likely to send out the wrong message. Communities may be used to receiving products and services from an organisation for free, and will find it hard to understand why they should repay loans to the same organisation;
- most importantly, implementation is not a donor’s mandate. Donors should be working on policies and broader issues, not on detailed implementation.

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Microfinance implementation by a donor

In Central Asia, a relief donor could not find any organisation with the relevant experience to implement a microfinance programme, so it implemented the programme on its own. However, since the donor’s rules and procedures did not allow for the programme to operate according to best practice, the auditors recommended that the programme be discontinued.
Executive summary

1-2 page summary stating the programme title, region of operation, goals and objectives, type of clientele served, funding required, timeline, agent's capacity to implement a microfinance programme, implementation plan, and monitoring and evaluation plan.

Organisational chart

A chart showing a brief explanation of staff positions and responsibilities.

1. Background

Environment:
- a short description of the environment where you are working, or planning to work;
- how has the area been affected by the conflict?
- are populations mobile, or are they settling down?
- how are the people and the economy recovering from the conflict?
- which microfinance organisations are active in the area?
- how do they operate, and what are their conditions for disbursement of loans?
- which other organisations are active in this area, and what are their activities?

Justification:
- how does the organisation’s experience tie into the programme being proposed?
- how does the organisation’s capability help address the issues?
- why is this organisation the best to carry out this programme?

Experience of microfinance and related activities:
- give the organisation’s overview of its current activities (microfinance and other), its experience in microfinance, short overview of its current mode of operation in microfinance: type of products (credit/savings/other), lending methodology, loan parameters (average and maximum loan size, interest rate, collateral, savings, repayment frequency), performance in microfinance, plans for sustainability, time frame, and plans for expansion.

Programme rationale:
- what is the need for the microfinance and how was that determined?
Programme objectives:
- general and specific objectives. Refer to logframe. Reproduce logframe in appendix.

2. Description of clientele
- what types of clients are to be served?
- how has this been decided?
- how does the choice of clients fit into the objectives of the programme?

3. Design and implementation
Give an overview of the organisation’s planned microfinance programme
- what are the essential characteristics of the programme (methodology, types of services, terms and conditions for the services)?
Justify selection of methodology and parameters, give data and facts to substantiate.
- what is the time frame for this programme?
- how will the programme be managed?
- how will the organisation coordinate its activities with other agents?

4. Expected results/outputs
What does the organisation expect from this programme in terms of:
- impact;
- outreach;
- sustainability;
- efficiency;
- provide future projections, including projections beyond funding period.

5. Monitoring and evaluation
Describe and explain monitoring and evaluation plan

6. Budget
- provide detailed budget for loan funds and operating losses (excess of costs over interest income) during the funding period;
- include future projections;
- include related inputs from other sources of funding.

7. Workplan
- provide an action plan and related timeframe;
- include sustainability strategy (financial and institutional);
- if an international organisation, include long-term strategy (exit from direct implementation).

Annex: Organisational background
- Provide the organisation’s history, establishment, type (NGO, credit union, national or international organisation), history of donor support, region(s) of operation, strategy, and vision of operations over 1, 2, and 5 years.
Checklist for project proposal
(all these points should be covered in the project proposal)

Institutional background

1. What is the organisation’s vision and mission?
2. How long has the organisation been working in the field of microfinance and in this country in particular?
3. Which financial services does the organisation provide? (micro-credit, micro-savings, micro-insurance, micro-leasing)
4. Is the organisation only involved in microfinance, or does it carry out projects in other sectors (multi-disciplinary)?
5. If the organisation is multi-disciplinary, how did it become involved in microfinance?
6a. What is the organisation’s goal in the field of microfinance?
b. What type of sustainability is the organisation aiming for, and by when?
c. Is the organisation considering raising savings (if not, has it done so already)?
d. Is it considering raising equity?
e. What other plans for expansion does the organisation have?
f. If an international NGO, is the organisation planning to create a local NGO? How?
g. If an international NGO, is the organisation planning to train a local organisation, and to transfer its assets to it? How and how soon?
h. Other options if the organisation is an international institution?
7a. If the organisation has a board or governing council, how is it elected, for how long and where is it located? If not yet in place, is the organisation planning to have a board or council, and what are the plans to make this happen?
b. What is the board’s mandate?

Operations

8a. Where does the organisation work in the country and why were these areas selected?
b. Who is funding its activities?
c. For how much and until when?
9. What is the organisation’s cost allocation between microfinance and other projects (for instance, for staffing costs, do staff work on all projects inter-changeably, or are they specifically assigned to certain projects. How are salaries and other operating expenses determined?)
10. What is the lending methodology? What is the rationale behind it?
11. What are the loan parameters for the microfinance project in this country, and what is the rationale for selecting them? (average and maximum loan size, interest rate, collateral, savings, repayment frequency, other services offered)

12a. Why is serving refugees or returnees with microfinance important for the organisation?

b. Does the organisation consider microlending to refugees/returnees financially feasible?

c. Is there any other social group that the organisation would preferably target throughout its activities?

13. What are the economic activities performed by the clients to date (by sector)?

14. How many staff members are working on the microfinance programme?

15a. What percentage of overhead does the organisation usually request?

b. What is the retention rate of clients in each project?

16. Does the organisation have branch offices or is it centralised? Where are the branch offices located?

17. Where and how does it promote its programme?

18. Who analyses and approves loans?

19. How often do loan officers visit their clients on average?

20. Where do clients make their payments?

21. How long does it take the organisation to complete the process from promotion to loan disbursement to the client?

22. What is the average loan officer caseload?

23. How does the organisation track loans? What sort of management information system is it using? What does the system track?

24. What are the arrears, write-off and recovery policies?

25. What kind of application forms are used?

26. Where are policies and procedures documented?

27. Does staff get any training? What kind, how often, and from whom?

28. Does the organisation have a project description and progress report from some of its current microfinance activities? If available, what are the financial ratios to date, including portfolio quality and efficiency ratios?

Cooperation with donor

29. Would a pilot project with the donor be of interest to the organisation even though it might remain fairly small? What would it take for the organisation to analyse the potential for this initiative?
Measurable criteria to assess a microfinance institution

Experience of the implementing agent

How many years have they been providing microfinance?
In how many conflict-affected communities have they implemented microfinance programmes?
In how many stable environments have they implemented programmes?
First look for implementing agencies experienced in microfinance in conflict-affected communities. If not available, look for agencies experienced in microfinance in stable situations.

Products and services

Do they provide a variety of products and services?
First look for providers of microcredit (and savings) in conflict-affected economies. If not available, look for providers of microcredit (and savings) in stable economies.

Outreach

What is their breadth of outreach? - numbers of clients, branches, loan portfolio outstanding. The larger the better.
What is their depth of outreach? Calculate this by taking their average loan size and dividing it by GNP per capita of the country, using World Bank statistics or other reliable sources.
The smaller this figure is, the deeper the outreach. A figure of less than 20% is considered to be a deep outreach.

Sustainability

What are the costs and incomes reported by the implementing agency?
Look at expenses for administration, for paying the prevailing deposit rates for the agency’s depositors, and for paying those who lent to the agency for their operations at prevailing deposit rates. For sustainability, total incomes should exceed the total of all these expenses.
Are their pricing policies appropriate?
Look for interest rates they charge. Check if the interest is greater than the inflation rate. For sustainability, it should cover inflation rates.
Is their portfolio quality good?
Check if they are keeping loan losses low and repayments high. Refer to benchmarks in the MicroBanking Bulletin for average portfolio at risk in several environments.
**Efficiency and productivity**

Look at administrative costs and loan portfolio and calculate the ratio. Compare this with the benchmarks available for the region and check if it is within the range or higher.

Look for the number of borrowers served per loan officer or staff.

**Institutional sustainability**

Is the client base strong and stable?

Look for low drop-out rates of clients. Refer to the MicroBanking Bulletin for benchmarks on client drop-out rates for various types of environments that may also include conflict-affected communities.

Are the staff dedicated and productive?

Look for low staff turnover. Refer to the MicroBanking Bulletin for benchmarks on staff turnover rates for various types of environments, including conflict-affected communities.
Assessing a non-financial agency

The challenge here is to deduce the ability of the agency to do microfinance based on their track record of non-microfinance. Even if you decide, after careful assessment, that the agency could develop into a potential provider, make sure that they work, or want to work, with people who have the expertise to build the capacity of the agency.

**Activity and experience**

What is their major activity and their secondary activities? How many years have they been doing this activity?
In how many conflict-affected communities have they implemented programmes?
In how many stable environments have they implemented programmes?
Consider whether the type of activity can complement microfinance. Check if the mission of the organisation is in line with typical missions of implementing agencies in conflict-affected communities. Consider whether it is a logical step for the agency to move into microfinance at this stage of its development. Bear in mind that agencies currently making grants to potential client communities are at a serious disadvantage here.

**Products and services**

Do they provide a variety of products and services?
Ask if these products and services are directed towards the potential clientele of microfinance.

**Outreach**

Look for the number of clients and branches served, to determine breadth of outreach.
Look for the number of clients who can be considered to be poor and highly affected by war by the standards of the region.

**Sustainability**

Do they have any major problems with their clientele? Are the staff dedicated?
Look for low staff turnover. Look at the costs and incomes reported by the agency. Check the total expenses listed for administration. For sustainability, incomes should exceed all expenses.
Are they charging for their services?
If so, how much? Are the rates appropriate?

**Efficiency and productivity**

Look for administration costs. They should not account for the majority of the total programme costs.
What are the number of clients served per staff? The larger the better.
Module 5  

Design of microfinance programmes

This module introduces the principles of microfinance programme design for a conflict-affected community. Most of the guidelines in this module also apply to stable environments. Special features of design for conflict-affected communities are discussed in more detail.

Learning objectives

By the end of this module, participants will:

- understand the various types of savings and discuss their use in a conflict-affected environment;
- understand the various types of lending methodologies;
- understand the various components of a loan, including loan purpose, loan term, grace periods, incentives and penalties, collateral, loan size;
- review the various ways of charging interest;
- how know-how to set an (effective) interest rate;
- understand other important design factors;
- be able to project an MFI’s portfolio size, caseload, income and sustainability.

1.1 Introduction to non-financial services

Much of the information required for designing a microfinance programme comes from market assessments. Two of the most important questions to bear in mind are:

- what business activities will potential clients be undertaking?
- are clients based in rural or urban areas?

Following the assessment, and based on these questions, MFIs will determine which products to offer, and how to design these products in such a way that they meet the needs of their clients, while also reaching the organisational objectives of impact, outreach and sustainability.
The following sections give an overview of non-financial and financial services, and discuss the latter in more detail, in particular on loan parameters and effective interest rates. Finally, this module discusses some other relevant planning issues, like resource requirements and costs, governance, and planning for sustainability and exit strategies.

Most MFIs exclusively provide financial services, yet some also provide non-financial services. Here we will look only at those non-financial services that are closely linked to financial services. These services are discussed in more detail in Module 8.

There are two broad approaches to non-financial products among microfinance practitioners. The minimalist approach says that one should focus purely on the provision of financial services. The integrated approach incorporates non-financial services along with microfinance. There is a lot of debate within the microfinance industry about which is more effective. The issue is somewhat ideological and often depends on the institution’s vision and mission. The minimalists emphasise that if an institution covers its costs, it is more likely to be sustainable and therefore reliably serve its existing and future clients (breadth of outreach). They agree that non-financial services are crucial, but they feel that these services should be offered by specialised agencies. The integrated approach sees the institution’s role as broader and seeks to balance the client’s sustainability with the institution’s sustainability. Client sustainability in this context means ways to enable clients’ businesses to become more profitable.

The two common forms of integrated microfinance are linking credit to education and linking credit to business training. The credit with education model usually targets women, using group meetings to advance literacy, health education, and other issues. The credit with business training model links providing credit to training in basic business management. Enrolment in business training may be a prerequisite for obtaining credit.
Freedom from Hunger: credit with education

Freedom from Hunger is a microfinance institution, which helps small groups of women to secure loans—on average $75 per client. It also provides a safe place for its clients to deposit their savings. The clients run very small businesses, such as making food products or making crafts. The aim is not only to generate income, but also to generate a sense of accomplishment and self-esteem.

Freedom from Hunger provides vital education to its clients through weekly meetings. As the women pay back their loans, they learn about health, nutrition, family planning and sound business practices. The education programme, together with the additional income, helps women break the cycle of chronic hunger and poverty.

Demos: credit with business training

Demos, a savings and loan cooperative in Croatia, provides business training and credit to its members in urban areas. The business training focuses on marketing, costing, breaking even and matching loan terms with business cycles. Demos is considering charging for its business training service to recover part of the costs incurred in offering this service.

2.1 Introduction to savings

- Savings prior to getting a loan.
  Microfinance programmes often use this savings method to determine clients’ commitment to their business and to the repayment of their loans. For the institution, the main advantage of this form of savings is that it generates additional funding to on-lend. Yet, since this type of savings poses a condition for clients to obtain a loan, it can reduce access to micro-credit. This is particularly a constraint in conflict-affected communities, where people have often lost their savings and assets, and where opportunities to re-generate savings are generally limited.

- Compulsory savings throughout a lending programme.
  Under this type of savings, microfinance institutions require that their clients have to save a fixed percentage of the loan, or a fixed amount. It also instills the discipline of savings, yet it implies a higher effective cost to the client.
Voluntary savings.

Under a voluntary savings scheme, clients have a choice: they can save if they want, but they are not obliged to do so in order to get a loan. Microfinance institutions that provide such schemes, usually offer a range of savings products, e.g. term deposits or quick savings.

Savings programmes can be dangerous in conflict-affected communities because there is usually no prudential supervision to oversee the microfinance institutions that take savings. If savings programmes are carried out incorrectly, people run a high chance of losing their money. Savings programmes are also complicated by the fact that the banking sector often does not exist in the immediate post-conflict stage.

If they have experienced financial instability and the collapse of a formal banking system, people often lose confidence in the financial sector. This further complicates savings programmes in conflict-affected communities. Nevertheless, some microfinance institutions working in conflict-affected communities have been able to offer simple savings programmes, either as stand-alone products or in conjunction with credit. In a stand-alone programme, institutions often promote savings clubs, which encourage members to set aside small amounts for emergencies or special occasions. The institution provides training to members in all administrative functions of the savings club. Savings clubs are often set up in refugee camps.

When offering savings programmes along with credit programmes, most institutions use an informal system of monitoring the deposits of their clients rather than physically maintaining the deposits. Usually the savings are deposited into one account and the breakdown of the group’s savings is tracked by the treasurer. These services are limited to existing credit clients and do not include the general public.
3.1 Lending methodologies

To understand the main issues related to designing loan products, it is important to be familiar with the standard lending methodologies. This section will therefore first give an overview of lending methodologies, and next discuss the design of loan products on the basis of six loan parameters.

The differences of methodology in microfinance all relate to the type of guarantees required. These methodologies have been refined over the years, taking different forms in different countries, depending on culture, economic stability and modes of business practice. There is no “pure” form of any of the standard methodologies, because microfinance institutions adjust parameters to specific circumstances.

This section discusses individual lending, and three types of group lending (i.e. solidarity groups, village banking and trust banks).

Individual lending

Individual lending is the most bank-like approach to microfinance. It involves relatively large loans with standard collateral such as real estate, vehicles, or other assets with market value. Loans are normally secured by guarantors. Individual lending tends to target more established businesses, which have sufficient assets to secure the loan.

Individual lending in the Balkans

Many microfinance institutions in the Balkans have chosen to offer individual lending, using guarantors or collateral as the form of guarantee. This is common in Bosnia-Herzegovina with microfinance institutions such as LOK, Partner, AMK, Sunrise and MEB, among others. It has also emerged as a common methodology in new microfinance programmes in Kosovo, such as KEP and Beselidhja/Zavet.

Group lending

Microfinance as “banking for the poor” is based on the group-lending model. Group lending was designed to address the lack of collateral that is common to poor households. The principle of group lending is the use of social collateral — that
people who trust each other can come together and form a group to guarantee each other’s loans. In the group lending methodology, if one person is unable to repay his/her loan, other members in the group have to take on that responsibility.

Group lending can be divided into two kinds, the solidarity group approach and the community-based organisation approach. The latter is, in turn, divided into the village bank methodology and the trust bank methodology.

**Solidarity groups** - This approach was pioneered in 1976 in Bangladesh under a system, which later became known as the Grameen Bank. Small groups, usually 4 to 6 members, guarantee each other’s loans and support each other in other social ways. In the Grameen Bank, groups come together to form village level centres of about 25 to 30 people. Each group meets weekly to collect repayments, issue new loans, make savings deposits, and discuss any issues that concern the members. The Grameen model was designed for social transformation - to empower women in Bangladesh. It has been widely adapted to other regions of the world.

