**ILO Action Programme on Skills and Entrepreneurship Training for Countries Emerging from Armed Conflict**

# Developing Financial Institutions in Conflict Affected Countries: Emerging Issues, First Lessons Learnt and Challenges Ahead

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## Preface

This document, by Geetha Nagarajan, has been prepared as an input to the ILO Action Programme on Skills and Entrepreneurship Training for Countries Emerging from Armed Conflict. This multi disciplinary and interdepartmental programme, under implementation during the 1996-97 biennium, is geared to, inter alia, making policy proposals, preparing guidelines for national and international capacity building, producing training materials, setting up a database and preparing a compendium of major training and employment-related initiatives in countries emerging from armed conflict. Besides several country-level research activities to generate relevant data and insights, the programme has prepared research papers that assess and compared the experience in several countries to come up with preliminary lessons learnt. Mrs. Nagarajan’s study is one example. It examines a crucial input - the provision of microfinane services - to the development of micro and small enterprises.

Lack of sustainable access to microfinance is a key constraint faced by micro and small enterprises (MSEs) in countries emerging from armed conflict. In these countries, characterized by massive poverty and unemployment, micro and small enterprise alone have the potential to provide income and employment for large parts of the population while at the same time laying the basis for economic development and poverty alleviation. Creating sustainable micro-finance institutions that deliver microfinance at affordable and convenient conditions help MSEs fulfil their potential.

Microfinance programmes have been set up in a number of conflict-affected countries by donor agencies, UN agencies and international NGOs. Few, however, are considered to be potentially financial self-sufficient. While the approaches vary widely, ranging from village banks and solidarity groups over revolving funds and guarantee funds to major on-lending schemes involving public banks, outreach and sustainability are, with a few exceptions, far from satisfactory.

Common to these approaches is the insufficient attention given to the analysis of the specifics of conflict-affected countries that may have an impact of financial intermediaries. Conflict affects the financial sector severely at the macro (disturbance of macroeconomic and financial stability), meso (destruction of financial institutions) and micro level (demonetization and related phenomena as well as disruption of social bonds and relationships based on trust). The experience made in developing countries and the lessons learned there in how to develop sustainable micro-finance institutions are expected to be applicable to the circumstances of countries like Cambodia, Mozambique and Somalia.

To overcome this lack of knowledge on how to efficiently and effectively establish microfinance intermediation in post-conflict countries, the ILO undertook this review of the experiences made by the ILO (especially in Cambodia and Central America), and other donors and international NGOs. This study by Mrs. Nagarajan provides an overview of the specific constraints for micro-finance in countries emerging from armed conflict, sketches the experience so far, identifies emerging issues, elaborates the first lessons learnt on developing sustainable financial institutions, puts forwards recommendations for policy makers, financial institutions and donors, and sketches the challenges ahead.

The study was supervised by Haje Schütte, from the Social Finance Unit of the ILO's Enterprise and Cooperative Development Department, who is also a member of the working team on the current Action Programme


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# Developing Financial Institutions in Conflict Affected Countries: Emerging Issues, First Lessons Learnt and Challenges Ahead

*Conflicts weaken or incapacitate institutions that govern and provide services to facilitate transactions at a low cost for sustained economic development of a civil society, and encourage opportunistic behavior -- Collier, 1995.*

## I. Introduction

The 1980s and the early part of 1990s witnessed major armed conflicts in several parts of the world [1]. By early 1996, most of the major conflicts in Southeast Asia, Europe, Southern Africa and horn of Africa had ended[2]. Conflicts in Bosnia and Chechnya are still continuing but at a lower pace (World Disasters Report, 1996). The prolonged conflicts in many African, Asian and Central American countries have resulted in massive destruction of their physical, human and social capital. Between 1994-95 the number of victims in Africa were estimated to be close to one million in Africa. In Lebanon, physical capital worth US$25 billion was destroyed, a total of about 200,000 skilled workers fled in search of jobs and safety, and per capita real income fell by two thirds during the conflict that lasted between 1975-1990 (Yaprak and Webster, 1995). In Africa, the countries in conflict are estimated to suffer a 8% decline in annual gross domestic product compared to a 13% increase for non-conflict affected countries (Ammons, 1996).

Conflicts result in disrupted information flows as part of social capital, destruction of physical capital, disavings, reduction in value of public and private assets and fuzzy property rights along with bleak outlooks towards future and long-term investment. As a result, several countries that emerge from major and prolonged conflicts face the challenges of recuperating the lost physical, financial and social capital to reestablish a civil society. In doing so, they are faced by the challenge of rebuilding/reforming/creating sustainable institutions to help replace the lost physical and human capital, and to replace the opportunistic behavior that prevailed during and immediately after the conflict with trust in order to restore social capital.

Financial intermediation plays a facilitating role in sustainable economic

[1] The armed conflicts discussed in this paper are ones which have arisen primarily due to differences in political, religious, geographical boundary and ideological issues. The armed conflicts due in part to the inefficient financial markets as recently seen in Albania are not considered here.

[2] There were a total of 30 armed conflicts recorded in 1995 compared to 45 in 1994; The 30 conflicts occurred in 6 African, 12 Asian, 6 Near and Middle Eastern, 3 European, and 3 Central and Latin American countries. Of this, 8 were major conflicts primarily observed in Africa and Europe. These major conflicts had little direct foreign influence -- World Disasters Report, pp. 136-137, 1996.

development through employment creation and consumption smoothing.  A financial system is a collection of formal, informal and semi-formal institutions that provides its clients through financial intermediation with opportunities to hold and productively invest their savings, with access to funds for credit worthy investments, and with insurance options through consumption smoothing. Therefore, development of financial institutions is considered to be a major tool by bilateral and multilateral donors to jumpstart an economy emerging from conflict.  But, several unique initial conditions prevail in conflict affected countries which challenge the development of financial institutions.

International donors are generally active and fairly successful in developing financial institutions in developing countries which have not been not significantly affected by major and prolonged conflicts (hereafter referred to as normal developing countries); their experiences are well documented and issues are being researched.  Although several experiments are being conducted by international donors among others in designing and operating financial programmes in post-conflict countries, their experiences are rarely documented.  The War to Peace Transition division at the World Bank, Centre for African Studies at Oxford University, The International Labor Office (ILO) Action Programme on Skills and Entrepreneurship Development for Countries Emerging from Armed Conflict and the War Torn Societies Project of the United Nations Research Institute for Social Development (UNRISD) are currently engaged in studying inter alia the reasons for and consequences of wars, conflict resolution, and effects of a peace dividend and reconciliation.  However, studies on the consequences of conflicts on the development of financial markets and on issues concerning the design and implementation of  financial programmes in post-conflict countries are very limited.  In short, issues regarding the development of financial institutions in conflict affected countries are emerging topics of interest on which there has been little research and even less published.

This paper is an initial attempt to document the first indicative findings of the experiences of some bilateral (e.g. United States Agency for International Development-USAID, German Agency for Technical Cooperation (GTZ)) and multilateral (e.g. International Labor Office (ILO), United Nations Development Programme (UNDP), InterAmerican Development Bank (IADB), and the World Bank) donors in the development of financial institutions in selected conflict affected countries.  The paper is based primarily on a desk review of literature collected from the reports prepared by/for ILO, World Bank, USAID and The Ohio State University, and secondarily interviews with selected staff at the World Bank dealing with war to peace transition countries.  This paper is not designed to arrive at a concise formula for developing financial institutions in post-conflict countries through a fully informed assessment of the issues but rather to generate preliminary lessons from the documented experiences and to stimulate discussion on this emerging subject that is of significant importance for sustainable economic development in post-conflict countries.

Discussion primarily focuses on four conflict affected countries: Cambodia, El Salvador, Mozambique and Uganda.  References will be made to other countries whenever deemed necessary.  The reasons for the choice of the four countries are the following:

1. to have a geographic representation from the major conflict affected areas,
2. to include countries that have signed the peace treaty and have been implementing it for at least four years so that developments can be examined over years,
3. to include countries where several international donors have been active or are planning to be active in providing financial services and,
4. to include countries that are undergoing economic adjustment processes from central planning regimes to market economies and/or are implementing structural adjustment programmes.

Currently, all the four countries have maintained peace since the early 1990s. While El Salvador and Uganda have implemented structural adjustment programmes, Mozambique and Cambodia have moved from socialist to market economies. The preliminary lessons learnt from these diverse experiences may improve our understanding of institutional development and may facilitate the development of broad guidelines for policy makers, donors and financial intermediaries.