**Group lending in Georgia**

Constantha, a microfinance institution in Georgia, implements a group-guaranteed lending programme. The programme was established by Save the Children in 1997 and funded by UNHCR, USAID and Save the Children USA. It focuses on internally displaced women as well as local women. Loans for small business purposes are provided to groups of 7 to 15 women. Groups must participate in four training and group building sessions before they can apply for credit. Constantha has more than 13,000 active clients and is fully operationally sustainable.

Another form of solidarity group lending focuses on the development of the client’s business. It does not have the social aims of the Grameen model, nor does it include the village centre concept. Microfinance institutions using this methodology argue that, because they focus more on the business, their programmes reach sustainability sooner, and therefore help more people in the long run.
**Group lending in Uganda**

FINCA-Uganda, a successful microfinance institution, uses the Village Banking approach. It covers all its administration costs from the interest payments of its clients.

**Village Banking** - The second form of group lending came out of a strong vision to create stand-alone village institutions. In the classic Village Banking model, a village bank has an internal account, which is its source of loans. Each village bank has its own president and treasurer who manage the bank and the internal account. Many versions of this model exist, with similarities to the Grameen model but with a few key differences.

Village banking is favoured by the very poor, who prefer to work under the protection of a large group of individuals. The model was introduced by FINCA and has been used extensively in Latin America. More recently village banking has been practiced in Africa, Asia and Eastern Europe.

**Trust banks** – Trust banks are a modification of village banks. Loans are made to a group of 15 or more members who co-guarantee each other’s loans. This methodology is also favoured by very poor people. Trust banks often pursue social and spiritual objectives in addition to microfinance.

**Credit unions**

Credit unions are common in developed countries such as Canada and the USA, often formed by people in the same sector or company. They rely heavily on savings as a way to raise funds to onlend to their members. They use both individual and group lending methodologies.

Few credit unions have emerged in conflict-affected communities, for a number of reasons:

- the role of savings in credit unions. Loss of savings during the conflict makes people reluctant to use a savings-based programme;
- the rigidity of the credit union structure;
- fraud, which could have been exacerbated during the conflict.

Despite this, in some conflict-affected countries, credit unions are implemented because they are the only kind of microfinance programmes that can operate legally.
Target groups and methodologies

Microfinance programmes may provide loans to a wide range of clients, varying from persons who engage in income-generating activities to small entrepreneurs. The latter group tends to have assets that can be used as collateral. So small entrepreneurs can apply to collateralised, individual loans.

Persons who engage in income-generating activities, on the other hand, don’t have such assets and hence this group will generally not be able to apply for individual loans. Yet they can overcome this obstacle by forming a group and guaranteeing each other’s loans. It is thus important to assess the individual and the economic activity, when selecting the appropriate lending methodology.

The key message of the previous section is that the lending methodology needs to be cost-effective and tailored to the target population. Therefore it is crucial to take into consideration the profile of the target clients. The client profile influences methodology, loan requirements, systems, and all other aspects of the programme. In conflict-affected communities, many people may have lost their collateral, and therefore group lending may be more appropriate. Yet at the same time, distrust and (ethnic) tensions may be more widespread in certain communities, and therefore group lending may be more difficult.

3.2 Loan parameters

When designing a loan product, the main thing to keep in mind is that loans have to be structured to suit the business activities of the client. Therefore, the following six, interrelated, loan parameters should be adapted to the profile of a group (segment) of potential clients:

- loan purpose;
- loan size;
- loan duration;
- collateral;
- incentives and penalties for early/late repayment;
- interest rate.

These loan parameters make up the design of a microfinance loan product.
Loan purpose

In stable-economy environments, microfinance programmes offer a range of loan products, which can include working capital loans, housing loans, short-term emergency loans, long-term loans for machinery and equipment, and loans for buying durable consumer goods such as TVs and refrigerators. In conflict-affected communities the product range is limited because the conditions for operating are more challenging. Usually a loan product is offered for one or two purposes, with additional products considered as the programme matures and the situation stabilises.

In conflict-affected communities, there are two main purposes for a loan: fixed asset and/or working capital loan purpose. Depending on the loan purpose, the product has to be designed differently.

Loan size

A loan is both an opportunity and a liability. It must not be so large that the client becomes enslaved to the microfinance institution. It has to be both recoverable by the institution and useful to the client.

A first loan should be large enough to allow the client to purchase the basics to start a business. If the loan is provided to expand a business, it must be large enough to allow the client to purchase the necessary inputs.

Microfinance programmes start with small loans, expanding to larger subsequent loans. Starting with small loans allows the institution to keep its risks down. In the beginning it has limited information on a client’s repayment capacity and has to trust the social collateral offered through a group structure. As a long-term relationship is built and the client’s business grows, the institution increases the loan size.

In conflict-affected communities there is the added dimension that clients are in the process of rebuilding their lives. They might be without houses or even without clothes. Family expenditures will probably be higher than in stable communities. The microfinance programme needs to consider the effect of the extra credit burden on the family. This is another reason for initial loan sizes to be kept low.
Clients usually want larger loan sizes, mostly because they want to use parts of the loan for other things besides the business, even at the risk of increasing their monthly payments. It is therefore important to conduct an appropriate business analysis in order to know exactly how much clients really need to avoid overburdening them with debt.

The loan size also depends on the regional economy. In some economies in Asia or Africa, as little as $50 can give a client access to micro-businesses like market vending, food stalls, or animal husbandry. Such small loans would be worthless in economies like in Eastern Europe, where $500 is usually the size of a first loan.

**Loan duration**

It is natural to prefer long-term loans. People think that the more time they have to repay a loan, the more they can do with the money. But the longer they have a loan, the more it costs them in terms of interest. Therefore it is not necessarily true that a long-term loan is better.

The duration of a loan should relate to the client’s business cycle, which is the time required for the business to produce or procure something of value and sell it to generate income. In some business activities, the business cycle is very short, in others it is much longer. Compare, for example, the business cycles of selling fur coats to the selling of milk. Generally, in the market settings where microfinance operates, vendors have short business cycles and need new cash injections frequently. A cereal crop farmer, on the other hand, has a business cycle, which begins at planting and ends at harvesting.

The different cash needs of each type of business must therefore be kept in mind when structuring loan terms. A loan must allow the borrower to continue to buy additional inventory or inputs. At the same time, profits must be high enough to cover the associated costs of repaying the loan.
Grace periods: a grace period is a period in the beginning of the loan, when the client is not required to pay principal, or principal and interest. The rationale is that certain business activities need time to generate enough profits, and therefore clients should not begin repayment of the loan immediately.

In stable microfinance environments, grace periods are rarely used, for a number of reasons:

- grace periods make the loan more risky by lengthening the overall loan term. This is particularly true for new clients who have not yet established a track record with the microfinance programme;

- part of the success of microfinance is its simplicity. Simple loan products, with standard repayment schemes, are a way of establishing a discipline of regular and on-time repayment;

- different repayment options, including grace periods, greatly complicate the management information system required to track the loan portfolio. Complicated tracking may lead to poor follow-up and late payments;

- because of the grace period, installments can be larger and therefore, it can be harder to repay the loan.

In conflict-affected communities where clients have multiple demands on their small incomes, a grace period may be desirable. On the other hand, grace periods may create an image of leniency, which may be counterproductive for the institution’s professional image. Microfinance programmes need a businesslike approach, especially if they are trying to differentiate themselves from relief activities. Grace periods are advisable only for very specific business activities, and need to be carefully designed.
Collateral

It is difficult for an agency to assess the reputation of new borrowers. This is especially true in conflict-affected communities, where the majority of clients of a new microfinance programme are first time borrowers. Collateral serves as a way to guarantee the promise of repaying a loan. It generally takes the form of tangible assets that can be confiscated by the microlender and sold to recover the loan.

In conflict-affected communities, there may be few tangible assets. There may also be no methods to assess asset values, no legal frameworks to help with confiscation, and no markets to sell assets. For these reasons, programmes working in conflict-affected communities usually use the collateral substitute guarantees (in group lending methodologies) as well as individual guarantors (in individual lending methodologies). Implementing such systems, however, requires intimate knowledge of the social and emotional values of the client community.

This is challenging to a microfinance programme with new staff members who do not know the community. It is easier to train staff members in standard policies and procedures than to require staff to be immediately innovative and creative.

Key points on collateral

- some assets do not have a lot of value, and it is often difficult to assess their value;
- the legal environment may make it difficult to actually confiscate assets;
- for the institution, it may also be difficult to take away precious things from people;
- peer pressure may be a more appropriate form of guarantee;
- when providing collateralised loans, it is crucial to understand the context very well (i.e. to know about legal aspects, and about culturally acceptable guarantees);
- when requiring groups-based collateral, ethnic and other tensions can complicate matters in conflict-affected communities.
Incentives and penalties

To make sure that people keep their promises to repay, microfinance programmes need to put in place both incentives for repayment (carrots) and penalties for nonpayment (sticks). Choosing the right set of incentives and penalties is different for each community.

**Incentives** for on-time payment include:

- the opportunity for a client to qualify for another larger loan if the initial loan is paid on time and in full;
- the opportunity for a client to qualify for other products (such as individual loans for group loan clients, or housing loans for individual loan clients);
- additional incentives for on-time clients, such as rebates on interest and faster processing of applications.

**Penalties** can be applied to individuals or groups. In group lending systems, a whole group can be penalised. Penalties to prevent nonpayment include:

- a charge for each day that a loan is late (either a flat amount or a percentage of the late payment);
- disqualifying clients from subsequent loans if their initial loans have not been repaid in full;
- giving out information to the community or employers about the unreliability of the client;
- sharing a client’s bad credit record with other microfinance programmes, thus blacklisting the client from access to microfinance services. This penalty may require coordination with microfinance influencers;
- pursuing legal action against the client to recover the loan. This is often used more as a deterrent to other clients, showing that the institution is serious. However, courts may not be fully functional in conflict-affected communities, and clients may know that legal action will not affect them.
3.3 Interest rates

Institutions that implement microfinance programmes following conflict, are often asked why they charge interest on their loans.

The answer to this question is, that the interest enables them to reach many poor people in a lasting way. This goal can only be fulfilled if the microfinance programme is sustainable.

Institutions that charge interest, can help more poor people - in fact, many more, and in a significant, lasting way - than institutions that just give money away as grants or interest-free loans.

It is important to recognise that credit enables people to earn money, which they otherwise would not earn. Only part of the extra money that they earn is paid as interest to cover the costs of the microfinance programme. Most micro-entrepreneurs are better off, even after paying the interest, than they would be without the loan.

Interest is both cheap and productive

A micro-entrepreneur in a tailoring business was making $100 a month. Because she had too many customers, she decided to train two of her neighbours. She then approached a microfinance programme for a loan to expand her business by purchasing two more sewing machines and also buying materials in bulk. The interest on the loan came to $10 a month. Within three months she was earning $200. The interest was $10 a month, leaving her with a net income of $190. She was $90 better off than before. The microfinance programme and the entrepreneur were both more secure and sustainable. The $10 interest was cheap considering the benefit gained.
Loan pricing

One can think about setting the interest rate in the same way that a market vendor sets the price of clothes. Such a vendor may travel to a neighbouring country every two weeks and come back with cartons of jeans to sell in the market. The jeans that she buys cost $10 each. She only has enough cash at any one time to buy $1,000 worth of jeans. How should she set the selling price?

The first consideration is that the selling price cannot be very different from the other vendors of jeans in the market. If her price is substantially higher, she is not likely to get customers. She can set the price a bit lower to attract more customers, but if she sets it too low, she will lose money. She will have a little more flexibility if her jeans are different from the rest, and she can justify the price difference. She should also bear in mind that all costs related to buying and selling of the jeans have to be covered in the selling price, not only the cost price of the clothes, but also other costs, like transport, wages for her helper, stall fees, and taxes.

Microfinance institutions have to consider pricing in the same way when setting their interest rate. They need to start with an understanding of the market rate – the interest rate that other lending institutions charge for similar microfinance products. However, in conflict-affected communities it may be difficult to assess what the market rate of interest is, because there are often no other providers of the same services. The financial products of commercial banks are not comparable because the bank works with more established businesses, and offers much larger loans. Therefore, commercial banks have much smaller overheads costs, in relative terms. Comparing market rates of microfinance in stable economies to microfinance in conflict-affected communities is also misleading.

In general, MFI interest rates end up being in between bank rates and informal lenders (loan sharks’ rates, since MFIs have higher transaction costs in handling relatively small loans, compared with banks. Besides, the cost of the loan should also reflect the services provided to the clients, e.g. access to credit, speediness of service delivery, tailored loan sizes and loan terms and conditions.
**Why bank interest is lower than microfinance interest**

The difference between a commercial bank and a microfinance programme is the same as the difference between a supermarket and a small corner grocery store. The supermarket offers cheaper prices, but the small grocery store is closer to your home, the owners know you, and they stay open late. These features warrant higher prices in the eyes of you, the customer. Microfinance, with its small loans and poor clients, is like the grocery store.

Its interest rates are higher than bank rates because of the higher transaction costs of small loans. Their higher interest rates also reflects the fuller service offered to their clients, including easier access to credit, speediness of delivery, tailored loan sizes and special loan terms and conditions.

When setting the interest rate, microfinance institutions should, at least, cover the operating costs, inflation rate, loan losses, and the costs of capital. The last component generally equals zero in conflict-affected communities, since microfinance programmes operate with donated funds in such environments.

### Interest rate components

<table>
<thead>
<tr>
<th>Margin</th>
<th>Cost of capital</th>
<th>Loan loss reserve</th>
<th>Operating costs</th>
<th>Inflation rate</th>
<th>Interest rate</th>
</tr>
</thead>
</table>

As a rough guideline, some microfinance institutions and donors check whether the interest rate is appropriate by using the following formula:

Monthly interest rate = monthly inflation rate + 1 to 2%
(calculated as a flat rate)

The key message is that the interest rate should by no means be lower than the inflation rate. This formula should not be used to calculate the interest rate, but rather as a means of verification.
Calculating interest rates

There are two standard ways that microfinance institutions use to calculate interest rates — the flat rate method and the declining balance method. The flat rate method is simpler and does not need financial calculators or spreadsheets. It is easy for clients to understand and calculate independently, so it is prevalent in village level microfinance programmes which set out their own interest rates.

The declining balance method is more accurate, in the sense that it is a true representation of how much someone has to pay to borrow money. It is used by microfinance institutions, which are on their way to becoming formal banking institutions. The declining balance method may be prescribed by a country’s laws.

Two ways of calculating interest rates

- **Flat rate**
  The amount of interest paid is calculated as a percentage of the total loan size. A fixed amount of interest is paid for each repayment installment. Flat rate interest is not dependent on the amount that has been repaid.

- **Declining balance**
  The amount of interest paid is calculated on the outstanding balance of the loan at the time of each payment installment. If the payment installment is constant, the interest portion decreases each month, and the principal repayment portion increases.

The declining balance rate becomes lower over time, while the flat rate interest remains constant. This means that a 10% interest rate on a declining balance is much cheaper than a flat rate of 10%. The exact difference will depend on the number of installments and the loan term. It is more costly to pay interest calculated on a flat rate method. Annex 1 contains more information on flat interest rates, declining balance rates and effective interest rates.

**Islamic banking**: working in traditional Muslim societies is often a challenge for microfinance institutions, since many Muslims believe that making money is haram or a sin. Yet “Islamic banking” allows for other ways to recover cost. The following box gives an overview of such alternatives.
Islamic Banking

Although Islamic Banking does not charge interest explicitly, it allows several ways for lenders to cover costs. These include:

- **Murabaha**: This is the sale of a commodity at a price that includes a stated profit known to both the vendor and the purchaser. It is the equivalent of a cost plus profit contract.

- **Mudaraba**: This is a contract between two parties whereby the one party (the lender) entrusts money to the other party who manages the funds (the borrower). The borrower uses the funds in an agreed manner and then returns to the owner the principal and the pre-agreed share of the profit, while s/he keeps the remainder of the profits. The division of profits between the two parties must be on a proportional basis and cannot be a lump-sum or guaranteed return. Also, the lender is not liable for losses beyond the capital he has contributed and the borrower does not share in the losses except for the loss of his time and efforts.

- **Musharaka**: This is a partnership, normally of limited duration, formed to carry out a specific project, similar to a western-style joint venture. It is regarded by some as the purest form of Islamic financial instrument, since it conforms to the underlying partnership principles of sharing in, and benefiting from, risk. Participation in a musharaka can either be for a new project, or for providing additional funds for an existing project. Profits are divided on a pre-determined basis, and losses are shared in proportion to the capital contribution.

- **Ijara Wa Iktina**: This is equivalent to the leasing and instalment-loan, hire-purchase, practices of the kind used to finance vehicles in western economies. Ijara wa iktina as applied by Islamic banks includes the requirement that the leased items be used productively and in ways permitted by Islamic law.

- **Muqarada**: This technique allows a bank to float what are effectively Islamic bonds to finance a specific project. Investors who buy muqaradah bonds take a share of the profits of the project being financed, but also share the risk of unexpectedly low profits, or even losses. They have no say in the management of the project, but act as non-voting shareholders.

- **Salam**: Here a buyer pays in advance for a specified quantity and quality of a commodity, deliverable on a specific date, at an agreed price. This financing technique, similar to a futures or forward-purchase contract, is used mainly for seasonal agricultural purchases. It can also be used to buy goods in situations where the seller needs working capital before s/he can deliver.
Should interest rates be different for conflict-affected communities?

The costs of implementing a microfinance programme are higher in conflict-affected communities, so the interest rates should be higher than for stable microfinance environments.

There is also a higher risk of hyperinflation in conflict-affected communities, and microfinance programmes should anticipate this when setting their interest rate.

Hyperinflation in the Democratic Republic of Congo

Microfinance programmes in the Democratic Republic of Congo have been confronted with hyperinflation in the last few years. Their first reaction was to index the loans to a hard currency, the US dollar. Unfortunately Laurent Kabila’s government forbade the use of the US dollar from late 1998 to December 2000, so the microfinance programmes had to create another mechanism for indexing.

To support its local microfinance partners, GRET worked out a system of indexing credit and savings products to inflation. This system referred to both the black market US dollar rate and an inflation rate, and was updated continuously by the University of Kinshasa. The microfinance programme accounting system had to be adapted so that it could follow the exchange risk position carefully and frequently, on a monthly basis. When the use of the dollar was authorised again, the microfinance organisations switched back to their former system, indexing products to the US dollar.

Indexing is complicated and requires sophistication. Nevertheless GRET’s experience was that despite hyperinflation, techniques can be found to help microfinance programmes survive these difficulties and continue serving their clients.

A microfinance institution may choose to deal with the higher costs of running a programme in conflict-affected communities in one of two ways:

- **charge higher interest rates**: interest rates have to cover the actual costs of operations, so they must reflect the added costs and risks associated with working in conflict-affected communities. International microfinance experience has shown that the interest rate has little effect on the demand for credit or on clients’ capacity to
repay their loans. This is confirmed by the fact that borrowers use informal moneylenders or other ways of accessing funds with much higher rates of interest than those charged by microfinance institutions;

- **revise projections for reaching sustainability**: the other approach is for the implementing agency to plan a longer period to reach sustainability. In stable social environments, microfinance organisations can achieve operational sustainability within five years. In conflict-affected communities this timeframe can be made a little longer, especially if interest rates do not cover all the programme’s costs. But beware of setting interest rates so low that sustainability may never be achieved. There is always a balance between a reasonable interest rate and a reasonable length of time in which to become sustainable.

### Assessing the real costs of a loan product

Microfinance programmes charge their clients in several ways. In addition to interest, some programmes also charge a fee. The most common way is to charge a flat amount (for example $10, regardless the amount of money borrowed), or a percentage of the loan size. This fee is charged upfront, and deducted from the loan. Such fees are an immediate and secure income for the microfinance programme.

To compare programmes with different interest rates and fee structures, we use a method called the effective interest rate. This is calculated by a formula that equates different fee structures, and different methodologies of calculating interest. A flat interest rate works out to a higher effective rate than an interest rate calculated at a declining balance method, (other things being equal). Annex 1 contains more information on the effective interest rate.
4.1 Potential clients

*Gender considerations*

Programmes trying to target the lowest income groups often focus on women. Research shows that women are the majority of the poor and are more influenced than men by social pressures to repay loans. Compared with men, women also tend to spend a larger share of their business income on the household. A complicating factor in some women-targeted programmes is the ghost client syndrome, when women apply for loans but in fact serve as a “front end” or entry point to the loan scheme by male borrowers. There may also be negative social costs to providing preferential treatment to women, such as the politics of the household and domestic violence.

In conflict-affected communities there are often a large number of women entering the workforce, replacing husbands and male relatives lost or incapacitated by the conflict. There will be more women heads of households than before the conflict, some of them with no previous work experience. Cultural barriers may make it difficult for women to run businesses, even though they have no choice but to support their families. Microfinance programmes need to think about all these issues when deciding whether or not to focus on women.

*Refugee, Returnee, IDP status*

Microfinance programmes need to consider the duration of stay of refugees and internally displaced people (IDPs). If their stay is expected to be long-term, they should be assessed in the same way as returnees or residents. Each context is unique, so there are no hard and fast rules about what long-term is. Some cases may seem obvious, such as Palestinian refugees or Sudanese refugees in Uganda or Kenya. Others are less clear.

At a minimum, refugees need to demonstrate their commitment stay in the region where the microfinance institution operates for the full term of their loans. If they leave earlier, they must be encouraged to repay the loans before they depart. Systems then have to be put in place so that the microfinance institution can coordinate with organisations like refugee resettlement agencies, which provide assistance to the refugees in their new destination.
In one country, some loan officers assessed whether refugees were staying in their hosting communities by looking at their gardens. Refugees who planted gardens or crops in the community were more likely to stay.

Trust and social capital

A common characteristic of conflict-affected communities is the breakdown of social structures. This presents a new challenge to agencies designing programmes for people with no collateral. In these situations, one should adapt the traditional criteria for group formation to match the situation. In traditional microfinance, for example, groups made up exclusively of family members are considered risky, because if an emergency arises, it will affect all of the family and put everyone in the group in difficulty. However in communities where people do not trust their neighbours, group lending involving family members may be the only way to work.

4.2 Resource requirements

Once an implementing agency has decided on the geographic area of its operation, the demand for financial services, and the loan parameters, it can plan what resources it needs to implement the microfinance programme.

Human resources

The programme will need a governing structure, management, administration and finance staff, and loan officers. Programmes that are large or rely on sub-offices will need branch managers and credit managers to function as mid-level management.

The loan methodology and the projected outreach will influence the number and skills of employees needed to implement the programme.

Organisational charts of microfinance programmes may be function-related, geography-related, product-based, or a mixture of these. The organisational chart is a reflection of strategic priorities, whether a client-driven approach (product-based chart) or decentralised approach (geography-based chart).
The lending methodology will determine the number of loan officers required. Group lending programmes have a higher client caseload (number of clients per loan officer) than individual lending programmes. Village banking programmes have the highest caseload, with an average of 408 clients (20 village banks) per loan officer. The caseload for group lending programmes lies between 250 to 280 clients. Individual lending programmes have the lowest caseloads, with an average of 230 individuals, and the loan officers have to be trained to assess applications and business plans.

Organisations cannot expect new loan officers to handle large caseloads without first gaining the necessary experience. It can take several months before a loan officer is performing at full capacity. Caseloads must be adjusted to geographic considerations - loan officers who work in remote areas cannot maintain caseloads as large as those working in populated urban centres.

**Loan capital**

The total loan fund needed by a microfinance programme depends on several factors: average loan size, average loan term, and the number of loans, which can realistically be disbursed each month. All these are linked to the geographic coverage of the programme and the number of loan officers on the staff.

Many donors have restrictive cycles, which only accommodate yearly grants. This is especially the case following conflict, where relief donors are very prevalent. This donor cycle should not influence the loan capital planning. Microfinance institutions should do their planning irrespective of the funds they have already secured through donors. Multi-year planning is the best way for microfinance programmes to anticipate their growth.

When planning, microfinance institutions need to think about the potential for offering more financial products so to maintain a high retention of their existing clients. This will in turn influence the size of the loan fund required.

The decision about whether to expand quickly or gradually depends on the institution’s management abilities, its ability to raise sources of capital, and the demand for the microfinance service. It is easier to manage gradual growth than aggressive expansion. Many organisations have failed by trying to do too much in a short time.
Assets

The microfinance programme will plan its procurements according to its lending methodology and according to geographic considerations. Transport for loan officers is a crucial area of cost. In some environments the most basic transport such as bicycles will be sufficient, in others 4-wheel drive vehicles will be needed to get the job done. Office equipment such as computers, telephones, photocopiers, printers and fax machines will also be needed.

Considerations of price should not be the only factor when deciding which equipment to purchase. Access to reliable maintenance for the equipment may be even more important than price.

Protection of assets, funds and people need even more attention in CACs.

Administration costs

Once staffing needs are determined, the organisation should calculate the costs of salaries, communications, transport, training, and other administration expenses. Indirect expenses must also be included — depreciation of assets and provisions for losses due to non-collectable loans. These costs are different from those of relief agencies and often do not correspond with the accounting practices of relief donors. Donors have to allow microfinance programmes to include such costs in their budgets. As a benchmark, one can estimate that direct costs should amount to 70% to 90% of all costs, although during the start-up phase indirect costs are higher.

Some challenges in conflict-affected communities

- **Human resources:**
  - ethnic issues in the workplace;
  - distorted labour market;
  - high staff turnover;
  - strong need to protect staff.

- **Loan capital:**
  - high prevalence of annual donor budgets;
  - difficult environment to plan and manage growth;
- high risk of fraud, and loss of loan capital due to the volatile situation.

**Assets:**
- Stronger need to protect assets;
- Maintenance of assets is often problematic.

### 4.3 Sustainability

Sustainability is the ability to support oneself without any external help on a permanent basis. Microfinance programmes aim for two kinds of sustainability, financial and institutional.

#### Financial sustainability

Financial sustainability means that a programme can cover all its costs from its client payments on a permanent basis, without donor grants or subsidised loans. Besides the costs of administering the programme, such costs include devaluation of funds due to inflation, in-kind donations and grants, and losses due to non-recoverable loans. The microfinance institution may also need to pay interest for its loan fund in order to conduct the lending operation.

Achieving financial sustainability depends on:

- **appropriate interest rates:** interest rates need to cover all costs in a reasonable timeframe given the loan portfolio;
- **loan recovery:** microfinance programmes must be able to maintain very high loan recovery so that they are able to continue to operate and revolve their loan fund, without increasing costs through losses of non-recoverable loans;
- **efficiency:** maintaining low costs is an important requirement of sustainability. This may be in contrast to the common practice in relief situations for organisations to spend on operations as quickly as possible, sometimes to access future tranches of funds;
- **Loan fund:** the size of the loan fund also affects the time needed for the microfinance programme to become sustainable. With a large loan fund, more can be lent, more income can be earned from interest (assuming high loan recovery), and therefore the institution can reach financial sustainability sooner;
retention rate: retention also contributes to sustainability. Follow-on clients tend to ask for larger loans, they require less monitoring and they tend to be less risky because the microfinance organisation has got to know them.

Institutional sustainability

Financial sustainability is not sufficient to build a sound microfinance programme that will survive and prosper over the long term. The implementing agency has to be led, governed and staffed by skilled people, dedicated to realising the vision and objectives of the programme. This is known as institutional sustainability. The important components of institutional sustainability are:

- governance: who is the owner and governing body of the organisation? Who makes up the board? What are their skills? To what extent do they oversee the institution? Board members must believe in the organisation’s mission and have the commitment to see it through. The involvement of boards can range from hands-off to very involved. The following issues should be taken into account when selecting board members:
  - board members should be individuals outside the agency who can offer meaningful guidance;
  - board members must oversee the director of the organisation and must be able to demand regular information on its performance;
  - board members should not have any conflicts of interest with the organisation. For example, a board member should not represent a competing agency or be a relative of a staff member or a loan client;
  - the selection of board members should reflect the institutional needs of the agency. For example, a new agency wanting sound legal advice might look for a reputable lawyer for its board. A more mature agency interested in securing commercial funding may need board members with strong knowledge of the formal financial sector.

- management and staff: microfinance organisations need well-trained managers and staff who are committed, share the same vision, and have the skills to implement the programme. Staff and management should have
opportunities to expand their knowledge and skills. Professional development, growth plans, performance reviews and bonus systems are all ways of developing staff and enhancing long-term institutional sustainability.

**systems and policies**: these must be clear, appropriate to the environment and be able to withstand internal and external shocks, such as changes in management, or internal fraud. Sound practices include:

- strong management information systems to track loan information at branch and head office levels, providing information consistently and on time. These systems can be either manual or computerised, depending on the complexity of the programme;

- strong accounting systems with sound internal controls;

- well-documented credit policies and procedures. These should include forms used by the institution and policies related to loans, such as rescheduling, write-off, follow-on loans, and late fees;

- personnel policies and procurement policies should be documented and applied uniformly.

### 4.4 Exit strategy

Donors or international organisations that do not plan to remain in the country in the long run, should have an exit strategy. This will enable the microfinance programme to have an impact even after the agency has left the country. The options are:

1. **unconditional transfer of funds**. In this case, the agency transfers the funds, and does not require any feedback on the progress of the programme. Funds may be transferred to a local NGO, an international NGO or to other agencies or programmes;

2. **conditional transfer of funds**. Some agencies transfer funds on the condition that they can still monitor the programme. They may also require that the agency who receives the funds, localises (see below). Conditions are usually defined in a memorandum. Monitoring is often done through one or two board members. At least during the period of transfer, technical assistance should be provided, to assist the agency who receives the funds in becoming sustainable;
3. *transfer of management responsibility, but no transfer of ownership.* This option is not sustainable in the long run;

4. *merging the MFI with another one;*

5. *localisation of the international NGO into a local organisation.* In this case, the international NGO will transform itself, and change its status from an international organisation into a national/local organisation. The local organisation will be registered under local laws, and as a separate entity, so that the microfinance programme is no longer a project of an international organisation.

Issues around the exit strategy:

- try to think of the exit strategy at the planning stage;
- do not request the loan fund back, unless there is a serious case of fraud in the microfinance programme. Microfinance is different from relief programmes in the sense that it can have a long-lasting impact on people’s lives. By requesting the loan fund back from an MFI, donors take away this opportunity of long-term impact;
- localisation is important, but this does not necessarily mean that localised organisations are more sound. Internal controls are very important. There have been cases where as soon as the funds were transferred to the local MFI, the owners took the funds and dismantled the organisation;
- when planning for localisation, the agency should be clear on who will own the microfinance institution. When the local institution is a credit union or cooperative, the ownership lies with the members. But otherwise the ownership depends on local laws.

The localisation process must be well planned and implemented, to avoid shock and discontinuity of the organisation. Various issues can slow down this process:

- finding suitable managers may be difficult;
- laws for local registration of microfinance institutions may not exist;
staff members may feel threatened if the international organisation that they work for, and by which they are protected, transforms into a local organisation. They may also be required to pay considerably higher taxes.

When designing a microfinance programme, the agency should define internal criteria or benchmarks, to assess whether the planned results are in fact being achieved. By comparing its results with these benchmarks, the agency can assess whether it is on the right track, and identify the need for adjustments in its strategy and implementation. This kind of measurement is discussed in detail in Module 7. Module 6 provides some information on the implementation process, and pays particular attention to challenges encountered in conflict-affected communities.

4.5 References

General


Methodologies


Interest Rates


**Product Development**


**Websites**

- Concern Worldwide and Springfield Centre project http://www.postconflictmicrofinance.org
- Calmeadow http://www.calmeadow.com/
- Consultative Group to Assist the Poorest www.cgap.org
- FINCA Village Banking http://www.villagebanking.org
- Freedom from Hunger http://www.freefromhunger.org
- Grameen Bank http://www.grameen-info.org
- World Council of Credit Unions http://www.woccu.org/

*Source for data: The Microbanking Bulletin, April 2001*
Module 6

Implementation in conflict-affected communities

This module presents the basic issues of implementation. Some of these are common to both stable and unstable environments. Specific lessons from conflict-affected communities are highlighted. This module will not go into details of implementation, but rather show some issues that are particularly relevant following conflict. The bottom line is that adaptation of implementation practices from stable environments will be necessary.