The paper is organized as follows: a framework to examine post-conflict countries and an outline of unique problems faced at macro, meso and micro level in developing financial institutions in conflict affected countries are followed by a synthesis of design and performance of financial institutions in case study countries. A discussion on preliminary lessons learnt from the literature search and an outline of challenges faced in developing financial institutions in newly emerging countries from conflict are presented next. The paper concludes with policy implications for the government, donors and financial intermediaries, and future directions for research.

## II. Framework to Examine Conflict Affected Countries

This section outlines a framework generally used to identify the actions to be taken in post-conflict countries and the sequence in which to implement them. Donor assistance in post-conflict countries is generally provided under the assumption that post-conflict countries move through a transition continuum from post-conflict emergency relief stage to rehabilitation to peace to development stage (Seaman, 1994; UNDP, 1994). It is suggested that the types of assistance in developing institutions and markets may vary according to the transition stages and can be mutually exclusive.

The continuum approach, however, has been criticized as being too limited in describing a complex transition process from conflict to development for at least two reasons:

1. there are many countries where the transition stages are not mutually exclusive but overlap with one another[3], and,
2. there is a consensus that flexible development orientated programmes should be implemented immediately after the conflicts for effective transition from conflict to development (Anderson and Woodrow, 1989; Maxwell and Buchanan-Smith, 1994), especially the ones aiming at the development of microfinance institutions.

It is argued that the relief to development continuum with well marked boundaries between relief and development stages does not exist.

It has been recommended to link relief measures to developmental efforts in order to improve the capabilities of the disaster affected communities to help reduce their vulnerability to future disasters (Anderson and Woodrow, 1989). A linkage between relief and development is suggested to be developed through the integration of disaster mitigation strategies into development projects and capacity

[3] The relief, rehabilitation and development are argued to happen simultaneously and independently in Angola (Seaman, 1994).

building elements into relief operations, and simultaneous emergency and development strategies (Herbinger, 1994; Longhurst, 1994).

Despite the criticisms, the continuum approach is widely used in examining post-conflict countries. It is argued that developing institutions through improper linkage of relief and development without proper assessment of the socio-economic and political environment may be more detrimental than transcending in stages from relief to development (Buchanan-Smith and Maxwell, 1994). Therefore, the continuum is slightly modified to incorporate some of the criticisms and used as a basic framework in this paper to examine post-conflict countries.

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(1) Emergency Relief

(2) Rehabilitation, Reconciliation, Peace, Developing

(3) Developed

**Figure. 1. Post-Conflict Relief to Development: A Transition Continuum**

Figure 1 represents a modified continuum that traces the transition from relief to development of a post-conflict country. The emergency stage begins immediately after the conflict and consists of relief measures and conflict prevention components, while the next stage encompasses several overlapping activities such as demobilization, reinsertion, reintegration and reconciliation that helps in stabilizing peace and results in early stages of economic recovery. This stage also focuses on the development of social, human, physical and financial capital through development of sustainable institutions. A development stage then follows. While the type of donor assistance for early emergency and late developed stages may be distinctly different, it may not differ very much during the transition period represented by double dotted lines in figure 1 since that stage is marked by highly overlapping and mutually supportive activities.

The recognition of overlapping activities helps in identifying the response of financial institutions during the transition period which includes early stages of development. For example, in addition to economic development, the microfinance institutions are also considered as vehicles of reconciliation to improve the trust and confidence among the members of society. The financial institutions follow various designs and adaptations to facilitate reconciliation aiming to peace and establishment of a civil society. Introduction of group loans and the use of ex-combatants applying for loans to provide community wide services as in Uganda are few of the modifications used by microfinance institutions to build trust and reintegrate ex-combatants and displaced people into the society. Use of a neutral NGO to function as a conduit for a post-conflict government to provide financial services to the ex-combatants who fought under different factions has also helped in the reconciliatory process. This is evidenced in the role of an international NGO, Catholic Relief Services-CRS, in channeling government funds as loans through its NGO affiliates to ex-combatants in El Salvador (Blum, 1996).

The speed at which the countries have moved from early emergency relief to the next stage may have implications for the development of financial institutions. Cambodia and Vietnam, and El Salvador to a lesser extent are observed to have rapidly moved from emergency relief stages by effective implementation of rehabilitation and economic adjustment programmes (Gonzalez-Vega, 1995; and Dodsworth, 1997). In Cambodia, the development of potentially viable financial institutions began in the emergency stage and a few of the institutions launched immediately after the emergency stage are now nearing operational self-sufficiency. In contrast, Mozambique is observed to experience a long, slow and ineffective progress in the transition from conflict to development (Colletta et al, May 1996) which has likely influenced the slow development of sustainable financial institutions (Graham, Nagarajan and Ouattara, 1995).

Uganda moved away from the emergency relief stage through a slow but steady process and is currently building financial institutions on a more sustainable basis. The financial institutions that were developed in Uganda for emergency and rehabilitation activities were mostly oriented towards poverty based lending at concessionary rates (Colletta et al., 1996). It took until 1995, about six years, for the NGOs in Uganda to operate potentially sustainable financial institutions[4].

Some of the factors which facilitated Cambodia and Vietnam to rapidly move from the relief stage towards development compared to that of Mozambique and Uganda can be summarized as follows: these economies were dominated by private, family based agriculture prior to conflicts; limited central planning prior to conflict; benefits through association with successful east Asian neighbors who were eager to invest in these low wage countries; and direct foreign investments and remittances from abroad immediately after conflicts. The initial economic reforms introduced along with emergency measures focused on high positive interest rates, limitations on state enterprise credit and on reduction of military expenditures (Dodsworth, 1997). In short, these economies facilitated institutional development from the early stages of the transition from conflicts.

## III. Challenges in Developing Financial Institutions in Conflict Affected Countries

Building sustainable financial institutions in developing countries has been a great challenge to governments, donors and practitioners. A recent study by Christen, Rhyne and Vogel (1995) could identify only about eleven programmes from several developing countries as best practices. Establishing financial institutions in conflict affected countries is even more difficult than normal countries due to unique macro, meso and micro conditions that prevail immediately after the conflicts.

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[4] Example is the Centenary Rural Development Bank (CERUDEB), launched mainly with local church funds and later provided with technical assistance from a German consulting firm called IPC. The bank suffered huge losses in the early 1990s due to mismanagement and poor financial design. After the technical assistance from IPC in 1993, the bank has redesigned its financial programmes to achieve sustainability. The bank now successfully makes and collects individual loans at market rates in urban and rural areas through its eight branches (personal communication with Douglas H. Graham, The Ohio State University, 1997).

In a conflict affected country, the economy loses capital through the disaving by private agents, the government and the opponents in a conflict of attrition, depletion of social capital, and financial capital flight and labor flight (through emigration) away from domestic markets. Consequently the output decline and breakdown of institutions affecting economic development (Azzam et al, 1994). As a result, unique challenges exist in developing financial markets in countries emerging from conflicts compared to normal countries that are currently undergoing transition from centrally planned economies to market economies as in Central and Eastern Europe (CEE) and Russia, and from underdeveloped economies as in several African countries. Some form of financial institutions and governance existed in centrally planned economies of CEE countries, as well as active informal and rudimentary formal financial systems along with ineffective central but strong local governments in several underdeveloped economies. In contrast, the governance structure and formal and informal institutions in conflict-affected countries are often destroyed or paralyzed depending on the intensity and duration of the conflict.

The extent of institutional collapse and the need for reforming/rebuilding/creating institutions depends on the nature of the conflicts. Long, recurrent and nationwide conflicts affect the governance and institutional structures more profound than short and sporadic conflicts and hence require longer time for institutional rebuilding (Azam, 1994). Post-conflict countries are in need of institutions which can work in an initial environment characterized by lack of security, trust and infrastructure, psychological distress of the refugees and war returnees, and high social mobility.

The development of financial institutions in conflict affected countries are challenged by the macro, meso and micro economic conditions that prevail in a country immediately after a long and widespread conflict. While several of these initial conditions impede the development of financial institutions, some facilitate it through increasing the demand for financial services. The challenge lies in recognizing and exploiting the disadvantages posed by some of these unique features to the advantage of the conflict affected countries through innovative ideas. These conditions are nonetheless expected to improve over time with a high level of commitment to the implementation of transition from conflict to development.

**A. Macro conditions**: These are the conditions that prevail at the national level that affect the development of institutions. They have implications for supply of and demand for financial services.

1. Lack of confidence in the economy due to weak government, lack of security and high inflation resulting in low foreign and domestic investor confidence and low investments. For example, there was a lack of trust in local currency and minimal use of banking facilities in Cambodia and Vietnam immediately after the conflicts.
2. Low level of financial capital at the government level for institutional development.
3. Abundance of donor funds available as grants. These donor funds reduce the need for local mobilization of resources but increase the amount of funds available for institutional construction/reconstruction.
4. Large capital flight and dollarization due to low confidence in local currency.
5. Substantial human flight in terms of the migration of skilled

personnel in search of jobs and safety. For example, nearly 200,000 skilled people fled Lebanon during and immediately after the conflict (Yaprak and Webster, 1995).

6. Fuzzy property rights making it difficult for private long-term investments and for use of property as collateral for loans. This situation may, however, encourage the use of collateral substitutes.
7. Large volume of remittances, as in Eritrea where the volume of remittances that facilitated transition to development were higher than donor funds. The flow of remittances in El Salvador was reported to smooth consumption and also increased the demand for financial services (Boyce, 1995).
8. Increased foreign direct investments, as in Angola where foreign investments were made in natural resources after the conflict. The neighboring industrialized countries in South East Asia also made huge investments in post-conflict Cambodia and Vietnam to take advantage of their cheap labor (Dodsworth, 1997). These investments create employment and increase the demand for financial services.
9. Active cross border trade and bootlegging, as widely observed in post-conflict Cambodia and Mozambique (Ueda, 1995; Graham et al., 1991).
10. Lack of access to market due to destroyed infrastructure which hinders the growth of economic activities. Also, the presence of live land mines restricts the free movement of goods, people and livestock.

**B. Meso conditions**: These are the conditions that affect transactions carried out through intermediaries such as financial intermediaries.

1. Financial intermediaries that can facilitate resource mobilization and capital augmentation through lending activities are ineffective.
2. Formal financial institutions are dysfunctional, riddled with large non-performing loans to the government and public entities to finance the conflict, suffer from low capital base and lack of skilled labor (Muscavele, 1996; Princ, 1996).
3. Semi-formal financial institutions are mostly donor assisted NGO initiatives that focus more on poverty oriented lending than on creating sustainable financial institutions per se. NGO activities can generally be classified into five different categories and level of NGO participation in these categories depend upon the political and economic environment of the host country: (1) refugee/survival services; (2) development grant initiatives to provide social and community wide facilities and infrastructure; (3) development lending for income generating activities where services are directed to a target population through grants and loans; (4) brokering services between low income clientele and lending institutions to facilitate access to loans to reduce transaction costs; and (5) financial intermediation to provide financial services explicitly or as part of other services to the community. The donor agencies and the international NGOs that were active during the conflicts and the emergency phase normally do not possess any experience in developmental activities such as capacity building. NGOs that would like to provide financial services require a different kind of mind-set from those who provide socially oriented relief work. Financial service providers need to follow a business like approach rather than a pure altruistic approach. It is difficult to change the mentality of staff accustomed to providing humanitarian relief services to provide efficient financial services. Also clients of relief will not expect the same institution/NGO to be tough enough with loan recovery. NGOs in Mozambique shifting from emergency aid to providing credit services are generally characterized by lack of coordination and by minimum ability to reach sustainability (Langa, 1996; Graham, Nagarajan and Ouattara, 1993). The NGOs, however, are endowed with resources that are used to provide grants and cheap credit and they tend to know the community and often times trusted by the community.
4. Lack of a strong supervisory and regulatory agency to oversee the financial sector.
5. Informal arrangements are disrupted or destroyed and limited to only very short-term small sized loans to finance trade and consumption. For example, the Xitique in Mozambique and Kibiina in Uganda are

popular forms of informal rotating savings and credit mechanisms (RoSCAs) in rural and urban areas prior to conflicts. They were disrupted and destroyed during the conflicts due to dislocation of people and lack of trust and confidence in the community. The main elements essential to the success for these informal group arrangements include personal knowledge of the group members and trust and confidence in them (Langa, 1996; Larson, 1993; Meyer and Nagarajan, 1994; Muscavele, 1996).

6. The formal and semi-formal financial arrangements focus on grants and credit rather than on deposit mobilization.

**C. Micro conditions**: These are the conditions that prevail at the micro level that directly influence the demand for financial services.

1. Lack of confidence and trust in institutions and society (Collier, 1995; Meyer and Nagarajan, 1994; Morris and Labao, 1994; Ijoyi, 1995; Graham and Fraciso, 1993). Collier and Gunning (1995) noted in Uganda that trust in the national economy was restored much faster than trust in communities and institutions.
2. Lack of productive activities and weak local labor, product and input markets.
3. Myopic vision on life span due to threat to life and safety, and due to diseases such as HIV destroying incentives to save and enter into long term investment contracts as observed in Uganda (Meyer and Nagarajan, 1994).
4. Lack of real assets that can be used as collateral for loans and lack of good client information due to displacement of people during the conflict. Collier (1995) notes that physical assets that have collateral value are also conflict sensitive and are usually liquidated during prolonged conflicts to avoid theft and to smooth consumption. As a result, the availability of assets that can be used as collateral are limited in a country emerging from conflict. However, this has led to experimenting with collateral substitutes such as peer pressure and business plans.
5. Need to reintegrate demobilized soldiers. Ex-soldiers form a distinct group that requires to be reintegrated into the civil society to maintain political stability and security. Experience from Uganda suggests that proper rehabilitation of the ex-soldiers into the civil society by increasing their access to land, labor and credit markets has decreased the incidence of violence [5]. However, the soldiers and ex-combatants have few entrepreneurial skills and lack capital to start a new venture. They have high demand for social services, technical assistance, training services and finance to successfully reintegrate into the civilian life.
6. Need to reintegrate displaced persons, widowed women, orphaned children and disabled into the society. Credit programmes that target specific groups have seldomly become financial and institutionally sustainable and have often caused considerable distortions of the financial sector.

Given the above macro, meso and micro conditions as initial conditions, several countries emerging from conflicts have been developing financial institutions to suit the environment. The next section provides a synthesis of design and performance of financial institutions in the case study countries since the conflicts ended.

## IV. Participants, Design and Performance of Financial Institutions in Case study Countries: A Synthesis

This section provides a synthesis of the type of financial sector participants and their programmes and performance in four post-conflict countries - Cambodia, El Salvador, Mozambique and Uganda - based on a review of literature.

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[5] See Colletta et al., June, 1996 for detailed information on social and financial programmes implemented as safety nets by NGOs and governments in Uganda, Mozambique, Ethiopia and Namibia for demobilized soldiers, ex-combatants and conflict displaced persons.

**A. Participants**

A broad sketch of the major participants and characteristics of finance related services provided by them at various transition stages from conflict to development is presented in Table 1. It can be observed that multiple agents providing finance related services emerge as the country progresses through the transition continuum. The emergence of multiple agents may be attributed to the financial reforms that have opened up the financial markets for competition thus encouraging participation by several agents.

While NGOs providing financial services combined with social services are active in the emergency stage, they tend to move towards establishing potentially viable financial institutions as the country progresses along the transition continuum to a mature development stage. Informal sector persists even during the conflict and in the emergency stage but tends to become very active at the end of the emergency stage. Private banking emerges as the transition continues with public banks being privatized and new financial institutions being established. There is also a move from grants to subsidized credit to credit at market rates, and from donor funds to deposits mobilized from the public as the transition to a market economy progresses. Supervision and regulatory units to oversee the financial sector activities are formed as the country develops.

Currently, all four case study countries record a variety of formal, semi-formal and informal financial agents providing various types of loan and deposit services [6]. State owned banks with majority state capital tend to dominate in number and volume of operations. Although formal financial institutions are reformed, they are observed to be very weak to provide sustainable financial services. They tend to be bureaucratic and lack modern know-how of microfinance. Privatization of state banks are implemented very slowly in Mozambique (Graham and Franciso, 1993) but fairly successfully in El Salvador (Gonzalez-Vega, 1995). Private banks capitalized mainly by majority foreign and a few domestic shareholders have begun to emerge.

A strong donor - bilateral and multilateral - presence is observed since the emergency stage. The majority are small and lack a track record in providing sustainable financial services (Sowa, 1995; Forster and Webster, 1995; Prins, 1996). The financial NGOs, international and national, are primarily supported by international donors. Some international donors such as UNDP, ILO, UNHCR, and WHO have also involved local organizations in capitalizing NGOs to provide financial and non-financial services as seen in their credit programmes implemented by Local Economic Development Agencies (LEDA) in Central America including El Salvador (see PRODERE, 1993, 1995 for details on LEDAs). However, there is often a lack of donor coordination carrying the potential to distort the emerging financial markets.

Informal financial agents are beginning to be very active as noticed in Mozambique and Uganda but their services and outreach are limited. Efforts to link the informal and formal arrangements have been minimal although some experiments are underway in El Salvador and Cambodia.

While the regulation and supervision apparatus is currently in place in all the case study countries, they are geared towards the formal financial sector and tend to be less effective in overseeing the non-bank intermediaries such as NGOs and in curbing fraudulent practices.