Learning objectives

By the end of this module, participants will understand how working in a conflict-affected community affects a microfinance programme. Special attention is paid to:

- security issues
- management
- governance
- external environment

1.1 Reducing security risks

Security considerations in a conflict-affected environment require microfinance agencies to take extraordinary measures to protect their staff, clients and assets. This is particularly so for agencies that disburse cash and are repaid by clients in cash.
Security guidelines for conflict environments
- hire more security guards and more field staff to disburse and collect loans;
- security staff should be individuals or companies whom the community recognises and respects;
- security demands good communication between field staff and management. It may be necessary to purchase radios or mobile phones for loan officers and field staff;
- premises will need added security measures such as gates, bars on windows, secure parking, and bright lighting;
- security of clients must also be considered. Loans should be disbursed and collected in a non-threatening environment, particularly if the agency practices mobile lending and goes to clients for disbursement. In these cases there is no option but to take out insurance against cash losses;
- encourage staff to be continuously aware. If you suspect a problem, immediately notify police;
- don’t wear uniforms. They set staff apart, making them easier to spot;
- don’t wear objects of personal value such as rings, chains or visible mobile phones;
- wear clothing which allows easy movement at all times;
- try not to travel during times of day known to be more dangerous, which may be as early as dusk;
- move by the most direct roads; avoid alleys and dangerous roads;
- when walking in groups, spread out rather than walking in a line. This way, if one is attacked, others can run for help;

When commercial banks are not available in conflict environments:
- equip offices with safes, vaults, and guards;
- collect payments at times other than group meetings;
- vary days of the week for repayments, and limit who has that knowledge;
- instruct loan officers to travel in greater numbers;
- use more vehicles for disbursement and repayment, in extreme cases, this may mean air taxis;
- reduce payment frequency to reduce number of exposures; alternatively increase payment frequencies and reduce the amount collected each time;
- purchase transit insurance policies;
- use informal structures for transferring money (for a fee, an extended family or business can do the transfers).

When commercial banks are available in conflict environments:
- use all the options mentioned above, plus:
- avoid having loan officers handle cash;
- make transactions by cheque, or get clients to collect cash from bank and make repayment at bank;
- ask groups to choose members at random to make repayments on their behalf at the bank;
1.2 Management

Staff management

Recruitment, lay-offs, promotions and staff development

Who you hire is linked to who your clients are. Many talented people leave conflict-affected communities for more stable environments, so it is often difficult to locate and attract talented staff members. Implementing agents have to address this problem at every level. People who are unqualified may have to be recruited - they should be selected for their capacity to learn. Staff development becomes essential, whether through classroom training or learning on the job. Staff have to perform to standards they may not be used to. Some potential staff members may have worked with relief agencies handing out food and blankets to the same community that may now be applying for microfinance. These staff members will need to change their view of the community from relief beneficiaries to microfinance clients.

Salaries and benefits

Salaries and benefits need to be relevant in the local context, recognizing that there is a lot of competition for qualified staff. Secure jobs are limited in conflict-affected environments, so it is natural for those who do have jobs to maximize their income in the short-term. This could mean that the microfinance institution that pays the highest wages can recruit the most talented or well-trained staff. It is therefore important to hire people who share the same vision as the institution, rather than those who are just seeking higher salaries. Other incentives can also help to keep trained and skilled staff in the organisation, such as training opportunities, bonus schemes, travel opportunities and pension funds.

Ethnic divisions

The same tensions which caused the conflict can continue once the conflict has subsided. Unexpected tensions can develop, for example between those who escaped and those who stayed to fight. Microfinance employers should make it clear that there will be no tolerance for discrimination within the organisation. The employee contract should state that discrimination towards any
faction or ethnic group will be regarded as misconduct and could result in dismissal. Management should respond to misconduct firmly, by firing or reprimanding employees who display intolerance.

**Policies on loans for staff**

In all microfinance environments, policies which give staff access to personal credit are difficult to implement. Such loans divert funds which could be available to clients. Staff members who have secure jobs and salaries should be encouraged to go to commercial banks for loans. An exception in conflict-affected communities (for example in Bosnia-Herzegovina) has been to make housing loans to staff members as an incentive for them to stay in the microfinance agency.

**Fixed asset management**

*Procurement and maintenance*

It can be difficult to find the right equipment in the conflict-affected area. Even if equipment can be found, it may be expensive. Implementing agencies may be forced to buy what is available without going through normal procurement policies. Bear in mind that even more important than price is access to skilled people who can maintain the equipment.

*Inventory control*

Physical security is an issue in conflict-affected communities, where there is a high potential for loss or damage. It is important to put into place strong inventory controls and to conduct inventory checks more often than one would in a stable environment.

*Assets and image*

The image of the institution has an impact on clients’ behaviour. When the institution is perceived as rich or relief-centered, clients may be less willing to repay their loans. Assets such as cars and offices, as well as logos play an important role in this regard.

**Portfolio management**

Conflict-affected communities are often characterized by limited or non-existent banking services. There may be no banks in the country where the microfinance provider can
Invest idle funds. Banks that do operate are likely to charge high fees for their services or provide low interest, or even zero interest. Unstable banks have high potential to lose holdings. All these factors can add up to huge costs for implementing agencies. Agencies must therefore look into ways to address these issues while minimising their risk, such as:

- diversifying holdings by using more than one bank;
- maintaining low idle funds;
- moving funds overseas to secure investments;
- searching for secure banks within the country, even if these are in different cities or charge higher rates;
- asking donors to transfer funds only when needed, or, if the donor cannot do this, establishing a partnership with an intermediate organisation that can;
- using banks where big institutions like UN agencies or the World Bank maintain funds. Such banks would have higher chances of being bailed out if losses are incurred.

**Bank collapses in Bosnia-Herzegovina**

In Bosnia-Herzegovina, many microfinance institutions lost deposits in local banks that collapsed several years after the conflict ended. Some microfinance organisations pre-empted the crisis by maintaining their reserves in multiple banks, so that their losses were minimal. Others protected themselves by holding most of their reserves outside the country, only transferring funds when they were needed.

**Programme / operations management**

**Infrastructure**

Conflict-affected areas may experience unstable power supply and frequent electricity cuts. Electricity backup systems, such as generators at offices, should be put in place. If power supply is too erratic, management might decide to use manual accounting and information systems.

Roads may also have been destroyed, making some locations inaccessible. Public transport systems may no longer exist. Microfinance programmes have to respond to this reality. They may invest in 4x4 vehicles to access remote locations, or use motorbikes or bicycles for
transport. Alternatively, they may need to design village-based programmes that rely less heavily on transport.

Application forms and credit checks

Many clients in conflict-affected communities have lost all forms of identification. There may be no way of verifying their identities. Microfinance programmes may need to rely on newly issued UN documents or documents from some other authority. Character references in conflict-affected situations therefore take on even more significance than they would in stable environments. Organisations also need to be aware that differences in political factions, ethnicities or religions may be used by some individuals to attempt to disqualify others from accessing credit.

Credit checking in Kosovo

In Kosovo, microfinance organisations jointly established the KCIS (Kosovo Credit Information Service) as a credit bureau to help build each client’s credit history. Each microfinance agency contributed a small percentage of the initial start-up costs to establish the bureau. KCIS was set up as a stand-alone company charging membership fees to microfinance organisations. The country’s only commercial bank also contributed as a member.

Verifying the credit history of clients is very difficult because of loss or destruction of documentation. Implementing agencies need to cooperate with other agencies, UN officials, and local government to obtain relevant information on clients. It is thus important for all institutions to maintain good, open relationships.

Disbursement and collection of loans

In stable environments, it is common to use the commercial banking sector as part of the disbursement or loan collection process. For conflict-affected situations this may not be an option. The microfinance programme will need to devise alternative flexible disbursement and collection systems.

The following issues should be taken into account:

- loan disbursement: security is a challenge in conflict-affected communities. Extreme steps may be needed to protect clients, staff and funds during the disbursement process;
loan payment collection: policies need to be appropriate for the level of security risks. If the environment is relatively insecure, the organisation collects cash and has cash in the office, it should make sure that policies are both extremely strict and very clear to the staff.

loan tracking: think of manual loan tracking systems if needed; always have back up systems and other people who can fulfill these functions. Make sure to include checks and balances to verify the date and warrant against fraud.

Information management

In conflict-affected communities, donors may want to know numbers of refugee or returnee clients, statistics which are not relevant in stable microfinance environments. At the same time, the microfinance organisation may be encouraging non-discriminatory practices and therefore not want to ask certain questions directly. Asking certain questions of clients may reinforce divisions in the community or create the impression that the organisation is biased in one way or another. Microfinance programmes therefore need to consider indirect ways to get this information. Rather than asking outright, organisations could ask clients for other documents (for example, ration cards) which show whether a client is a refugee or an internally displaced person. Where there has been ethnic conflict, statistics on the ethnicity of clients are very sensitive. It is best to estimate this information informally, from names, languages used, information from loan officers, and other indicators.
Delinquency management

Managing late payments from conflict-affected clients presents a new challenge. Implementing agencies need deterrents appropriate to the particular environment. If the justice system is ineffective, the deterrent of taking clients to court for non-payment is not a realistic option.

Non-payment management in Kosovo

In Kosovo, community and social relationships were enormously important. Microfinance organisations found that an effective deterrent for non-payment was to go to the family of the client and request payment from a guarantor or other relative. Often a person’s reputation in the community was so crucial that they would avoid this outcome at all costs.

1.3 Governance

In stable environments, a successful microfinance organisation is led by an efficient managing director who is appointed by, and reports to, a strong governing board. Yet it may be difficult to find capable people to serve on the board in conflict-affected communities, and some programmes do not manage to establish a board at all. Once established, the board itself needs to develop the MFI’s capacity. A concerted effort must be made to equip board members with the tools they need to govern properly. Board development in conflict-affected communities can also be complicated by differences in ethnicity, religion, or other factors related to the conflict.

1.4 Factors in the external environment

Competition and market distortions

An unfortunate reality in conflict-affected communities is that donors and implementing agencies want to see a quick injection of money into the local economy, without taking into consideration the distortions that this creates. Such programmes may have offered grants or subsidised loans to the same people who are potential clients of microfinance. In such circumstances the client may say “If NGO X doesn’t require that I repay, why should I repay Organisation Y?” It is very difficult to change
people’s mentalities to the repayment of loans and interest after the luxury of grants.

It is therefore critical that the microfinance programme maintains a distinct businesslike image and gives clear messages to clients. This can be accomplished through the professionalism of staff and publicity material which clearly states rates, requirements and consequences of not meeting obligations. It may even be advisable to make obtaining a loan difficult. Adding certain steps in the application process will deter clients who may be looking for something for free. This practice is in contrast to microfinance in stable situations, where ease of access is a priority.

Local politics

Traditionally microfinance programmes do not get involved in local politics, but in conflict-affected situations they may have no choice. Local and federal officials often see both microfinance and relief programmes as ways to gain political favour with the population, and they may be looking for ways to divert funds to their constituents. In other situations the opposite may be true - microfinance programmes may face local government obstruction.

The challenge for implementing agencies in conflict-affected communities is to gain the support of local officials but not allow them to interfere with implementation or with client relationships. One has to be patient, listen to officials without compromising, and inform them of your activities. Through such dialogue, cooperation may improve. Some institutions hire a special staff member skilled in working with politicians, whose job is to smooth the cooperation. This person needs to be clear that the programme will allow no favours or financial compensation to government.

Another strategy for the programme is to keep a very low profile and give the impression that its finances are not sufficient to warrant the interest of politicians.

Protective legal frameworks

Conflict-affected environments can become so extremely hostile that programmes are closed down and police harass staff. In such cases the implementing agency may ask the UN or other international mediators to help negotiate a settlement which is perceived to be fair by
local officials. This effort can sometimes be extended to developing a legal framework for microfinance activities at the federal level. In general, it is useful to have the support of international bodies when negotiating with the government on the legal framework for microfinance.

**Legal options for microfinance in Croatia**

Adapting the programme to what is allowable under the law is sometimes the only way to operate. In Croatia, for example, in order for any microfinance to be conducted, organisations had to either be registered to work with commercial banks or registered as savings and loan cooperatives. Two microfinance organisations chose to register as cooperatives, while a third chose to work with the banks. The two microfinance cooperatives spent a considerable amount of time and money on the registration process, but after completing it they were able to operate independently. The programme that chose to work through the banks relies on the banks for lending, while it handles the review and follow-up with clients. Working through banks has proven costly for this organisation, and it will need to address its sustainability at some stage in the future.

**Inflationary economies**

There is a great deal of discussion in the microfinance industry on what to do in inflationary environments, but there is still little consensus on who should carry the burden or the loss. Several agencies transfer the costs of inflation to the borrowers through lending in hard currencies or through indexing the loans to a hard currency. Some agencies believe that the costs of hyperinflation must be shared between the borrower and the lender and that institutions must be prepared to accept a decrease in the value of their loan funds during these extraordinary times. These agencies estimate the inflation risks and incorporate these estimates when they determine the interest rate.
Module 7

Monitoring and evaluation

This module shows how to monitor and evaluate the implementing agents and the clients of microfinance programmes, with a special focus on impact assessments.

Learning objectives

By the end of this module, participants:

- understand monitoring and evaluation of microfinance programmes and the importance in a conflict-affected context;
- understand the roles and responsibilities of donors and implementing agents in monitoring and evaluation;
- become familiar with monitoring indicators;
- understand how to measure impact;
- understand evaluations and benchmarks;
- understand how to analyse microfinance results.

1.1 Introduction

What is monitoring?

The success of a microfinance programme is its impact on the livelihood of poor people. The real impact happens over time, by building long-term institutions that provide microfinance services while at the same time sustaining themselves.

Donors and implementing agencies should monitor the microfinance programme, both at the institutional level and at the client level. At the client level, the focus will be on impact. At the institutional level, the focus will be on sustainability.
Monitoring is measuring performance compared to set objectives. This is an on-going process.

Monitoring is an essential part of any sound management practice.

Implementing agencies need to monitor their programmes to:

- ensure that the programme meets its objectives;
- perform a trend analysis, comparing results over time;
- identify weak areas in the programme;
- identify areas which require corrective measures;
- keep watch on potential fraud and mismanagement.

Donors need to monitor their implementing partners, to:

- check if agencies are complying with the conditions of their contracts;
- detect fraud and mismanagement;
- develop new funding goals;
- provide additional technical assistance packages when needed.
What is effective monitoring?

Success in microfinance depends on depth of outreach, breadth of outreach, impact and sustainability. Monitoring is the measurement of indicators of all these factors in order to show how the microfinance programme is performing.

Yardsticks (benchmarks) for monitoring targets are normally identified early on in the design phase and built into the contract between donor and implementing agency. To facilitate this, donors can provide microfinance organisations with simple and effective reporting formats.

Implementing agencies should be transparent in their operations and give donors free access to policies, procedures and all data from which reports are generated. For monitoring to be effective, management needs good quality data - reliable numbers and reports. These can only come from sound management information and accounting systems.

1.2 Indicators for monitoring and reporting

Monitoring

Tool 6 gives an overview of the basic indicators that should be gathered to monitor microfinance performance.
### Key indicators for monitoring and reporting

<table>
<thead>
<tr>
<th>Component</th>
<th>Indicators</th>
<th>How to measure it?</th>
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<tbody>
<tr>
<td><strong>Breadth of outreach</strong></td>
<td><em>Is the programme meeting a broad segment of the potential client population?</em></td>
<td></td>
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<tr>
<td></td>
<td>Active number of borrowers</td>
<td>Number of borrowers with an outstanding loan</td>
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<td></td>
<td>Volume of loans outstanding</td>
<td>Volume of loans outstanding</td>
</tr>
<tr>
<td><strong>Depth of outreach</strong></td>
<td><em>Is the programme reaching poor clients?</em></td>
<td></td>
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<tr>
<td></td>
<td>Average loan balance</td>
<td>Volume of loans outstanding / number of active borrowers</td>
</tr>
<tr>
<td></td>
<td>Average savings balance</td>
<td>Total volume of savings balance / number of active depositors</td>
</tr>
<tr>
<td></td>
<td>Depth</td>
<td>Average loan balance or average savings balance / GNP per capita</td>
</tr>
<tr>
<td><strong>Institutional sustainability</strong></td>
<td><em>Is the organisation moving towards full cost recovery?</em></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Portfolio yield</td>
<td>Income from lending activities / average outstanding balance</td>
</tr>
<tr>
<td></td>
<td>Operational sustainability</td>
<td>Operating income / operating expenses plus provision for loan losses</td>
</tr>
<tr>
<td></td>
<td>Financial sustainability</td>
<td>Operating income / operating expenses plus financing costs plus provision for loan losses plus cost of capital</td>
</tr>
<tr>
<td><strong>Portfolio quality</strong></td>
<td><em>Is the institution maintaining a good portfolio?</em></td>
<td></td>
</tr>
<tr>
<td></td>
<td>on-time repayment rate</td>
<td>amount paid this month / amount due this month</td>
</tr>
<tr>
<td></td>
<td>portfolio at risk (over 30 days)</td>
<td>balance of loans in arrears (over 30 days) / values of loans outstanding</td>
</tr>
<tr>
<td></td>
<td>loan loss rate</td>
<td>amount written off / average loans outstanding</td>
</tr>
<tr>
<td><strong>Institutional efficiency</strong></td>
<td><em>Is the institution efficient in its delivery of services?</em></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Borrowers per staff</td>
<td>Number of active borrowers / Number of staff</td>
</tr>
<tr>
<td></td>
<td>Cost per borrower</td>
<td>Administrative expenses / average numbers of borrowers</td>
</tr>
<tr>
<td></td>
<td>Client retention rate</td>
<td>number of follow-on loans made during the period / number of loans paid off during the period</td>
</tr>
<tr>
<td></td>
<td>Administrative expenses</td>
<td>Administrative expenses / average loan portfolio</td>
</tr>
</tbody>
</table>
Reporting

In addition to these indicators, microfinance institutions should report on the nature of their operations, their loan product, institutional development and other relevant issues. Preferably, donors should provide reporting formats, yet in the absence of such formats, the following can be used as a guideline for reporting to donors:

- assets - equipment and buildings purchased
- staff development - training sessions, on the job training etc.
- governing board - number of times met, major issues discussed, decisions made, attendance
- number of branches and plans for expansion
- number of total staff and number of loan officers
- client breakdown by gender
- lending methodology
- loan size
- interest rate
- income
- expenses (administrative, interest paid on loans and deposits, non-recoverable loans)
- challenges
- other relevant issues

Timeframes and trend analysis

The reporting frequency normally depends on the experience and performance record of the agency.

“Trend analysis is like viewing a film rather than seeing a photo.”
- microfinance practitioner

Information on a particular indicator, for example the loan portfolio outstanding, should be requested not only for the current period but also for the previous six consecutive periods. This is because information for the current period provides very little information about progress made, whereas monitoring over time - known as
trend analysis - helps to understand what has been changing in the institution. It can reveal if a programme is improving or stagnant or declining. Some of the typical indicators to track over time are:

- loan portfolio
- number of clients
- administrative costs
- loan loss rates
- staff productivity
- portfolio yield
- sustainability

Data presented in a report should not only reflect activities funded by one donor. The data should rather cover all the activities of the microfinance institution, to give an overall idea of the health of the organisation. If the management information system is capable, a breakdown showing the use of each donor’s funds is preferred.

1.3 Repayment rates

Many programmes refer to their achievements by pointing out the repayment rate. The repayment rate by itself, however, is not a sufficient measurement of success. Like any ratio, it can be manipulated. The method used to calculate the repayment rate may hide or reveal different aspects of a programme. The generic definition of the repayment rate compares the money actually received with the money expected to be repaid.

\[
\text{Repayment rate} = \frac{(\text{payments received} - \text{prepayments}) \text{ in the period}}{\text{Payments due for the period}}
\]

1.4 Portfolio quality

Monitoring requires a good understanding of the above-mentioned indicators, and the ways in which they are calculated. There is not "one best indicator", since only a good mix of indicators reflects microfinance performance at various levels (e.g. outreach, sustainability, impact). Yet there is one indicator which deserves special attention. This is the Portfolio at Risk indicator (PAR). This indicator is very important, since it reflects the quality of the loan
portfolio, which is the largest asset of a microfinance institution.

**Note:** the loan portfolio is different from the loan fund, since the latter also includes funds set aside for future disbursements.

**Outstanding portfolio** = principal amount of unpaid loan balances that are outstanding

**Portfolio at Risk (PAR)** = unpaid principal balance of all loans with late payments / outstanding portfolio

**Example**

John had three friends: Andrew, Bob and Claire. In January, Andrew asked John if he could borrow some money. John agreed to lend him $1,000 without interest, on the condition that Andrew would repay in monthly installments of $100. In August, John also lent $1,000 to Bob and Claire, under the same conditions.

Until the end of August, Andrew, Bob and Claire repaid their loans on time. Yet in September, John did not receive any repayments from Andrew and Bob.

**Question:** Which loan represents the largest risk for John?

For Andrew's and Bob's loans, the amount late equals $100. Yet Bob's loan represents more risk, since Bob still has to repay $900, whereas Andrew only has to repay $200. Claire's loan represents the smallest risk for John.

**Question:** What is the Portfolio at Risk (PAR) for John's loan portfolio in September?

The outstanding portfolio is 1,900. The unpaid principal balance of loans with late payments (i.e. Andrew's and Bob's loans) is 1,100. The PAR = 1,100 / 1,900 = 0.58.
PAR versus repayment rate

The PAR gives a more accurate and transparent reflection of quality than the repayment rate. The repayment rate does not indicate portfolio quality. Unlike the repayment rate, the PAR reflects that more risk is concentrated in larger loans. Sometimes it only takes one large loan to endanger the entire portfolio, and hence the repayment rate may give an overly optimistic view of the situation. Yet when assessing the PAR, one should take into consideration the pace at which the portfolio is growing. If the portfolio grows very quickly, poor portfolio quality is not reflected in the PAR indicator. So it is crucial to compare the PAR with the speed at which the portfolio is growing.

In conflict-affected communities, a large portion of lending activities is not covered by traditional collateral, but rather based on group guarantees and other collateral substitutes. In such an environment, portfolio quality can deteriorate quickly, due to volatile situations. It is therefore even more important to track the PAR on a regular basis.

1.5 Benchmarking

When assessing their programme, microfinance institutions need some milestones to compare their results to. These milestones are called "benchmarks". Benchmarks are defined by comparing the results of well-performing microfinance institutions. They are the standard against which institutions can compare their performance. The portfolio at risk, for example, is an indicator, whereas the benchmark for the portfolio at risk is 5%.

The most well-known set of benchmarks is established by the MicroBanking Bulletin (MBB). This bulletin is published twice a year, and sets benchmarks, based on data from diverse microfinance programmes. The Bulletin can be used as a tool for microfinance institutions to compare their programmes to those of their peers. Yet when making such comparison, one should keep in mind the following pitfalls:

- data are very context-specific. Circumstances in one country or region can be completely different from those in another country or region. Few results
Evaluation

2.1 Introduction

The core reason for doing microfinance is to have a positive impact on the lives of the poor. The aim of evaluation is to measure to what extent the programme is complying with its overall objectives.

Evaluation is more comprehensive than monitoring. Monitoring is continuous, whereas evaluation is not continuous. Evaluations take place less frequent, are more thorough and have a wider scope. Monitoring focusses on more measurable outputs, whereas evaluation also includes less tangible factors, such as strategic planning and management of the programme. Monitoring is inherently internal, whereas evaluation can be done both by internal and external persons.

Evaluations take place at the end of the programme (final evaluation), but may also take place during the programme (e.g. mid-term evaluation).

2.2 Measuring impact

A microfinance institution measures impact to find out whether its programme has a positive influence on its clients’ lives, and if so, to what extent their lives have changed for the better. Therefore, the institution must find out how its products and services affect its clients. Impact assessments are also an important tool for decision making. The impact information can be used for future management decisions.

Impact occurs at different levels. The institution must be clear on the type of impact it seeks, i.e. at which level it attaches most importance.
Levels of impact

The discussion on impact assessments has been quite controversial. There are several opinions on how to measure impact:

- the first school of thought claims that the client retention rate is a sufficient indicator for impact. This group equates satisfaction with impact;

- the other school of thought suggests that satisfaction and impact are two different things. The analogy would be eating a lot of candy. This is something that some people enjoy a lot, although they know that it is not good for their health. This group concludes that client satisfaction provides important information, but it does not provide sufficient information to determine the impact of the programme. More aspects must be taken into account, to find out how a microfinance programme affects the lives of its clients.

Most impact assessments are quite expensive, yet there are also some cost-effective assessment tools that focus on using internal resources.

Impact assessment tools

The following are some key tools for impact assessments:

- **Aims tools** (Assessing the Impact of Micro-enterprise Services):
  - Quantitative tools: impact survey, client exit survey;
  - Qualitative tools: client satisfaction tool, loan use tool, client empowerment tools;

- **MicroSave tools**: focus group discussions.
Tracking repeat clients

Continuous and consistent tracking of repeat clients provides valuable information. If clients can afford increasingly larger loan sizes without repayment difficulties, this implies their businesses are generating increasing profits. If clients are applying repeat loans to assets or differentiated businesses, this implies that they are expanding their businesses and potentially generating greater profits.

Client exit interviews

A microfinance programme can learn a lot from clients who have left. If clients left unhappy and decided to go elsewhere for credit, the programme should try to find out why these clients left, and change its products and services. Exit interviews can easily be incorporated into the regular activities of loan officers, to be done whenever they meet people who did not take out repeat loans. Exit interviews are especially useful when there is a large client dropout rate, to find an explanation of the exodus.

If implementing agencies have the human and financial resources to conduct special surveys, they can use a more extensive method like the AIMS tools No. 2 - Client Exit Survey.

Client satisfaction tool

This can be administered at every intake of a repeat loan, or periodically by using a focus group. The client satisfaction tool is used to understand why clients are coming back to the programme. It can also function as a market research tool to develop or modify existing practices to meet client demands.

For established programmes, the variety of rigorous market research tools developed by MicroSave are helpful to refine the programme.
2.3 References

**Client satisfaction**

- *Introduction to Client Assessment for Microfinance Practitioners.* (course offered by CGAP and the Microfinance Centre in Warsaw, Poland.

**Financial ratios**

- MBB No. 7 Nov. 2001

Livelihood programmes

Microfinance is not for everyone or for everywhere. It is neither a panacea for success. People who have access to microfinance often need other support services as well. People who are not (potential) microfinance clients may also need some support to sustain their livelihoods or to become potential clients of microfinance programmes. This module provides an overview of services, other than microfinance, that can be offered in addition to, or instead of microfinance.

Learning objectives

By the end of this module, participants will be able to:

- define livelihood programmes, self-reliance and “extremely vulnerable individuals”;
- identify where livelihood programmes are appropriate;
- consider the design, implementation, monitoring and evaluation challenges of livelihood programmes;
- compare the advantages and disadvantages of different livelihood programmes.

1.1 Introduction

Livelihood interventions are any interventions that promote and enhance poor people’s income-generating activities, business activities and livelihoods. They can be provided alongside microfinance as additional business support, or they can be provided to people who can eventually become microfinance clients.

Like microfinance, livelihood activities require thorough planning and management. The programming cycle, as discussed in the introduction of this module also applies to livelihood activities.
Livelihood activities are activities or projects that enable beneficiaries to be self-reliant.

Self-reliance is the ability to access services and resources and to use them to respond to individual and/or community needs.

Extremely vulnerable individuals (EVIs) are individuals who are dependent on others for daily survival and who do not have close relatives to take care of them. Being an EVI implies depending on others for survival. Examples include people who are too young, too old, physically or mentally disabled, sick, or in a critical social situation.

Welfare activities are not considered as livelihood interventions and will not be addressed in this manual.

Extremely vulnerable individuals

In the relief community, the term “extremely vulnerable individual (EVI)” is used often. According to our definition of EVIs, an old person living with family would not be considered an EVI. An elderly person or a person in the last stage of HIV/AIDS, without family or with young dependents, however, would be classified as an EVI.

How can livelihood interventions reach EVIs?

- Livelihood interventions can reach EVIs directly. To target them directly, organisations would have to offer welfare of assistance which can not become sustainable;

- Experience has demonstrated that livelihood interventions reaching the caregivers of EVIs has been more successful. Programmes focusing on the caregivers at the household level have achieved better results in terms of providing support to EVIs.

1.2 Types of livelihood programmes

Livelihood interventions can be financial or non-financial. A grant is an example of a financial livelihood intervention. Non-financial interventions include vocational training, skills development and skills training (including business training), marketing linkages and information, support to small holders and business associations, employment guidance, food or cash for work programmes or promotion of improved agriculture technologies.
The price of livelihood interventions to the client is a combination of:
- fees for the livelihood services;
- in-kind contributions;
- transaction costs, for example time spent to access these services.

2.1 Introduction to grants

Sometimes after conflict, microfinance is not possible, or is not enough. In these situations, grants can fill the gap or complement microfinance programmes. Grants are small amounts of money or materials given to very poor people. Grants are very predominant in conflict-affected communities, but not exclusive to the post-conflict context. Being temporary, they are not likely to make a significant impact on poor people’s lives. It usually takes more than a one-time intervention to get people out of poverty. Nevertheless, grants can be appropriate in situations when only temporary impact is acceptable, or when populations are so sparsely dispersed that a microfinance programme will be too costly and inefficient.

Be careful of assumptions

Donors often assume that poor people cannot afford to pay the price of financial services, without basing this on a real assessment. They conclude this from their own view of the situation, or from anecdotal evidence.

Grants are provided for two purposes:
- **social or welfare grants**: examples include grants of food, shelter or clothing for subsistence, immediate mitigation of distress, purposes;
- **business grants** help vulnerable people to start or increase economic (and small business) activities.

<table>
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<th>Grants</th>
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<tr>
<td><strong>In-kind grants</strong></td>
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<td>Conditional grants</td>
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<td>Unconditional grants</td>
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<tr>
<td><strong>Cash grants</strong></td>
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<td>Conditional grants</td>
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<td>Unconditional grants</td>
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This module discusses business grants only. There are four types of business grants: in-kind grants, cash grants, conditional grants and unconditional grants.

- **in-kind grants** are non-cash grants. Common examples in conflict-affected communities include:
  - agricultural and livestock inputs such as seeds, cows, chickens, goats, and production tools. These goods are distributed to vulnerable households, to help them get started in farming and animal husbandry;
  - business support services, such as transportation, marketing, storage, maintenance, which are provided to vulnerable households when these services are not yet locally available;

- **cash grants** are given to vulnerable households to buy production tools or inputs to start or support income-generating and business activities;

- **conditional grants** are grants awarded after the beneficiary has fulfilled a predefined requirement, such as completion of training or the preparation of a business plan. The beneficiary has to give something in return (such as the offspring of livestock), or donate a percentage of vegetables grown to vulnerable people;

- **unconditional grants** have no conditions attached. Once the eligibility criteria are met, the grant is handed over in full.

Grants are not considered as microfinance because:

- they are not sustainable;
- they do not reach very many poor people (limited breadth of outreach);
**Trickle Up - conditional grants**

The Trickle Up programme extends conditional grants of up to US$100 in two instalments. In order to gain access to the second instalment, recipients have to meet the following requirements:

- promise to commit 250 hours to the business within the first three months
- save or reinvest at least 20 percent of the profit in the business
- secure local approvals or licences required to run the business
- anticipate the prospect of continued business growth and self-employment
- demonstrate accountability by reporting regularly on business progress.

### 2.2 The danger of grants

- **Grants often result in a handout (entitlement) mentality.**
  They can be destructive to people’s initiatives to sustain themselves.

- **Grants are not sustainable, have very limited outreach and generally achieve only limited impact.**

- **Grants should be clearly targeted.**
  They should only be offered to people who are not potential clients of microfinance programmes. Selection should be careful, based on people’s actual needs and profiles. Grant programmes will attract both needy and less needy people, so they should take steps to ensure that they reach the most needy. Unfair treatment of certain people or groups should be avoided.

- **Grants programmes should be clearly separated from microfinance initiatives.**
  If the same organisation offers both grants and microfinance services, the grants programme will affect the image of the organisation. Borrowers may no longer feel the necessity of repaying loans to an organisation that hands out grants. It could even happen that employees of the organisation may not be able to distinguish the mission of the microfinance programme from that of the grants programme.
3.1 Introduction

Non-financial livelihood interventions aim to help poor people to start up income-generating activities or micro-enterprises, or, if these activities are already functioning, to improve performance and ability to compete.

Examples of non-financial livelihood interventions
- small business training;
- vocational and skills training;
- employment services;
- advocacy;
- marketing assistance;
- product development;
- small business linkages.

3.2 Small business management training

Small business management training teaches existing or potential micro-entrepreneurs how to maintain records, manage cash, and analyse markets, cash flows and profitability. This training can be of real help to refugees who are far away from their homes and trying to take up their former economic activities. However skilled they may be, the new environment will be strange for them. Their new customers may have different preferences and the competition may be stronger. They may have to learn new skills or choose new income-generating activities.

ILO Start and Improve Your Business Training (SIYB)

The ILO has developed a training programme, which develops and strengthens basic management skills of micro- and small entrepreneurs. The programme provides training institutions or others implementing the programme with a comprehensive set of training materials for various target groups in the small business sector. It also provides a wide variety of supporting materials and tools through which institutions can monitor and evaluate their training programmes. The SIYB programme targets small-scale entrepreneurs in developing and transition countries. It has been introduced in over 80 countries worldwide, and the handbook has been translated into over 30 languages.
3.3 Technical skills training

*Skills training* refers to the technical competence needed to make certain products. It is often informally organised, such as tinsmith and blacksmith training, or improved agriculture technology training.