**B. Target sectors**

While some programmes target specific client groups, others target sub-

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[6] Consult the following documents for a detailed overview of the financial sector in the following countries: See Meyer and Nagarajan, 1994; Morris and Labao, 1994 for Uganda. See Danby, 1995; Gonzalez-Vega, 1995; and Hoyle and Letona, 1995 for El Salvador. See Sowa (1996) for Mozambique. See Prins, 1996 for Cambodia. See Abiad, 1995; and CGAP, 1996 for Vietnam.

sectors or geographic areas. Client groups often include ex-combatants, conflict displaced persons and women while sub-sectors include microenterprise and export sectors.

Demobilized soldiers, returnees and internally displaced persons make an important target group for NGOs and governments at least through the early stages of their rehabilitation into the community [7]. However, the experience with providing finance related services to this target group has not been successful. For example, an IFAD supported credit project by the Development Bank (BPD) and another revolving fund financed by GTZ to BPD in Mozambique focused on liberated war veterans and returned miners from South African gold mines. These schemes failed due to mismanagement and refusal on part of most borrowers to repay because they considered the loans as an entitlement (Vletter, 1993; Graham and Franciso, 1993). The experience has been similar in Cambodia where the demobilized soldiers, having sold their assets and mismanaged the subsidized loans from NGOs and the government, were unable to repay their loans and returned back to the army. They also threatened the loan officers who tried to collect the loans (Taylor, 1994). Generally, loans were made to demobilized soldiers and ex-combatants who had little potential business plans and/or had low skill levels and willingness to implement them. The cost of servicing the ex-combatants was also very high. The credit programmes for reintegration of ex-combatants initiated by the Ethiopian Government with GTZ funds incurred heavy costs and were not sustainable. It was estimated that the credit programme incurred ETB 1,750 per beneficiary compared to food-for work that costs ETB 243/beneficiary and distribution of agricultural implements that costs ETB 117/beneficiary (Colletta et al., June 1996). However, targeting ex-combatants and demobilized soldiers for financial assistance has become a political necessity to promote overall security and stability. The challenge is to find specific approaches for a limited period of time so that disruption to the financial markets due to targeting is minimized.

Women are considered as major targets but outreach to them has been modest. It was estimated that women represented only up to 60% of the total clients in about 20 NGO programmes in Cambodia that specifically targeted women (Prins, 1996). There are, however exceptions including the ILO assisted NGO programme in Cambodia, ACLEDA, where women represent 92% of their clientele (Webster and Tucker, 1996) [8]. Another example is the village banks in El Salvador, that are partially funded by UNDP/ILO/UNHCR/WHO and USAID and implemented by an international NGO called FINCA, where women clients represent about 80-85% of total clients [9] (Gonzalez-Vega, 1995; FINCA, 1995).

Some countries also target producers for export markets. Examples include targeting of Coffee producers in El Salvador, and Tea and Vanilla producers in Uganda. Agricultural activities for food production was the lowest priority (Langa, 1996; Forster and Webster, 1995).

Micro enterprises are the primary targets of the majority of the NGO

[7] About 125,000 former soldiers, representing about 6% of the total population, entered civilian life in El Salvador after 1990 (Saavedra, 1994).

[8] It is estimated that 57% of the population in Cambodia is composed of women and approximately 35% of households are headed by widowed women (Taylor, 1994).

[9] FINCA, Foundation for International Community Assistance, is an international NGO that provides financial services in several Central American countries including El Salvador. In El Salvador, FINCA has organized several village banks using funds from UNDP/ILO/UNHCR/WHO through their PRODERE programme, and from USAID. FINCA also implements a micro enterprise credit programme using funds from USAID (FINCA, 1995).

programmes in all the four case study countries, especially after the emergency stage. NGOs generally concentrate on microenterprises due to five reasons:

1. their experience with microenterprise financing in other parts of the world,
2. microenterprises are easy to start, operate and diversify using small and short-term loans,
3. microenterprises do not require much land and therefore avoid titling issues,
4. women can be profitably employed, and
5. agricultural systems that are destroyed during the conflicts require more time to develop/reconstruct while trading enterprises flourish immediately after conflicts.

**C. Operational Methods**

The formal financial intermediaries are bureaucratic in processing of loan applications and use collateral based technology. They have nonetheless gradually moved towards deregulated interest rates and less targeting.

NGOs operate with various operational methodologies. While some use individual lending, others use solidarity groups and village banks to provide loans to their clients. Whereas some NGOs explicitly provide financial services, several combine financial services with non-financial services. The majority follow a credit only/credit first philosophy. A few NGOs have now begun to mobilize savings from the public on a more compulsory basis. Sub-sectoral and client targeting is highly prevalent. The majority subsidize the borrowers through interest rates or by provision of free or subsidized non-financial services including training and technical assistance.

The informal financial market is composed of a few trader lenders and less socially cohesive groups. But traditional group based arrangements are beginning to gain momentum as noticed in the wide use of Xitiques in Mozambique and RoSCAs in Uganda (Langa, 1996; Larson, 1993; Muscavele, 1996). The informal lenders provide small and short-term loans secured by collateral. There is, however, less documentation of and research on the informal financial markets. The linkages between informal and formal institutions are rare. Indeed, linkages are often promoted but less often implemented. Efforts are now underway to identify effective linkage mechanisms as the ones in El Salvador, Cambodia and Mozambique.

There has been less transparency in accounting, especially among the NGO programmes. Detailed documentation of the costs of providing the services has been rare. Only a few NGOs end to maintain fairly good records which are accessible for scrutiny (this includes the ACLEDA programme in Cambodia and financiera CALPIA in El Salvador). [10]

A very important component in risk management is appropriate provisions for loan losses. Several NGOs estimate their loan losses to be less than 5% of the total loan portfolio without adequate assessment of the risks of their loan portfolio. An exception is noticed in the operation of

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[10] GTZ has provided financial and technical assistance since 1988 to an independent department "Servicio Crediticio" of an NGO called Salvadorian Association of Medium and Small Enterprises (AMPES) to provide credit to small enterprises and small farmers in San Salvador. The Servicio Crediticio converted into a formal financiera in 1995 and is now called as CALPIA. The principal shareholders of CALPIA include IADB (25% shares), Banco Centroamericano de Integracion Economica-BCIE (25% shares), national NGOs (20% shares) and AMPES (30% shares). The financiera CALPIA tend to satisfy both social and profit objectives since majority of its share holders are development oriented donors. It receives technical assistance (paid by GTZ) from a German consulting firm called IPC (see Gonzalez-Vega, 1995 for more details).

financiera CALPIA in El Salvador that provisions for losses based on the riskiness of its loan portfolio measured by the age of the loan in arrears (Gonzalez-Vega, 1995). Given the risky nature of the environment, especially in the early stages of the transition, the loan loss provisioning followed by several NGOs and State banks has been inadequate. While budgetary provisions are made at the early stages of development to wipe out unrecoverable debts accumulated by the State Banks, an infusion of fresh equity is pumped into NGO programmes or allocated from the revolving fund to meet loan losses. These measures have severely undermined the sustainability of the financial programmes.

### D. Products offered

Currently, the majority of the NGOs provide small sized short-term loans in urban areas and mobilize deposits on a compulsory basis. No programme in the case study countries is observed to collect deposits on a voluntary basis in large volumes. For example, 11 NGOs in Cambodia that collect local deposits do it on a compulsory basis (Prins, 1996). On the one hand, the local investors require time to recoup their capital and gain confidence in the institutions that mobilize their deposits. On the other hand, the costs involved in collecting deposits is high and the abundant donor funds has reduced the need to mobilize local deposits to operate the programmes. While USAID assessed the demand for deposit services to be high in Mozambique (Aeschliman, 1996), some researchers concluded that the demand for savings mobilization in Cambodia has been unclear (Forster and Webster, 1995) [11].

Government and the NGOs provide only grants and concessionary credit during the emergency and early periods of transition. The credit programmes implemented by the government and donors for emergency and rehabilitation purposes in Uganda, Mozambique, and Ethiopia have been observed to be the most expensive interventions and the most difficult to manage (Colletta et al., May, 1996). Several of the NGO services are limited to urban areas where microenterprise activities are abundant. Currently, some NGOs such as ACLEDA and GRET (financed by GTZ) in Cambodia and CALPIA in El Salvador are expanding to the rural areas and providing loans to the agriculture sector.