**The unhappy tinsmith**

A tinsmith interviewed during a small business assessment had a pile of tin suitcases of varying sizes made from recycled cooking oil tins. He lamented “These boxes you see here have lasted four months since I made them. No one has bought them”. He had however trained 10 others in his trade. When asked why he chose this trade, he responded promptly “This is the only trade skill I am experienced in. I used to do this in Sudan and cannot do anything else....”

The example of the tinsmith reveals the importance of skills training to help people adapt to market demands which differ from the markets they knew at home or prior to the conflict. It highlights the importance of training courses to impart alternative skills.

**Ex-soldiers go into business**

In Uganda, CARE International ran a training course on how to select, plan and manage income generation activities. The course was geared towards illiterate and semi-literate demobilised soldiers, as well as people from the host community. The learning methodology was highly participatory and conducted in local languages.

The course took the form of one four-hour session per week over a period of five weeks. Participants analysed their household and local economies, and selected appropriate business activities. Their choice was based on careful consideration of technical skills, funding required, availability of markets, and profitability prospects. They identified implementation phases, determined the resources required, and budgeted costs for the activity they selected. Financial management, risk management, and loan repayment instalments were also addressed.

Almost three-quarters of the participants were able to start up or expand businesses with the skills acquired on the course. No seed money was provided, but participants were linked to other technical or financial resources for additional support to their enterprises.
**Vocational training** refers to training, usually in a formal training centre, in economic activities with recognised national standards, such as teacher training or electrician training. Usually certificates are awarded.

**Formal training centres** offer formal education, with examinations set by the national education department of the government. Unfortunately, many such centres have proved to be inefficient and not cost-effective, often failing to equip trainees with employable skills. The advantage of formal centres is that they already have the infrastructure, and may be willing to admit refugees. This is important if the only alternative is establishing and constructing parallel training centres. After completion of a formal training programme, trainees can consolidate their skills through apprenticeship or internship programmes.

**Uganda - earning while training**

An institute in Uganda provided opportunities for refugees, along with nationals, to train in civil and construction engineering. Refugee and local trainees got the opportunity to practice their skills by being contracted through the training institute to construct buildings or do maintenance work in the wider community. Through the wages that they earned, the trainees repaid their training fees.

**Mobile training centres** reduce costs of transportation and save time for trainees, because the instructors move from one place to another, teaching trainees in their own communities. The mobile approach is particularly suited for bringing training to marginalised or vulnerable groups. Mobile centres use local facilities like participants’ homes, the shade of trees, classroom blocks and places of worship.

**Mobile training for stove construction**

A project in Tanzania combined the objectives of environmental protection and income generation. The project aimed to protect the surrounding trees by providing returnee women with skills for the construction of energy saving stoves. Project staff moved from settlement to settlement to train a few women in each community, who in turn constructed charcoal stoves, or trained other people in the community.
Scholarships can provide the skills needed in the community, while at the same time rewarding outstanding individuals who have done well in their secondary education. Scholarships for tertiary education can allow students access to university or to vocational training colleges. Sometimes the scholarship is linked to affirmative action to ensure that more vulnerable or marginalised groups get access to higher education. In the short term, scholarships benefit only a few, but in the longer term, if the scholars come back to their community after completion of their training, the community as a whole benefits from their skills.

3.4 Designing the training curriculum

Vocational and skills training are specialised services, aiming to impart knowledge and skills leading to formal employment or self-employment. Popular training programmes in conflict-affected communities include carpentry, agriculture, tinsmithing, tailoring, leatherwork, vehicle repair, welding, construction, and handicrafts.

**Questions for skills assessment**

(See also Module 3 on assessments for other relevant questions)

- What economic activities (paid, unpaid, full-time, part-time) are going on in the community?
- What skilled activities would meet the demand for goods and services?
- How many skilled people are already engaged in those activities?
- How many more may be needed?

Training is not an end in itself, but a means to an end. When designing training programmes, agencies should focus on training which reduces the imbalance between work opportunities and skills in the community. The short and long-term demand for skills should be determined by a market assessment. The limited scope for employment in the formal sector should be acknowledged by gearing the training to the local labour market, possibly with apprenticeships. For refugees, the implementing agency should focus primarily on skills that will help their business activities in their country of asylum, but at the...
same time consider how these skills might secure them a livelihood when they return home.

Training institutes should be realistic about their organisational expertise and their potential to develop expertise. Their programmes should be client-responsive with regard to delivery, technology, timing, location, and social organisation. To assist the employability of trainees, programmes should measure results and refine their approaches. Other issues to consider are cost-effectiveness, efficiency and sustainability.

3.5 On-the-job training

Apprenticeships are appropriate in communities where there are skilled people producing goods and services. The skilled person agrees to train one or more apprentices for a given period in his or her own workplace, in return for benefits in cash or in kind. The apprentice gets some remuneration for working, while the craftsman gets an extra pair of hands to increase productivity. Apprenticeships are useful for school graduates to enhance their CVs with work experience.

**Hairdressing apprentices set up own business**

An agency working with urban refugees identified local hairdressers willing to train refugees for a fee. After training, some women refugees set up their own hair saloons in a suburb of the city, with micro-loans from the agency. After the donor ended its relief assistance, the women were able to support their families from the income of the new business.

**Resource centres combining training and production** can offer tools and workspace to skilled workers, in exchange for training refugee apprentices. The craftsmen benefit from the use of the facilities and the free labour, while the apprentices gain useful skills.

**Production apprenticeships in Malawi**

A project in Malawi provided income generation opportunities to skilled artisans in exchange for their training others in production activities. The skilled producers were offered free access to workshop facilities, provided they trained apprentices.
Lessons learned from training programmes

- careful design of the curriculum is essential. Bear in mind that many trainees cannot find employment even after graduating. By developing curricula based on market demand, one can increase their chances of employment;
- training is not enough. Graduates also need work space, tools and raw materials in order to apply their newly acquired skills;
- establish linkages. Linking trainees to small businesses helps them to see their trade from a business perspective. Graduates can be put in contact with microfinance programmes and potential markets to help them towards self-employment or small business employment.

**Linking tailors to the market**

An agency trained some conflicted-affected people in tailoring skills, then linked them to several city schools to market their services. The trainees soon got several contracts to make uniforms for the schools on an ongoing basis. The agency then linked them to a microfinance programme which provided loans for the tailors to procure equipment and materials.

**Key indicators of training programme success:**

- proportion of trainees completing course successfully;
- proportion of refugee graduates finding employment or self-employment in host country;
- new skills and technologies introduced in the local economy;
- goods and services introduced in refugee community (relief substitution);
- increase in productivity or profits resulting from the training;
- long-term impact of the training programme;
- improvement in living conditions of the graduates;
- recurrent/fixed cost per graduate;
- recurrent/fixed cost per graduate finding gainful employment.
3.6 Marketing assistance

Marketing assistance covers a range of interventions which all aim at getting the products and services from the micro-enterprise to the final consumer. Because of their short-term involvement, relief donors can facilitate and support, rather than directly provide such services.

Marketing assistance includes:
- market information. Informing people about markets and prices at various locations;
- provision of storage facilities. This is especially important in conflict-affected communities, where such facilities are often not available;
- establishing linkages between micro-entrepreneurs;
- linking entrepreneurs with potential buyers.

The costs of these services should be charged to the client at a rate that reflects the actual costs of the service. A charity approach can be detrimental to the long-term availability of the service, and hence to the sustainability of clients’ businesses.

Smallholder Business Associations (SBAs)

Smallholders are low-income people who run small businesses, and who have little access to land. Smallholder business associations are smallholder-owned and controlled organisations providing services to their members on a non-profit basis. Their purpose is to help members realise greater profits from their businesses.

The concept of a smallholder business association is to give members more power than if they operated individually. The association is organised around mutual needs or interests of the smallholders. Profits from its activities are shared among the members, in proportion to how much they have marketed through the association, or how many inputs they have purchased through the association. Smallholder business associations are fully democratically controlled and owned by their members. They give their members a stronger voice. The association can use its size to:
- bargain for better prices of production materials;
- set more favourable market prices;
bargain for discounts on retail goods for members;
- access shared production equipment, for example hiring or buying a vehicle or a food processing machine;
- lever political or technical support from government, trade officers, other stakeholders, and donor agencies.

Smallholder business associations operate in a demand-driven way, and should be run as businesses, providing services required by the majority of their members for key business operations. They cannot do the productive work of members, but they can facilitate this work by offering specific services.

Because of their short-term involvement, relief donors should facilitate and support such services, rather than provide them directly. They can encourage conflict-affected communities to set up smallholder associations, and provide technical assistance.

A successful business association

In Uganda, a group of bee keepers and business people decided to sell their honey on the external market, since there was significant demand in the European market for the honey. They created the Uganda Honey Bee Keeping Association. The association developed a training, which focussed on appropriate technologies for producing quality honey, the building of bee hives, production of tools and protective outfits, as well as marketing and business management skills. It also identified small honey production groups in the country and trained these groups. Refugees also participated in the training. The honey was sent to the capital, Kampala, using sealed buckets and local public buses. In Kampala, the honey was processed by a micro-enterprise established by the founders and sponsored by a development donor. The honey was then sent abroad, whereas a small part of the money was sold on the local market.

This example has different positive aspects:

- The founders of the association were motivated and creative;
- They stimulated local producers to improve production to increase their income;
They linked the field producers with a larger group of producers, which created a network throughout the country, and strengthened their position in the market;

They also encouraged small holder associations in bee keeping, carpentry, tailoring, tinsmith, business management, and driving sectors to work together;

The project was also based on the cost-efficient utilisation of local resources and appropriate technologies;

As a result of these initiatives, some of the beneficiaries were able to access microfinance services to increase their business.

3.7 Employment services

Employment services can create some jobs in conflict-affected communities. Yet one cannot reach a large number of people through such programmes, and the labour market may be particularly contracted in these environments.

Conflict-affected communities have little information about labour markets, particularly immediately after the conflict. People who have fled their home country, may have limited or no knowledge about where and how to look for a job in the host country. They may lack the required permits or language skills. In such contexts, implementing agencies can help refugees by providing information on employment, and addressing problems such as discrimination and exploitation. Before trying to place refugees in employment, the implementing agency should acquaint itself with government policies and practices regarding employment.

Employment opportunities for skilled and unskilled people may be available within United Nations and other relief or development organisations working in the region. These opportunities are limited and temporary, but they can contribute to the development of important skills.
Implementing agencies can consider a range of employment services:

- **orientation courses:**
  to introduce refugees to the local economy and the skills needed by local employers;

- **career guidance and counselling services:**
  for refugees and the local population, focussing on opportunities in the labour market, skills required and training possibilities;

- **information on legal protection for refugees:**
  to warn about legal obstacles, discrimination and exploitation in the labour market

- **information on working conditions:**
  for refugees and the local population, to warn against unhealthy condition;

- **language education:**
  for refugees, to overcome obstacles imposed by spoken or written language constraints.
## Advantages and disadvantages of different interventions

The table below lists advantages and disadvantages of several livelihood programmes.

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<th>Livelihood programmes</th>
<th>Advantages</th>
<th>Disadvantages</th>
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<tbody>
<tr>
<td><strong>Business grants</strong></td>
<td>- matches short-term donor cycles;</td>
<td>- not sustainable since grants do not revolve;</td>
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<td></td>
<td>- contributes towards injection of cash into the local and refugee economies;</td>
<td>- tends to increase dependency;</td>
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<td>- may be the only option if the conflict-affected population is sparsely dispersed.</td>
<td>- benefits only a few people;</td>
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<td>- low implementation costs.</td>
<td>- risk of not reaching those who need it most, due to weak selection mechanisms;</td>
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<td></td>
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<td>- unproductive use of grants is common;</td>
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<td>- distorts local financial markets.</td>
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<tr>
<td><strong>Small business management training</strong></td>
<td>- prepares clients to address business risks and challenges;</td>
<td>- impact of training is limited if follow-up support is not accessible by trainees.</td>
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<td></td>
<td>- clients more likely to be creditworthy due to improved skills and attitudes.</td>
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<td><strong>Vocational training / skills training</strong></td>
<td>- provision of practical skills, making clients more readily employable in the market.</td>
<td>- often supply rather than demand driven;</td>
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<td>- risk of distorting markets if curriculum is not diversified;</td>
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<td>- may lead to frustration if government regulations restrict employment of refugees or their involvement in trade;</td>
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<td>- does not solve problems of access to raw materials and other resources;</td>
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<td>- stereotyping of gender issues in vocational skills, training is common;</td>
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<td>- does not solve problems of access to raw materials and other resources;</td>
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<td>- stereotyping of gender issues in vocational skills, training is common;</td>
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<td>- can be cost-ineffective and inefficient.</td>
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<td><strong>Resource centres</strong></td>
<td>Quality of learning:</td>
<td>experience in a real work environment is limited.</td>
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<td></td>
<td>- hands-on experience;</td>
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<td>- flexible timing of training;</td>
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<td>- promotes self-reliance;</td>
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<td>- complementary sets of skills can be learned and harnessed during production.</td>
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<td>Relationship to economy:</td>
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<td>- promotes development of local economy through trade interaction.</td>
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<td><strong>Mobile training centres</strong></td>
<td>- no saturation of markets.</td>
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<tr>
<td><strong>Training centres</strong></td>
<td>easy to monitor learning;</td>
<td>high costs per trainee;</td>
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<td></td>
<td>possibility of formal trade activities.</td>
<td>dependency created on centre where raw materials are provided.</td>
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<td><strong>Scholarships</strong></td>
<td>provide talented people educational opportunities which otherwise would be impossible to access.</td>
<td>only a few benefit;</td>
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<td>very expensive;</td>
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<td></td>
<td>management can be difficult.</td>
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<tr>
<td><strong>Marketing assistance</strong></td>
<td>may be quite cost-effective;</td>
<td>success affected by several external (security situation, inflation, changing demands);</td>
</tr>
<tr>
<td></td>
<td>could initiate small business associations.</td>
<td>access to accurate and reliable market information may be low.</td>
</tr>
<tr>
<td><strong>Employment services</strong></td>
<td>provide s considerable benefits for employed persons;</td>
<td>government policies and practices may not be favourable;</td>
</tr>
<tr>
<td></td>
<td>can address issues of discrimination of people from conflict-affected communities.</td>
<td>qualifications of refugees may not be recognised in the host country.</td>
</tr>
<tr>
<td><strong>Small business associations</strong></td>
<td>cost-effective when properly designed and implemented;</td>
<td>does not guarantee success for individuals;</td>
</tr>
<tr>
<td></td>
<td>promotes social reconstruction.</td>
<td>in some countries, associations have a bad reputation;</td>
</tr>
<tr>
<td></td>
<td></td>
<td>takes a long time to build the trust and culture required to succeed.</td>
</tr>
</tbody>
</table>
4.1 Introduction

This session will should how to undertake livelihood interventions based on the programming cycle. The steps in programming livelihood initiatives are exactly the same as those in programming microfinance initiatives.

4.2 Assessment

Assessing the target group

- Excluded due to context:
  - remote
  - low density
  - no market
  - too unstable
  - no cash economy

- Excluded due to profile:
  - Too vulnerable
  - Too rich
  - Not entrepreneurial
In livelihood programmes targeting must be as specific as possible. The aim remains to target as many people as possible with the resources available. Many of the livelihood activities can be done at lower cost (e.g. skills development through “peer to peer” training in a specific agriculture technique). Resources are limited and demand will be high, especially if you are providing assets without cost recovery. The demand will often exceed supply. It is important to ensure objectivity and transparency in the selection process.

Module 3 discussed how and why assessments should be conducted before designing microfinance programmes. Assessments for livelihood programmes are equally important, because:

- the services that are considered relevant by the donor and the agency may be quite different from the demand for services or products within the conflict-affected community. The agency should be careful not to be supply-driven, and provide what is not in demand;

- there may be business opportunities (unmet demands) which the donor or implementing agency may not be aware of;

- the implementing agency may not have the requisite resources and skills to implement the particular livelihood programme being considered;

- there could be other agencies offering similar services, which the donor or implementing agency is not aware of;

- refugees, returnees, and internally displaced people, as well as local populations, always have some skills and resources. It is a mistake to think that they have nothing to offer.

Knowing a community’s demand for goods and services, and how they might want them provided, is a primary starting point for the design of the programme’s products and services.
Assessment of the refugee socio-economic profile.

The data for this may already exist with the relief organisation in their caseload registrations. If so, the assessment becomes a matter of reviewing and analysing the data. In the absence of existing data, or to fill in knowledge gaps, a new assessment will be needed.

Assessment of the local economy.

A number of areas should be explored:

- type of economy: cash/subsistence, rural/urban, agricultural/manufacturing;
- types of dominant businesses, common problems faced, and their demand for skilled and unskilled labour;
- existing or potential markets, their location and scale;
- government perceptions and local regulations concerning the involvement of people from conflict-affected communities in gainful economic activities in the host area;
- access of the community to land, raw materials and other natural resources;
- local practices concerning access to employment through adverts, job centres, training certificates;
- transportation systems (existing or needing to be developed);
- problems facing existing enterprises in the conflict-affected community;
- perceptions of the community about non-financial services that could improve economic activity in general, and business enterprises in particular.

Assessment of the legal environment and related practices.

What regulations exist to enable refugees to take part in training and economic activities?

- the 1951 Geneva Convention stipulates the rights and responsibilities of governments and refugees;
while some countries have ratified this convention, others have done so with some reservations on rights of refugees. The position of the host country should be clearly established by the implementing agency;

there are situations where practice may depart from policy. Caution is needed in these contexts;

include meetings with officials, politicians and technical experts in conflict-affected communities in the assessment.

\textit{Appropriate assessment tools}

Assessments should gather qualitative data about livelihoods, such as why people do what they do, and what are their attitudes towards products and services. Assessments should also gather quantitative data, such as number of markets, and distance from settlements. A combination of tools can be used:

- review of secondary data, such as line department reports and reports of other implementing agencies working in the area (if available);
- key information interviews in the area with refugees, returnees, IDPs, community members, settlement leaders, camp commandants, politicians, government technical officers, NGOs;
- focus groups with women, men, youth and vulnerable people;
- household interviews.

\textit{Looking at the environment}

Who are the suppliers and influencers of livelihood programmes?

\textbf{The suppliers} can be training institutes, vocational schools, universities, companies, government, NGOs, international organisations and community members.

\textbf{The influencers} can be the government (if refugees are not allowed to work or pursue an education). Influencers can also be political, social and economic factors. For example, refugees or IDPs are mainly located in the
poorest regions of a country, often bordering conflict zones. They differ from their host communities in terms of language and culture, and can be resented or isolated by the local population. They can also be perceived as a “burden” or a possible threat by the local population or government.

**Design**

The following parameters have to be determined in the design stage:

- expected goals;
- expected results;
- timeframe;
- selection criteria for the target group;
- budget;
- cost recovery mechanism.

When designing livelihood programmes, the level of intervention should also be considered. For example, the intervention could be at the individual, household, community, district or province level.

**Some important considerations:**

- it is crucial to look at the long-term market implications of livelihood programmes. After receiving skills training, for example, workers must understand how to sell their services and products, how to link with buyers, and how to organise themselves into organisations. Training itself is not enough. Livelihood interventions require creativity and complementary services and linkages, and a thorough assessment of how, and to what extent, markets can absorb trainees, job seekers and the like.
Funding microfinance and livelihood programmes

In one of the northern districts of Uganda, no financial services were provided for the local population. Relief organisations were implementing microfinance activities for refugees. Best practices, however, were not applied. Professional microfinance organisations were contacted to explore if they could provide microfinance services to refugees and the local population in these districts. Three microfinance organisations visited the area and one of them, after a careful assessment, decided to implement a programme. UNHCR provided start-up funds to that MFI, together with development donors. UNHCR channelled part of its funds to other livelihood programmes, preparing vulnerable groups to access microfinance services provided by the MFI.

Ownership of the programme by the beneficiaries will determine the sustainability of livelihood interventions. If the ownership is weak, chances increase that one person takes over the programme and sells the assets, or that the equipment is not being used and deteriorates. Projects imposed by outsiders stand little chance of lasting success.

Livelihood interventions may achieve sustainability, however, this must be planned in the design phase.

4.3 Implementation

In livelihood programmes, implementation issues can be divided into the following categories:

- staffing;
- policies and procedures;
- assets and procurement;
- programme management:
  - distribution mechanism;
  - monitoring mechanism.

The implementation of livelihood activities is often perceived as easier than conducting microfinance. However, if livelihood activities will have a positive impact on self-reliance, the programming cycle must be followed as rigorously as for microfinance. Microfinance programmes are perhaps somewhat easier to implement than livelihood programmes, in the sense that there are more available best practices for microfinance.
4.4 Monitoring and evaluation

Success in microfinance is measured in terms of depth, breadth and length of outreach (sustainability), and impact.

The following parameters are relevant for livelihood programmes:

<table>
<thead>
<tr>
<th>Parameters for success in livelihood programmes</th>
</tr>
</thead>
<tbody>
<tr>
<td>depth of outreach;</td>
</tr>
<tr>
<td>breadth of outreach;</td>
</tr>
<tr>
<td>impact.</td>
</tr>
</tbody>
</table>

Rarely does one hear about unsuccessful livelihood programmes. Yet success stories are often based on satisfaction surveys. Many people think that satisfaction equals impact in livelihood programmes. Yet in fact, a larger set of issues should be looked at, to determine the impact of livelihood programmes.

In livelihood programmes, monitoring, reporting and accountability are very important. In that sense, livelihood programmes do not differ much from microfinance programmes.

Planning, implementation and monitoring of livelihood programmes must be based on a set of indicators, similar to those for microfinance.
The following indicators can be used to measure progress in livelihood programmes:

<table>
<thead>
<tr>
<th>Indicators for livelihood programmes</th>
</tr>
</thead>
<tbody>
<tr>
<td>cultivation rate/use of land (sampling);</td>
</tr>
<tr>
<td>goods and services available in the community;</td>
</tr>
<tr>
<td>market prices for commodities;</td>
</tr>
<tr>
<td>number of small businesses/small enterprises and number of people employed;</td>
</tr>
<tr>
<td>nutritional status;</td>
</tr>
<tr>
<td>skills training: number of people who applied for training, who are trained, who use their skills through (self) employment;</td>
</tr>
<tr>
<td>increase in household income;</td>
</tr>
<tr>
<td>level of community-based management of services;</td>
</tr>
<tr>
<td>level of community based maintenance of infrastructure, water points, etc;</td>
</tr>
<tr>
<td>gender distribution in access to services and resources and participation in management;</td>
</tr>
<tr>
<td>savings capacity of individuals;</td>
</tr>
<tr>
<td>level of access to services requiring cost-sharing (education, health services, water, etc);</td>
</tr>
<tr>
<td>surplus agriculture production versus subsistence production;</td>
</tr>
<tr>
<td>level of community-based care and support provided to EVIs.</td>
</tr>
</tbody>
</table>
4.5 Summary and key lessons learned

**Key issues in livelihood programmes**

- people in conflict-affected communities are not helpless. They have skills and other resources on which they can draw to support themselves. Implementing agencies should make the effort to assess these resources and build on them;

- livelihood programmes can be just as difficult to undertake as microfinance initiatives, and may not have the desired results;

- there is a considerable risk that livelihood programmes contaminate the ground for future development initiatives, including microfinance;

- if done correctly, livelihood interventions are not necessarily easier than microfinance;

- there are several kinds of livelihood interventions. Some are complementary to microfinance (skills development, skills training) and some are in direct competition (grants);

- indicators have to be set from the early stage of the programme, and should be regularly monitored.
4.6 References


- Business development services - Seminar Reader: “Developing commercial markets for BDS: can this give the scale and impact we need?”, http://training.itcilo.it/bdsseminar, (Spanish: http://training.itcilo.it/bdsseminario), Second Annual Seminar, 10 – 14 September 2001, Turin, Italy.


Websites

- Enterweb http://www.enterweb.org

- International Labour Organization - Small Enterprise Development http://www.ilo.org/sed

- SEEP Network http://www.seepnetwork.org/bdsguide.html

- Swiss Agency for Development and Cooperation (SDC), Small Enterprise Development (SED) http://www.intercooperation.ch/sed
Calculating interest rates

Flat rate method

Flat rate calculations are done with these four formulas:

- **monthly interest payment** = loan amount \times monthly interest rate;
- **monthly principal payment** = loan amount / loan term (in months);
- **total monthly payment** = monthly interest payment + monthly principal payment;
- **remaining balance (in a specific month)** = loan balance outstanding (in that month)– monthly principal payment.

Based on the information in Sample Repayment Schedule One below, these formulas for the end of the second month can be calculated as follows:

- **interest payment**
  \[1000 \times 1.67\% \text{ per month} = 16.67 \text{ per month};\]
- **principal payment**
  \[1000 / 6 \text{ (months)} = 166 \text{ per month};\]
- **total monthly payment**
  \[16.67 + 166.67 = 183.33;\]
- **remaining balance (2nd month)**
  \[(1000 - 166.67) = 833.33 - 166.67 = 666.67.\]

Declining balance method

The calculation of the monthly payment using the declining balance method requires a financial calculator, although it can also be done using Excel formulas. In this method, the first step is to work out the total monthly loan payment that a client would have to repay. This amount remains constant each month, so that the balance of the principal increases over time and the interest amount decreases.
Using an Excel spreadsheet, first calculate the monthly payment. The formula is:

- **monthly payment** = \( P \times M \times T \) (Interest rate, loan term, loan amount)

- **interest payment** = Outstanding loan balance \( \times \) monthly interest rate

- **principal payment** = Monthly repayment – interest payment

- **remaining balance** = outstanding loan balance from previous month - principal payment

Based on the information in Sample Repayment Schedule Two below, and the calculations in the Excel spreadsheet, the formulas for the end of the second month can be calculated as follows:

- **monthly payment**
  - 176.52

- **interest payment**
  - \( 840.14 \times 1.67\% = 14.00 \)

- **principal payment**
  - 176.52 - 14.00 = 162.52

- **remaining balance**
  - 840.14 - 162.52 = 677.62

**Effective interest rate**

The following formula can be used to calculate the effective interest rate without a financial calculator. To measure it completely, one needs the Internal Rate of Return (IRR), the time value of money, and the frequency of payments.

- **effective rate** = amount paid in interest and fees / average principal amount outstanding.
Annex 2

References

General


Websites

Post-conflict microfinance

- Concern Worldwide and Springfield Centre project http://www.postconflictmicrofinance.org
- International Labour Organization - Social Finance Programme http://www.ilo.org/socialfinance
- Consultative Group to Assist the Poorest http://www.cgap.org

Microfinance

- Calmeadow http://www.calmeadow.com/
- Consultative Group to Assist the Poorest http://www.cgap.org
- Planet Finance http://www.planetfinance.org/rcs/PlanetFinance/ Site/Web/Fr/Accueil/index.jsp
- Pride Africa http://www.prideafrica.com
- UNDP / UNCDF - Special Unit for Microfinance (SUM) http://www.uncdf.org/sum/index.html
Humanitarian relief

- Relief Web - http://www.reliefweb.int/w/rwb.nsf
- United Nations High Commission for Refugees
  http://www.unhcr.ch

Networks

- SEEP Network - http://www.seepnetwork.org/
- Small Enterprise Education and Promotion Network
  www.seepnetwork.org
- Microcredit Summit
  http://www.microcreditsummit.org/
- Microfinance Network
  http://www.bellanet.org/partners/mfn/

Other relevant sites

- INCORE - http://www.incore.ulst.ac.uk/
- IRIN, UN humanitarian information unit
  http://www.irinnews.org
- Virtual Library on Microcredit – www.gdrc.org/icm
- World Refugee website
  http://www.worldrefugee.com
- Springfield Centre
  http://www.springfieldcentre.com
## Glossary

**Active borrowers:** Clients with loans outstanding at a given point in time. An institution’s official statistics on number of active clients are usually recorded as the number of clients with loans outstanding on the date its financial statements are filed.

**Active clients:** Active savers (or depositors) and/or borrowers of a microfinance institution.

**Active loan portfolio:** The total amount loaned out less the total amount of repaid loans; i.e., all money that is on the street, or owed to the institution in the form of loans at a certain point in time. It can also be defined as an outstanding principal balance of all of the MFI’s outstanding loans (including current, delinquent and restructured loans, but not loans that have been written off). It does not include the amount of interest receivable.

**Arrears:** The amount of loan principal (or principal plus interest) that has become due and has not been received by the microfinance institution.

**Arrears rate:** The amount of late payments (principal, or principal plus interest) divided by the portfolio outstanding.

**Assessment:** Assessments include instrumental appraisals, rating exercises, and other activities that may determine how well an institution performs financially, operationally, and managerially. It may also be used to determine the demand for microfinance, identifying potential clients, implementers and partners.

**Balance sheet:** Financial Statement that presents a summary of an institution’s financial position at a given point in time. The balance sheet is a stock statement, which is a snapshot of the MFI at a moment in time. The statement reflects what the MFI owns, what is owed to it (assets such as cash, investments, loan portfolio, or fixed assets), what it owes others (liabilities - such as loans from banks, accounts payable), and the difference between the two (equity or net assets). The balance sheet shows the net worth of an institution at that moment.

**Balloon payment:** A large single repayment of loan principal or principal and interest that may be charged at the end of a loan or lease.
<p>| <strong>Benchmarking:</strong> | Peer group benchmarking puts performance measurements in context by comparing an institution (e.g., an MFI) with similar institutions based on a common factor, such as region, size or methodology. A benchmark can also refer to the standard against which all similar institutions are compared. |
| <strong>Capacity building:</strong> | The financial, personnel and institutional development of an organisation, local authority or local entity. |
| <strong>Care and maintenance:</strong> | The phase in refugee assistance following an emergency. During this phase, governments attempt to refine the census of refugees and emergency victims, turn from curative medical care to preventive care, encourage programmes leading to the self-reliance of refugees, and explore durable solutions for the refugee population. |
| <strong>Client caseload:</strong> | The number of active clients per loan officer. This is an important measure of institution's efficiency. |
| <strong>Collateral:</strong> | Assets pledged to secure the repayment of a loan. Traditionally, these include property, land, machinery and other fixed assets. Alternative forms of collateral include group guarantees, compulsory savings, nominal (household) assets and personal guarantors. |
| <strong>Collateral substitutes:</strong> | Non-tangible or non-traditional assets that will reassure lenders that a loan will be repaid. Examples include group guarantees, jewelry or assets of high personal value to the borrower. |
| <strong>Community banking:</strong> | See &quot;Village banking&quot;. |
| <strong>Compulsory savings:</strong> | Savings that an MFI's clients are required to maintain as a condition of an existing or future loan. Obligatory savings may be either held by the MFI as a deposit, or be held outside the MFI. In the latter case, the MFI facilitates savings accounts for its clients. |
| <strong>Credit union:</strong> | A nonprofit, common-bond cooperative financial institution, usually saving-based, owned and run by its members. Members pool their funds to make loans to one another. The volunteer board that runs each credit union is elected by the members. Most credit unions are organised to serve people in a particular community, group or groups of employees, or members of an organisation or association. Members may deposit money with the organisation, or borrow from it, or both. |</p>
<table>
<thead>
<tr>
<th><strong>Creditworthiness:</strong></th>
<th>Ability and willingness to repay debt, as demonstrated by the financial background of a person, his or her business performance and personal credit history, in the present and the past. Sometimes determined by an external analysis of the business.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Declining interest rate method:</strong></td>
<td>Interest calculated on the outstanding principal amount of the loan, that is actually in the hands of the borrower during each period of the loan term.</td>
</tr>
<tr>
<td><strong>Default:</strong></td>
<td>This occurs when a borrower cannot or will not repay his/her loan and the MFI no longer expects to receive repayment, (although it keeps trying).</td>
</tr>
<tr>
<td><strong>Delinquency:</strong></td>
<td>Failure to make loan payments in time.</td>
</tr>
<tr>
<td><strong>Depth of outreach:</strong></td>
<td>The poverty level of clients reached by a microfinance institution.</td>
</tr>
<tr>
<td><strong>Disbursement:</strong></td>
<td>The actual transfer of financial resources. The disbursement of a microloan reflects the transfer of the loan amount from the lending institution to the borrower.</td>
</tr>
<tr>
<td><strong>Effective interest rate:</strong></td>
<td>Interest rate that includes the effects of interest, fees, commissions, calculation method and other loan requirements (e.g. forced savings) on the total cost of the loan. It is always expressed as declining balance interest calculation - either monthly or annual, includes the effects of compounding and represents the financial costs to the borrower.</td>
</tr>
<tr>
<td><strong>Employment:</strong></td>
<td>A broad term that includes all types of work in the formal and informal sector, including casual, waged, self and partial employment.</td>
</tr>
<tr>
<td><strong>Enterprise development services:</strong></td>
<td>Non-financial services for micro-entrepreneurs, including business training, marketing and technology services, skills development, and sub-sector analysis.</td>
</tr>
<tr>
<td><strong>Evaluation:</strong></td>
<td>A systematic analysis and review, normally by an outside consultant, of the impact, effectiveness, efficiency and relevance of operational activities when compared to the organisation's objectives or the durable solution envisaged.</td>
</tr>
<tr>
<td><strong>Extremely vulnerable individuals (EVIs):</strong></td>
<td>Individuals who are dependent on others' assistance for their basic daily survival activities. Their dependence is due to causes such as age (unaccompanied minors or elderly persons alone), physical condition (disability, chronic sickness, bedridden, severe malnutrition), psychological condition or severe social or cultural conditions with no access to income generation.</td>
</tr>
</tbody>
</table>
Financial cooperatives: Member-owned financial institutions that have no external shareholders, with each member having the right to one vote in the organisation. Members may deposit money with the cooperative or borrow from it, or both.