The loan and compulsory deposit services provided by NGOs come invariably with and/or are linked to non-financial services including training, technical assistance, health and education services. The integration of financial activities with other activities vary widely. For example, there are currently 30 NGOs identified who provide financial services in Cambodia. Of them, some NGOs including CARE, UNICEF and World Relief have integrated programmes where finance is combined with education, health and agricultural training activities. Finance is used to attract clients for the other non-financial programmes. Others, such as CRS and Action Nord Sued, separate microfinance activities from their other activities. Some like ACLEDA and GRET exclusively provide financial services although ACLEDA also

[11] People in Cambodia appear to prefer saving in pigs than in livestock, jewelry or cash. It is assumed that pokers represent a good way of saving. Given the security problems, lack of trust and confidence in external agents, and live land mines, animals that can be tended to at home are preferred to animals that require large grazing areas (Taylor, 1994).

provides business development training that is closely linked to the provision of credit (Forster and Webster, 1995; Prins, 1996). It is estimated that 60% of the ACLEDA staff time and efforts were used for the training programme while only 40% were utilized for provision of financial services; the training programmes to the clients were provided free of cost and cross subsidized by financial programmes (Webster and Tucker, 1996). Such trends are also noticed in Vietnam (Abiad, 1995; CGAP, 1996) and Mozambique (Sowa, 1995). PRODERE programme implemented by UNDP/ILO/UNHCR/WHO in Central America including El Salvador uses credit along with technical assistance, health and infrastructure improvement activities as promotional instruments for employment creation (PRODERE, May 1993).

Moneylenders are now active in rural and urban credit markets but provide very small and high priced loans (up to 10-50% per month in nominal terms) with collateral. They are mostly middlemen and traders who provide access only to people operating in the market places. The informal group mechanisms have become active in mobilizing deposits and in providing loans to members on a rotating and non-rotating basis (Forster and Webster, 1995; Larson, 1994; Ijoyi, 1995; Graham et al., 1991, 1993).

**E. Terms and Conditions, and Recovery Rates**

NGO loans are usually small in size and provided as short-term loans for six months or less to finance and working capital requirements at flat monthly rates that are usually less than positive in real terms. The loans are required to be repaid through a weekly or monthly repayment cycle. Most of the interest earnings are used to cover NGO operating costs while some goes towards recapitalizing the revolving funds used as the equity capital. While tangible collateral is not necessary for several NGO loans which follow group and village banking methods, collateral is required for individual loans. Some programmes such as ACLEDA and CALPIA successfully provides individual loans based more on character and business plans than on tangible collateral (Gonzalez-Vega, 1995). In group based lending programmes members are expected to be jointly liable for losses.

NGO loans are usually made in small sizes compared to bank loans. For example, the average size of the majority of the microloans in Cambodia vary from US$30-50 per member of a solidarity group/village bank and are charged a nominal rate of 2-5% per month; average size of individual loans range from US$ 45-55. The small business loans from ACLEDA range between US$100 and $400 and are made at 10% annual nominal interest to individuals primarily on the basis of business plans and character analysis and secondarily based on collateral such as land title or property (Prins, 1996) [12]. In the absence of clear land titles and central registry for property, ACLEDA use the tax receipts as proof of land ownership (Ueda, 1995) [13]. In Uganda, the receipts obtained from the government for returning fire arms are used as proof of ex-combatant status to qualify for targeted credit (Colletta et al.,

[12] ACLEDA was the only NGO that provided small business loans in Cambodia in 1996. GRET and two other NGOs are reported to be assessing the feasibility of small business lending along with microfinance (Prins, 1996).

[13] Land is taxed in Cambodia.

June 1996). In El Salvador, the average loan size per borrower vary from a minimum of US$78-110 through the village banks run by FINCA and financed by USAID and UNDP/ILO/UNHCR/WHO to US$ 550 from financiera CALPIA to US$ 4,400 through a USAID funded NGO to US$7,800 through the Agricultural Development Bank supported primarily by the government funds. The nominal interest rates per month varied from 3 to 4% among all financial intermediaries. Seldom do the interest payments fully cover all of the operating costs and opportunity costs of the capital. Compulsory credit related training is essential prior to release of loans in certain programmes while the training is voluntary in a few NGO programmes (see later discussion).

The loan recovery rates of state banks, if reported, are very low. The self reported repayment rate in NGO programmes vary from 20-100%. Village banking schemes of ACLEDA in Cambodia reported a recovery rate of 95% (Prins, 1996). Recovery rates for all the 17 PRODERE programmes in El Salvador has been 87% in July 1995; the recovery rates for loans guaranteed by the programme has been very low (20-35%). Group loans made by the village banks organized by FINCA in El Salvador recorded a recovery rate close to 100% on par with the financiera CALPIA programme that provided individual loans (Hoyle and Letona, 1995).

### F. Minimalist vs. Maximalist approach

A minimalist approach considers that a loan by itself can create opportunities for wealth and health improvements of the clients. A maximalist approach requires technical assistance and social services to be supplied along with credit to improve wealth and health of the clients (Von Pischke, 1997).

Several NGO programmes provide training that is compulsory to obtain credit. Examples include the GTZ funded programme to assist ex-combatants and Danish supported credit programme for urban artisans in Mozambique (Sowa, 1995), and ACLEDA programme in Cambodia (Webster and Tucker, 1996). There are some programmes in Mozambique such as the credit programme to urban existing vendors supported by GTZ that do not require training as a prerequisite for credit although they offer training programmes at a very low cost (Sowa, 1995). Several programmes also provide technical assistance in production and marketing, health and education services along with credit as was discussed earlier (see Sowa, 1995; Prins, 1996).

The efficiency of providing a package of financial and non-financial services compared to exclusive financial services on client performance and repayment rates has been debatable. However, no conclusive evidence exists to suggest that a package approach is cost effective. Indeed, several of the NGO programme staff in Mozambique were observed to be inefficient in providing technical assistance and production based training to their clients and increased the operating costs of the programme (Graham and Francisco, 1993). The ambivalent objectives that promote social activities along with financial activities were observed to limit the coverage and efficiency of the microenterprise credit programme in El Salvador implemented by FINCA using USAID funds (Gonzalez-Vega, 1995). The CRS programme in El Salvador that provided individual loans, technical assistance and social services to the demobilized soldiers and ex-combatants recorded a repayment rate of less than

50% since the borrowers considered the NGO loan as a compensation for their sacrifice during the conflict and reward for participation in the training programmes (Blum, 1996). ACLEDA in Cambodia is observed to provide basic management development training to its borrowers and is considered as crucial for repayment performance, to help in familiarizing the members of the community with one another and ACLEDA staff (Webster and Tucker, 1996).

Provision of non-financial services along with rightly priced financial services as seen in Grameen Bank of Bangladesh, one of the best practices, shows that a package approach can be followed without compromising at least the operational sustainability of the institution. Non-financial services such as training on accounting and cash-flow management may be provided by these financial institutions by technical experts and not by the credit officers on at least a moderate cost covering basis.

### G. Human capital

The human capital endowment of several formal and semi-formal institutions has been poor. The staff lack training and incentives for engaging in diligent screening of applicants, monitoring of borrowers and enforcement of contracts. As a result, the portfolio efficiency affected by operating costs of the majority of NGOs has been very low. However, there are exceptions, such as the CALPIA staff in El Salvador (Gonzalez-Vega, 1995) and ACLEDA staff in Cambodia (Webster and Tucker, 1996) that have received intensive training.

One of the primary reasons for poor quality of the staff can be attributed to the lack of facilities to train the staff in modern banking techniques. Several of the staff employed by the NGOs are trained extensively in social services and therefore have limited ability to provide financial services that require a business like approach. The programme staff should develop skills in effective screening, monitoring and enforcement if they intend to transform from being agents for grant schemes to becoming self-sustaining financial intermediaries. The efforts of the ILO/UNDP assisted programme, ACLEDA, in Cambodia is worth noting: the programme invests 30% of its overall operating budget for training programme staff in servicing microfinance clients. ACLEDA management considers this as one of the keys to its success in becoming financially self-sufficient.

### H. Sustainability

Christen, Rhyne and Vogel (1995) establish sustainability as a major criteria to evaluate the success of a financial institution. There are two aspects of sustainability: (i) financial sustainability, and (ii) organizational sustainability.

1. A financially self-sustainable institution is one that is able to cover all of its operating costs and the imputed costs that are necessary to maintain the real value of its capital without subsidies. There are two hurdle points to overcome in reaching financial self-sufficiency: (1) operational self-sufficiency that requires the programme to cover all non-financial expenses (administrative costs, salaries, depreciation and loan losses) out of the programme fees and interest charges, and (2) full self-sufficiency that requires the programme revenues to cover both

non-financial and financial costs on a commercial basis so that subsidies are no longer required to operate the programme (Christen, Rhyne and Vogel (1995). Yaron (1994) developed a Subsidy Dependency Index (SDI) that provides an estimate of the subsidy a programme requires in order to earn a return equal to the opportunity cost of the capital. It denotes the percentage increase required in interest rates for the programme to break even if the subsidy is removed.
2. Organizational sustainability focuses on management, organizational structure and motivated staff to avoid collusion with programme participants (Johnson and Rogaly, 1997). The institutional sustainability concerns itself with the overall stability of the institution to survive and expand over time.

Financial programmes identified by Christen, Rhyne and Vogel (1995) as best practices from Bangladesh, Bolivia and Kenya show that financial services can be provided to the poor on a financially sustainable basis along with satisfying organizational and institutional sustainability. Gurgand, Pederson and Yaron (1994) also identified six best financial programmes in Benin, Burkina Faso, Cameroon, Malawi, Togo and Rwanda indicating that the development of sustainable financial institutions is possible even in conflict affected countries such as Rwanda [14]. The characteristics of these best practices include:
1. full coverage of operating costs,
2. certain volume of lending (scale) made at low transactions costs,
3. interest rates set to market levels and reflect risk and transaction costs,
4. mobilization of local resources and reduced dependence on donor funds,
5. dedicated, well trained and motivated staff, and
6. short small demand driven loans made on character and collateral substitutes such as joint liability of group members and are repayable in short and frequent intervals.

While full financial self-sufficiency in some programmes was reached five to seven years after the implementation of the programmes, operational self-sufficiency was achieved three to four years after several programmes were launched.

[14] The institution, Banques Populaires, in Rwanda was evaluated to be a best practice prior to 1994 when the conflicts erupted to unimaginable heights. The current situation is unknown to the author. However, Rwanda was subject to conflicts in early 1980s and this institution was built after these conflicts.

Applying the above criteria to the financial programmes identified in the case study countries reveals that no programme/institution has yet reached the stage of full financial self-sufficiency. A few programmes in Cambodia cover about 30% of operating costs while the majority cover less than 10% [15]. Some NGOs such as CARE and CRS are handing over microfinance operations to local agents to reduce costs and to encourage capacity building at local levels (Prins, 1996).

All programmes are heavily subsidy dependent and all financial activities are funded by donor grants. For example, all loans outstanding from NGOs in Cambodia at the end of 1996, estimated at about US$6.1 million, were financed by donor funds. Local deposits were collected for only $150,000 on a compulsory basis. However, given the insecurity and unstable political conditions in the country, the ability of the NGO programmes to convince their clients to make deposits is limited and grows only with repeated transactions. Mobilizing deposits to decrease donor dependency increases with growing trust in the country's stability and in the financial soundness of the financial institution.

There are some programmes that have the potential to reach operational self-sufficiency in near future. Sowa (1995) identifies the Save the Children Micro Credit Programme in West Bank and Gaza as a potential candidate for reaching operational self-sustainability in the near future. The NGO, ACLEDA, supported by UNDP and ILO qualifies based on future projections is likely to reach and sustain financial self-sufficiency. The operational efficiency indicator for ACLEDA has increased from 6.6% in 1993 to 40% in 1995 (Webster and Tucker, 1996). Only one NGO programme in El Salvador, CALPIA, appears to be nearing full self-sufficiency. The SDI, without accounting for the technical assistance from IPC, was calculated to be around 15.2% in 1994 and was expected to reduce further by 1995 [16]. In contrast the microenterprise credit programme implemented by an international NGO, FINCA, and financed by USAID registered a SDI of 130% in 1994 (Gonzalez-Vega, 1995).

The programmes should strive at least to be operationally self-sustainable and cover the major portion of their administrative costs and anticipated loan losses. Donor subsidies can be used for capacity building at all post-conflict transition stages. However, use of donor subsidies to continuously cover loan losses and operating costs will undermine the financial markets. The decision of UNDP/ILO/UNHCR/WHO to stop subsidizing the operating costs of their NGO partners in Cambodia and Central America after 1997, and the efforts of GTZ in providing technical assistance through IPC for capacity building rather than subsidizing the operating costs of its NGO affiliates are policies in the right direction.

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[15] The administrative costs are high for NGOs providing financial services in post conflict countries since dealing in a new area and with a new set of clients applying a new set of methodology that are different from emergency relief measures involve high fixed and operating costs. Also costs of reaching remote parts planted with land mines is very high. However, it is difficult to charge an interest rate high enough to cover all these costs and record a high recovery rate at the early stages of transition.

[16] SDI closer to zero indicates that the institution is able to cover all operating and majority opportunity costs of capital with the interest payments.

Organizational sustainability is also generally weak among the financial programmes identified in the case study countries. However, the quality of staff and their dedication to the programme has been evaluated to be high for CALPIA in El Salvador (Gonzalez-Vega, 1995) and ACLEDA in Cambodia (Webster and Tucker, 1996).

Institutional sustainability that refers to the ability of the institution to adjust its design and methodologies has been generally weak but some programmes are flexible allowing for learning by doing. For example, the village banks formed by ACLEDA in Cambodia expanded rapidly in 1994 but stopped after 1995 when the demand for village banks was found to be low. People lacked trust in the community and peer monitoring essential in these group programmes was considered synonymous with the conditions that prevailed during the conflicts that required spying on their neighbors [17]. Moreover, some people dropped out of village banks for not wanting to be liable for another person's loan especially in areas that are resettled by returnees who lack a strong community bondage. The PRODERE programmes implemented by UNDP/ILO/UNHCR/WHO through several financial intermediary affiliates in Central America are judged to be flexible for replication (ARIAS, 1995) and have been replicated with some modifications in Cambodia. The CALPIA programme in El Salvador is a successful replication of several of the financial institutions designed by IPC through GTZ funding in Latin America.

**I. Outreach**

Another major criteria which measures the success of a financial institution is growth in the number of clients served through quality services. Growth implies outreach (Yaron, 1994) and also sustainability of financial institutions since services are demanded only from viable institutions (Gonzalez-Vega, 1996).

The programmes examined in the case study countries reach the targeted population but the scale has been very small. For example, only 12-15% of the rural population in El Salvador had access to financial services from any source (Blum, 1996); the 30 NGOs in Cambodia could cover only 2.4% of their targeted population (Forster and Webster, 1995; Prins, 1996); the formal financial institutions in Mozambique could cover only 4% of the total targeted population (Sowa, 1995). The Development banks have the potential for a larger outreach due to nation wide branch networks but majority of branches are reported to be dysfunctional as assessed in Mozambique by Graham and Fraciso (1993). The quality of services are not high and are observed to have high transactions costs.

The number of repeat borrowers have been low in several of the programmes. For example, people dropped out of village banks in Vietnam after the second or third loan cycle and did not increase their demand for a larger loan size as they progressed in their loan cycles (Abiad, 1995). Microentrepreneurs in Cambodia were observed to lack the will to expand their activities after they have reached a

[17] During conflicts, family members were made to inform on each other and children were made to disown their parents. As a result, the current society's trust in their neighbors and desire to cooperate with them has declined (Taylor, 1994).

survival stage. By the seventh loan cycle, they reached their satisfaction level and dropped out. Most of them did not graduate from the survival strategy level. Some, however, successfully graduated from receiving micro loans to small ones that are no longer secured by the peer pressure of solidarity groups, but are individual loans.

Programmes in their early stages may face a tradeoff between outreach and sustainability. For example, the CALPIA programme in El Salvador reached 6,300 clients while the village banks run by FINCA reached about 24,600 clients by 1994. However, CALPIA provided larger loan sizes with much less donor dependence to a steadily growing number of clients compared to FINCA. Sustainability today ensures outreach tomorrow (Gonzalez-Vega, 1997) and therefore programmes should endeavor to reach sustainability while increasing their outreach. Wide and deep outreach compromised by low levels of self-sufficiency should be avoided. The decision of ACLEDA to limit its services only to self-employed entrepreneurial poor and low income earning population to improve programme viability rather than to reach a larger clientele including the poorest of the poor who have no income earning opportunity is a step in the right direction.

**J. Special mechanisms used**

The financial intermediaries used several special mechanisms to enhance the provision of financial services to the target clientele.

Credit guarantee programmes are widely used to entice reluctant lenders to extend credit to risky clientele. The credit guarantee programme in Mozambique, the Guarantee and Co-Participation Funds implemented by the Cabinet for Promotion of Small Enterprises, was considered a failure in terms of its outreach and its sustainability. By October of 1995, only seven projects were guaranteed even though a total of 62 projects were evaluated to be eligible for guaranteed loans from the Development Bank. The volume of funds utilized for guarantee was very minimal since the fund was decapitalized due to high operating costs (FDC, 1996). The government guarantee programmes in Uganda (Meyer and Nagarajan, 1996) and PRODERE organized guarantee programmes in El Salvador were also evaluated to be failures due to their very low outreach (Gonzalez-Vega, 1995; Danby, 1995).