Financial self-sufficiency (FSS): Total operating revenues divided by financial expenses, loan losses and total administrative costs, adjusted for low-interest loans and inflation. In a microfinance context, an institution is financially self-sufficient when it has enough revenue to pay for all administrative costs, loan losses, losses and commercial borrowings. The purpose of most of these adjustments is to model how well the MFI could cover its costs if its operations were unsubsidized and it were funding its expansion with commercial-cost liabilities.

Fixed assets: Long-lived property of a microentrepreneur or firm that is used in that business' production (i.e., a sewing machine is a fixed asset for a micro-entrepreneur who makes clothing). Fixed-asset lending is a type of microfinance product that disburses loans for the purpose of purchasing these fixed assets, which aid in production volume and income.

Fixed-asset lending / loan: Microfinance product in which loans are disbursed for the purpose of purchasing fixed assets, which aid in production volume and income. Also called "investment loan" or "term loan".

Flat interest rate method: Method for calculating interest as a percentage of the initial loan amount rather than as the amount outstanding during the term of the loan, irrespective of the payment plan (which may be a lump sum or in installments).

Flow statement: A chart used to determine the status of a revolving fund. It shows the cash (from savers or borrowers) flowing into the fund and cash (to borrowers and savers) flowing out of the fund. The flow statement shows how much is borrowed or disbursed to savers, how much enters into the fund, and from which transaction.

Formal financial institutions: Financial institutions that are subject to not only general laws and regulations but also to specific banking regulation and supervision.

Governance: Process by which a board of directors, through management, guides an institution in fulfilling its corporate mission and protects its assets.
<table>
<thead>
<tr>
<th><strong>Grace period:</strong></th>
<th>Initial period after the disbursement of a loan during which the borrower is not required to pay principal, or principal and interest.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Group lending:</strong></td>
<td>Lending methodology which allows a group of individuals - often called a solidarity group - to provide collateral or loan guarantee through a group repayment pledge. The incentive to repay the loan is based on peer pressure - if one group member defaults, the other group members make up the payment amount and lose access to future loans.</td>
</tr>
<tr>
<td><strong>Hyperinflation:</strong></td>
<td>Very high rates of inflation which can cause major economic problems and political instability.</td>
</tr>
<tr>
<td><strong>Indexing loans:</strong></td>
<td>A process whereby loan repayments are tied to inflation or to an external, stable currency.</td>
</tr>
<tr>
<td><strong>Influencers:</strong></td>
<td>Those who directly or indirectly, positively or negatively, affect the environment for microfinance.</td>
</tr>
<tr>
<td><strong>Integrated approach:</strong></td>
<td>An approach to microfinance which incorporates the provision of non-financial services with microfinance. Two common approaches to integrated microfinance are linking credit with education and linking credit with business training.</td>
</tr>
<tr>
<td><strong>Internally displaced persons:</strong></td>
<td>People forced or obliged to flee from their homes in particular as a result of armed conflicts, generalized violence, violations of human rights or natural disasters, but who have not but who have not left the borders of their country.</td>
</tr>
<tr>
<td><strong>Impact assessment:</strong></td>
<td>Process to identify whether a programme has had the desired outcome. The assessment determines to what extent the desired changes can be attributed to the programme's activities.</td>
</tr>
<tr>
<td><strong>Implementing agent (IA):</strong></td>
<td>Organisation responsible for putting a microfinance programme into effect.</td>
</tr>
<tr>
<td><strong>Income generation:</strong></td>
<td>There is no clear-cut demarcation between income generating activity (IGA) and the small business activity assisted by microfinance. In general, income generation involves less reinvestments, it is more mixed with the household economy, it requires less (or no) fixed assets, less management and other skills and a lower level of literacy.</td>
</tr>
</tbody>
</table>
**Income statement:** The income statement is also known as the profit and loss statement. It is a flow statement that summarizes all financial activity during a stated period of time, usually a month, quarter or year. It displays all revenues and expenses for a stated period of time. The bottom line of an income statement is the net income (or net profit or surplus) for the period.

**Institutional viability:** Achieving self-sufficiency of the implementing agency by ensuring that it is led, governed and staffed by dedicated and qualified people. It includes aspects of financial self-sufficiency, operational and financial systems and procedures, human resource, management and leadership, asset quality, governance.

**Interest:** The charge for borrowing money. The amount a borrower pays in addition to the principal of a loan to compensate the lender for the use of the money.

**Interest rate:** The expression of interest as a percentage of the principal.

**Islamic banking:** Methods sanctioned by Islamic culture whereby interest is not charged explicitly but allows for other ways for lenders to cover their costs.

**Job placement centres:** Places which link people searching for work with employers seeking to recruit staff.

**Loan agreement:** Written contract between a lender and a borrower that sets out the rights and obligations of each party regarding a specified loan.

**Loan guarantee:** See Collateral.

**Loan loss rate:** Total write-offs for the period divided by the average outstanding portfolio. Represents the percentage of the MFI's loans that have been removed from the balance of the gross loan portfolio, because they are unlikely to be repaid. A high ratio may indicate a problem in the MFI's collection efforts.

**Loan loss provision:** A non-cash expense that is used to create, or increase the loan loss reserve in anticipation of losses due to default. It is shown on the MFI's Income Statement.
<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loan loss reserve:</td>
<td>The portion of the gross loan portfolio that has been expensed (i.e. for which a provision has been made) in anticipation of losses due to default. The loan loss reserve is not a cash reserve, but rather an accounting device to provide information about the size of the anticipated loan losses. It is shown on the MFI Balance Sheet.</td>
</tr>
<tr>
<td>Local integration:</td>
<td>A situation where voluntary repatriation is not possible and refugees have, in the long term, the opportunity to reside legally in the host country.</td>
</tr>
<tr>
<td>Local partner:</td>
<td>A local rather than an international implementing agency partner.</td>
</tr>
<tr>
<td>Local population:</td>
<td>People originally inhabiting a given area.</td>
</tr>
<tr>
<td>Loan products:</td>
<td>Types of loans with particular sets of terms and conditions, and often for a particular use. Within the field of microfinance, loan products include working capital loans, fixed-asset (investment) lending and home improvement loans. Microfinance institutions often distinguish between individual and group lending programmes, because these are targeted at different client groups.</td>
</tr>
<tr>
<td>Localisation:</td>
<td>A hand-over process whereby a microfinance institution is independently registered under local laws, and the management of the programme transferred to local staff members.</td>
</tr>
<tr>
<td>Market rate of interest:</td>
<td>Interest rates that are charged for the similar loan products by other (usually commercial) providers of financial services in the market.</td>
</tr>
<tr>
<td>Merger:</td>
<td>A process whereby microfinance programmes which require technical assistance and cannot be fully independent without external support, unite with implementing agencies (local or international) that have demonstrated their capacity to implement sound microfinance.</td>
</tr>
<tr>
<td>Microcredit:</td>
<td>A part of the field of microfinance, microcredit is the provision of credit services to low-income entrepreneurs. Microcredit can also refer to the actual microloan.</td>
</tr>
<tr>
<td><strong>Microenterprise:</strong></td>
<td>A small-scale business, usually, but not necessarily, in the informal sector. Micro-enterprises often employ less than 5 people and can be based out of the home. Micro-enterprise is often the sole source of family income but can also act as a supplement to other forms of income. Examples of micro-enterprises include small retail kiosks, sewing workshops, carpentry shops and market stalls.</td>
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<tr>
<td><strong>Microentrepreneur:</strong></td>
<td>Owner/proprietor of a microenterprise.</td>
</tr>
<tr>
<td><strong>Microfinance:</strong></td>
<td>The provision of financial services to people with low incomes. Microfinance is broader than micro-credit, encompassing services such as micro-savings, micro-insurance, micro-leasing, payment and remittance transfer services.</td>
</tr>
<tr>
<td><strong>Microfinance institution (MFI):</strong></td>
<td>An organisation that offers microfinance services. Many MFIs are non-governmental organisations committed to assisting some sector of the low income population, however, MFIs can be registered in different legal and organisational forms - such as banks, credit unions, finance companies and financial cooperatives.</td>
</tr>
<tr>
<td><strong>Microloan:</strong></td>
<td>A loan imparted by a microfinance institution to a microentrepreneur, to be used in the development of the borrower's small business. Microloans are used for working capital in the purchase of raw materials and goods for the microenterprise, as capital for construction, or in the purchase of fixed assets that aid in production, among other things.</td>
</tr>
<tr>
<td><strong>Minimalist approach:</strong></td>
<td>An approach to microfinance which focuses only on the provision of microfinance, without other livelihood interventions.</td>
</tr>
<tr>
<td><strong>Monitoring:</strong></td>
<td>Ongoing review to ensure that inputs, work schedules and agreed actions are proceeding according to plans and budgetary requirements.</td>
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<tr>
<td><strong>Niche market:</strong></td>
<td>A highly targeted group of individuals who are most likely to need what you have to offer.</td>
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<tr>
<td><strong>Operational income, expense, profit or loss:</strong></td>
<td>Stemming from an institution's core business as opposed to non-operational items, such as donations, that are not produced by the business activity and that may not recur. Operational income is also commonly called Operating revenue.</td>
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</table>
**Operational self-sufficiency (OSS):** This measures how well an MFI can cover its costs through operating revenues. In addition to operating expenses, it is recommended that financial expenses and loan loss provision expenses be included in this calculation, as they are a normal (and significant) operating cost. If the resulting figure is greater than 100, the organisation under evaluation is considered to be operationally self-sufficient. In microfinance, operationally sustainable institutions are able to cover administrative costs with client revenues.

**Outreach:** Breadth of outreach refers to the number of clients reached by a microfinance programme. Depth of outreach refers to the poverty level of its clientele.

**Outstanding:** Remaining to be paid. An outstanding loan is a loan that has been disbursed but neither paid in full nor written off. Outstanding portfolio is the unpaid principal balance of all loans owed to the lender.

**Part-time or casual employment:** Type of employment where employees have limited rights and the length of employment is not fixed. Wages may be in cash or in kind.

**Prepayment:** Payment of a loan in advance of the payment schedule in the loan contract.

**Principal:** The total loan amount received, on which the interest is calculated.

**Portfolio at risk:** Measurement of the total outstanding balance of loans with payments past due (not late payments or payments not yet due) - divided by the total outstanding portfolio. A more rigorous manner of assessing portfolio quality than arrears rate, portfolio past due/delinquent portfolio.

**Portfolio outstanding:** See "active loan portfolio".

**Quick impact project (QIP):** Small-scale interventions, made up of simple inputs and activities, intended to be an immediate injection of support to meet community based needs, where constraints in the returnee/refugee integration process have been identified by the community members and where they have a commitment towards change. Examples include bridge repair, small-scale dam projects, and other activities that have development implications, but which also provide jobs to returnees and enhance returnee programmes.
<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
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<tbody>
<tr>
<td>Rapid appraisal:</td>
<td>A type of quick assessment using focus groups (8-15 members) to determine roughly the characteristics of clients and their potential use of microfinance services.</td>
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<tr>
<td>Refugees:</td>
<td>Those who are outside their countries and who cannot or do not want to return because of a well-founded fear of being persecuted for reasons of their race, religion, nationality, political opinion or membership of a particular social group.</td>
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<tr>
<td>Regulation and supervision:</td>
<td>The creation and enforcement of a set of rules and standards for financial institutions, including MFIs. These rules are usually set by a country’s central bank or superintendency of banks, or by other banking agencies with the purpose to protect the rights of depositors and integrity of the country's financial systems.</td>
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<tr>
<td>Repayment capacity:</td>
<td>The ability to pay back a loan.</td>
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<tr>
<td>Repayment rate:</td>
<td>The historic rate of loan recovery, measuring the amount of payments received compared to the amount due.</td>
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<tr>
<td>Resettlement:</td>
<td>Organised transfer (usually assisted by UNHCR) of an individual refugee or a group of refugees from a country of first asylum to a resettlement country granting permanent protection and asylum. Resettlement is one of the three durable solutions for problems of refugees, the others being voluntary repatriation and local integration in the country of asylum.</td>
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<tr>
<td>Returnees:</td>
<td>Refugees who return from exile to their country of origin voluntarily, safely and with dignity.</td>
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<tr>
<td>Revolving fund:</td>
<td>A credit fund which is renewed as its money is lent, where loans are repaid so that new loans can be made with the same fund. Theoretically, the fund retains a balance all times.</td>
</tr>
<tr>
<td>Rotating savings and credit associations (ROSCAs):</td>
<td>Informal financial service suppliers. Members of these associations contribute a previously agreed sum of money into a fund (commonly referred to as the pot) at every meeting. This pooled amount is awarded randomly to one member at each meeting based on some previously agreed methodology. After every member has received their due share of the fund, the cycle starts again.</td>
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<tr>
<td>Scale of outreach:</td>
<td>The number of clients served by a microfinance programme.</td>
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<tr>
<td><strong>Self-reliance:</strong></td>
<td>The creation of livelihood and the capacity of people to care for their own needs; to access and maintain services; to organise themselves; and to respond to the special needs of community members. For refugees, the promotion of self-reliance can be a temporary solution pending their return. It does not automatically imply citizenship and assimilation in the country of asylum.</td>
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<tr>
<td><strong>Semiformal institutions:</strong></td>
<td>Institutions that are formal in the sense that they are registered entities subject to all relevant general laws, including commercial law, but informal insofar as they are, with few exceptions, not subject to bank regulation and supervision.</td>
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<tr>
<td><strong>Sharia:</strong></td>
<td>Islamic law, administered by councils of advisors, that dictates, among other things, which financial products and services are acceptable.</td>
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<tr>
<td><strong>Small enterprises:</strong></td>
<td>Enterprises that employ between 11 and 50 people.</td>
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<tr>
<td><strong>Social capital:</strong></td>
<td>The assets of community cohesiveness viewed as part of the development process. Social capital refers to institutions, relationships and norms that shape the quality and quantity of a society's social interactions.</td>
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<tr>
<td><strong>Solidarity group:</strong></td>
<td>See Group lending.</td>
</tr>
<tr>
<td><strong>Supply:</strong></td>
<td>The quantity of a resource, good or service that lenders or businesses are willing to produce and sell during a specific time period.</td>
</tr>
<tr>
<td><strong>Sustainability:</strong></td>
<td>An organisation's ability to cover costs. There are varying degrees of sustainability, ranging from not sustainable to financially sustainable (see Financial Self-Sufficiency and Operational Self-Sufficiency).</td>
</tr>
<tr>
<td><strong>Targeting:</strong></td>
<td>Focusing exclusively on specific types of clients or activities.</td>
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<tr>
<td><strong>Trend analysis:</strong></td>
<td>The comparison of performance indicators over time.</td>
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<tr>
<td><strong>Trust banks:</strong></td>
<td>A modification of village banks where loans are made to a group of 15 or more members who co-guarantee each other's loans.</td>
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<tr>
<td>Term</td>
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<tr>
<td>Village banking:</td>
<td>Lending methodology in which clients - typically women - form groups of approximately 10-30 individuals that are autonomously responsible for leadership, bylaws, bookkeeping, fund management and loan supervision. The group pools funds to use for business loans, savings, and mutual support, and members cross-guarantee individual loans.</td>
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<tr>
<td>Voluntary repatriation:</td>
<td>The voluntary return of refugees to their country of origin, often assisted by UNHCR in close co-operation with the countries of origin and asylum.</td>
</tr>
<tr>
<td>Vulnerable groups*:</td>
<td>Groups of people in refugee emergencies or disasters who are especially susceptible to starvation, disease or exploitation. Vulnerable groups needing special assistance and protection include pregnant or unaccompanied women, infants, unaccompanied or orphaned children, and the elderly.</td>
</tr>
<tr>
<td>Working capital:</td>
<td>Defined as the difference between current assets and current liabilities, excluding short-term debt.</td>
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<tr>
<td>Write-off:</td>
<td>The elimination of an un-collectable loan amount from the loan portfolio in the balance sheet.</td>
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