The experience with credit guarantee programmes even in normal countries has been negative. Meyer and Nagarajan (1996 and 1997) evaluated several credit guarantee programmes in normal developing countries and concluded that the guarantee programmes were not cost effective and did not satisfy the intended objective of increased loans to the targeted clientele. Several programmes in Latin America have also been less successful in their outreach and in their ability to be sustainable without subsidies (see the collection of papers in The Financier, 1997). The reasons for failure of guarantee programmes are due in part to the inability of the guarantee programmes to deal with double moral hazard and double adverse selection problems that increases the risk and administrative costs of the programmes rendering them unsustainable (see Meyer and Nagarajan, 1996 for more details).

Second tier organizations such as revolving/rotating funds are used extensively by donors to capitalize their NGO affiliates. In Mozambique, there was no adequate policy to assure the recapitalization and preservation of revolving funds from depreciation.  The funds rapidly eroded in real terms affecting the flow of funds to the intended credit projects (FDC, 1996).  The experience has also been less than positive in El Salvador (Gonzalez-Vega, 1995).  The majority of funds revolved just once.

Credit unions are non-existent to being in an experimental stage in the case study countries [18].  The credit unions associated with the cooperative sector in El Salvador are inefficient and are slowly recovering (Gonzalez-Vega, 1995). The USAID is currently facilitating the credit union movement in Mozambique since the demand for deposit services has been assessed as high in the USAID project areas [19]. The credit unions have been designed to closely dovetail the existing credit and savings programmes in the region.  Credit union development in a country is a decade long exercise and needs technical assistance on a declining basis for that long period.  This requires consistent donor support in the form of capacity building [20] (Aeschliman, 1996).

Village banks and solidarity groups are popular types of institutional modes used by the NGOs [21].  The village banks in Mozambique are mostly indigenous activities and register a very low volume of business.  They collect short-term deposits that pay no interest and provide short-term emergency loans at concessionary rates.  They record high recovery rates and incur very low costs of operation.  Women are the preferred clientele in these banks (Le Brun, 1994; Sowa, 1995).

Village banks are also organized by ACLEDA in Cambodia using funds from UNDP/ILO, FINCA using funds from UNDP/ILO/UNHCR/WHO and USAID in El Salvador, several other donor funded NGO initiates including CRS in El Salvador and world Relief in Mozambique.  The village banking experience of ACLEDA in Cambodia has not been good.  ACLEDA expanded up to 15 banks but abandoned the expansion in 1995 due to the following: costs of forming village banks were very high compared to those of solidarity groups since they were labor intensive, and

[18] There are no credit unions in Cambodia yet (Prins, 1996).

[19] Success rate of credit unions in Lusophone countries has been minimal so far (Aeschliman, 1996).

[20] Credit unions similar to that of World Council of Credit Unions (WOCCU) that stimulate membership and savings growth, safe and sound management practices and policies including the use of market interest rates, adequate reserves and the use of professional management may be tried during the development stage of a post conflict country.  These credit unions are self-regulatory and may therefore fill the gap in financial markets while the capacity to regulate and supervise NGOs by a central agency develops.

[21] In solidarity groups, about 4-5 members join together and assume joint liability for each others loans.  Five or more groups join to form a village bank with about 20-100 members.  The village bank members elect their committee and the NGO provides seed capital in the form of a revolving fund to the village bank that manages the fund by making and collecting on loans to its members.  All managerial activities are decentralized at the village bank level.  The members with a good record are expected to graduate through increasing level of loans in subsequent cycles.

clients were interested in managing their own credit rather than in the management of a bank and had less trust in a large group made of unknown members (Webster and Tucker, 1996). The village banks organized by FINCA were successful in reaching a large number of clients and in recovering loans in El Salvador but required heavy subsidization of their costs (Gonzalez-Vega, 1995).

Cantinas are popular informal institutions found in Mozambique that provide financial services. These are general stores or retail shops where the farmers can obtain cash and in-kind credit with a promise to repay with products at harvest time (a product-credit linked contract). The cantinas are outlets for credit and output, and are important information centers in the village. By 1995, 8,500 cantinas (accounting for about 68% of pre-conflict period cantinas that survived the plundering/destruction during the conflicts) operated in rural Mozambique serving an average of 1,600 clients each. Linkage experiments are now underway to use the cantinas as agents to supply short-term bank loans in rural areas (Le Brun, 1994; Muscavele, 1996).

In addition, trust funds, cofinanciers and financieras are used by international donors as affiliating institutions to provide financial services primarily in Central American countries. Financieras are savings and loan banks allowed to lend to a broader set of clients and to mobilize time deposits [22].

## V. Preliminary Lessons learnt

Designing and operating financial institutions in post-conflict countries is an emerging issue. The following is a summary of the several preliminary lessons learnt from the experiences in Cambodia, El Salvador, Mozambique and Uganda in developing financial institutions in a post-conflict environment.

### A. Conditions for Developing Financial Institutions in Post-Conflict Countries

*The enabling environment that facilitates microfinance to promote economic growth and employment is unlikely to be present in countries emerging from armed conflicts:* The ideal conditions for development of efficient financial institutions include the following: A stable and well committed government to govern a civil society; a less suppressed financial sector that can encourage private sector investments and employment generation; financial intermediaries with long-term objectives to maximize their client reach in a sustainable way without undermining the financial market; well coordinated donors' efforts for capacity building without undermining the spontaneous financial market development; and efforts of the community to strengthen social, physical and financial capital through cooperative efforts and to avoid a donor dependency syndrome.

*Financial sector reforms closely dovetailed with real sector reforms appear to be effective in building potentially viable financial institutions.* The positive results of well implemented financial and real sector reforms on financial markets and private sector is observed in Cambodia, Vietnam and Lebanon. These experiences show

[22] See PRODERE (1993) for guidelines for use of finacieras, trust funds and cofinaciers by PRODERE programmes in Central America.

that the economy may first be stabilized through flexible exchange rates and by increasing interest rates to reflect inflation and, secondly by placing emphasis on rebuilding the banking system, encouraging the use of domestic currency, and by avoiding massive build up of non-performing loans and debt forgiveness. Encouraging competition and formation of a strong regulatory and supervisory unit appear to be very effective.

*Coordination among the key players is crucial to arrive at an agreement in the approaches followed in providing financial services. Several financial programmes in post-conflict countries have been observed to suffer from uncoordinated donor activities.* Coordinated donors' efforts are paramount for successful development of financial institutions since they avoid unhealthy competition that undermines the market and waste of resources through duplication of efforts. Coordination is important among donors, between donors and government, and between donors and local/traditional organizations. The success of some of the programmes in El Salvador can be attributed in part to the improved coordination among several donor agencies and local organizations. It is important to examine the reasons behind the failure of the Credit Committee for Rural Development (CCRD) created in 1995 in Cambodia to coordinate all the financial programmes to improve sustainability (see Forster and Webster, 1995 for more details on CCRD). Coordination should not, however, curtail the freedom of the coordinating agents from experimenting with different micro-finance approaches to better serve their clientele.

*Developing financially sustainable institutions in post-conflict countries is possible but may take longer time and efforts compared to normal developing countries.* Currently, there are a few programmes identified in Cambodia and El Salvador that are likely to reach operational self-sufficiency. It is to be noted that operational sustainability was possible nearly after about five years since the launching of the programme, only a little longer than that observed among best practices in normal developing countries. There are only a few programmes identified as sustainable even in normal developing countries.

## B. Design of Financial Institutions in Post-conflict Countries

*Emergency relief programmes may involve minimal financial assistance to avoid creating a donor dependency syndrome.* Emergency programmes, often provided by government and NGOs, may involve a minimal financial assistance package and simple delivery through decentralized institutions which build on existing social capital and local organizations and which do not create a donor dependency syndrome. Several programmes tend to develop a dependency syndrome as noticed in Uganda, Ethiopia, El Salvador and Nicaragua. The donor grants and concessionary credits provided at the emergency stage were not repaid since they were considered as a reward for the suffering during the conflicts. However, efforts for capacity building to actively provide financial services may begin at the emergency stage.

*Institutions with potential to reach operational self-sufficiency were launched at small levels at the early transition stage and later expanded.* Examples of ACLEDA and GRET in Cambodia, and CALPIA in EL Salvador show that these programmes started small during the early phase of the transition from conflict to development and are now expanding thanks to consistent donors' support for building equity capital, capacity building and for covering majority of operating costs. They are flexible programmes that tend to learn by doing and have a dedicated and well trained staff who are motivated by appropriate staff incentives. Lending activities are less targeted and carried out at non-subsidized interest rates. Outreach has been small but growing steadily.

***Institutions that have potential to reach sustainability were launched with a financial technology that is simple and with products for which there was a high demand.*** The examples of ACLEDA and CALPIA shows that programmes that started with simple financial technologies designed through preliminary market analysis and discussion with local community leaders can grow and attain sustainability. Conducting regular market surveys were helpful in tailoring their products to meet the demand. These programmes were designed to meet the demand rather than with a supply leading principle.

*Information and collateral based lending technologies generally used in normal developing countries may not be suitable for post-conflict countries at their early stages of transition.* The information flows are highly disrupted and physical assets that can be used as collateral are depleted or destroyed in countries emerging from conflicts. Therefore, financial intermediaries need to develop innovative lending technologies based on collateral substitutes. Group based lending technologies successfully used in normal developing countries may not be effective in post-conflict countries until they reach a stage where reconciliation among the community members is possible. The problems faced by the village banks in their expansion in Cambodia show that trust and confidence essential for group based technologies takes time to develop/restore in post-conflict countries.

*Moderate success with the use of collateral and information substitutes are observed.* Use of local religious leaders and support groups such as veterans association to guarantee loans have been used with some success in Uganda (Colletta, June 1996). CALPIA in El Salvador has effectively used business plans and character references to substitute for collateral (Gonzalez-Vega, 1995). Receipts issued for return of fire arms are used in Uganda to verify the ex-combatant status of the applicants for loans under the ex-combatant targeted credit programme (Colletta, June 1996) and receipts issued for land taxes are used by ACLEDA in Cambodia to verify the property titles of loan applicants (Webster and Tucker, 1996).

*Deposit mobilization from the public by NGOs may not be attempted until the country has stabilized peace and has established regulatory guidelines for non-bank intermediaries.* It is important for the NGOs to mobilize local resources to reduce their dependence on donor funds and to increase their equity base. But savings mobilization is extremely difficult in conflict affected countries due to reasons such as lack of trust, unstable monetary environment, and a prohibitive legal and regulatory environment. It is important for the NGOs to prove that they are responsible in handling other people's money before going into the local deposit mobilization drive. In addition, they should be able to make profits that indicate that they are strong enough to absorb the commercial costs of operation and funds without decapitalizing. Furthermore, a strong central regulatory and supervisory agency that can detect fraudulent practices and punish illegal practitioners needs to be in place. There is also a need for a favorable legal and regulatory environment for micro-finance institutions that provide deposit services. Donor assistance can be focused in this area.

*Mechanisms such as credit guarantee programmes and revolving funds have been ineffective until now.* The credit guarantee programmes have been very expensive and unsustainable without subsidies and have been less successful in their outreach. The prerequisites for effective functioning of guarantee systems include macroeconomic stability, adequate regulatory and legal framework, generation of benefits higher than costs, and restraints on public sector intervention into the financial markets (Llisterri, 1997). These conditions have not yet been met in post-conflict countries. Nonetheless, guarantee programmes and revolving funds are less successful even in several normal developing countries suggesting that such mechanisms implemented in the current format may not be suitable for a developing country, whether conflict affected or not.

*Training and technical assistance programmes cross subsidized by financial programmes may increase costs of the operation with no consequential improvement in effectiveness of the financial services.* Evidence from programmes such as CALPIA in El Salvador and ACLEDA in Cambodia shows that programmes that provide exclusive financial services are as effective as programmes that provide loans and compulsory credit related training. Financial programmes combining only minimum non-financial with financial services are more likely to attain self-sufficiency than programmes that provide an integrated assistance package to micro and small entrepreneurs.

*If training programmes are offered by NGOs offering financial services, they should be demand driven, provided on a cost covering basis and preferably provided separately from financial services.* In Ethiopia, training in tailoring by a NGO financed by GTZ was less successful since the market was already saturated with tailors while training in construction was in high demand (Colletta et al., May, 1996). Training provided free of cost along with loans in El Salvador was less effective in increasing loan repayment since loans were considered as payment for the participation in the training programmes (Blum, 1996).

## C. Donor Initiatives in Post-Conflict Countries

*Donor grants may be essential for capacity building of NGOs who provide financial services.* Appropriate uses of donor subsidy/grants to NGOs may include institutional development at all stages of the institution's life. Microfinance institutions are site-specific and their design is often influenced by the local culture. Therefore, donor assistance may be required in developing local capacity and microfinance intermediaries that reflect local culture. This may involve more donor time, money and efforts compared to normal countries. Therefore, donor support for capacity building through developing the capacity of national project teams may probably be justified for a longer time compared to normal developing countries.

*Donor grants may be essential for initial capitalization of NGOs providing* *financial services but continued capitalization may create a donor dependency syndrome on and may reduce NGO efforts to mobilize local resources.* Donor grants may be essential for initial capitalization to build equity base that can be used to generate investment income, build loan portfolio and leverage funds from local banks. However, continued capitalization may undermine the efforts of the NGO to mobilize local deposits to increase the capital base. Several countries prohibit NGOs from mobilizing deposits from the public due to a lack of deposit insurance and weak prudential regulations. Donors may help develop a favorable environment for microfinance services including deposit services by the NGOs through drafting of regulatory and supervisory guidelines for the deposit taking NGOs. Furthermore, donors may encourage the NGOs to leverage funds from local banks.

*Donor grants without a clear exit option for subsidizing NGO operating costs are likely to be less effective in developing viable financial institutions.* Coverage of all the operating costs may be difficult at the very initial stages of a financial institution and therefore may require some donor subsidization. Donor commitments to subsidize some of the initial operating costs of their NGO affiliates may be made with a well specified exit option. But donors should not subsidize loan losses and donors may encourage their NGO affiliates to fully cover their operating costs and loan losses. Donor assistance with such characteristics appear to be successful in developing potentially viable financial institutions.

*Appropriate uses of loans from donors to NGOs should be based on their current performance and future projections.* Loans can be made on a concessionary basis to start-up NGOs to help them build their equity base but insistence on their raising capital from local sources including the public and local banks is necessary. Donors should avoid undermining local savings mobilization efforts through their cheap loans to both start-up and established NGOs. The donors need to be careful not to burden new NGOs with foreign exchange risks through loans made in hard currencies.

## D. Challenges Ahead for Newly Emerging Countries from Conflicts

*There is no blue prints available that can be replicated in countries emerging from conflicts.* But broad implications for newly emerging countries from conflicts can be derived from the above analysis. *First,* efforts should be made to avoid recurrence of conflict and resurgence of opportunistic behavior (as happened in Rwanda and Angola) in order to restore peace, stability, safety and investor confidence. ***Second***, quick and well committed transition from conflict avoids donor fatigue and produces good effects. However, efforts should be taken to avoid overheating of the economy with very rapid and uncoordinated economic and financial reforms. *Third,* patient, continued and committed efforts by donors and stable governments is a necessary condition for restoring investor confidence, trust and confidence of the public in the society and institutions. *Fourth,* donors need to be careful to avoid creating a dependency syndrome through provision of grants and cheap credit. Exit options need to be specified from the start. *Fifth,* improved coordination among the donors, government and local populations need to be sought right from the inception of a finance related programme. Attempts may be made to develop institutions in a small way with local initiatives and participation and later graduate it to higher levels. Local economic development has proven to be most effective in conflict-affected countries for economic, social and political considerations. *Sixth,* financial products that are demanded and ensure economies of scope and scale need to be considered right from the inception of the financial programme. Financial institutions may try to achieve the twin objectives of outreach and sustainability without satisfying sustainability. Sustainability ensures outreach of tomorrow. *Seventh*, best and worst practices, especially from conflict affected countries need to be examined carefully before they are replicated/adapted in other post-conflict countries.

## VI. Policy Implications for the Government, Donors and Financial Intermediaries

There are several issues of interest to policy makers, donors, and financial intermediaries in post-conflict countries. They include: what is the role of the government and donors in developing financial markets and what are the most appropriate direct and indirect intervention methods? What measures are required to create a conducive environment for efficient financial intermediation and how to build viable financial institutions? This paper does not attempt to address all of the above issues. But, broad based policy implications can be derived from this study for government, donors and financial intermediaries in post-conflict countries.

### A. Role of the Government

The primary role of the government right from the emergency phase is to create an environment favorable for the development of institutions which facilitate efficient transactions. In order to create a favorable environment for institutional growth, the government should implement macro stabilization policies by reducing inflation rate, stabilizing exchange rates to improve investor confidence, and stabilize peace through reconciliation to recuperate the social capital. Barriers for financial intermediation such as interest rate ceilings and mandatory targeting need to be removed followed by policies to promote effective private financial intermediation including the development of asset registry to perfect collateral and of judicial systems to legally enforce contracts. Investments to improve infrastructure and support institutions are also necessary.

The government may engage in direct intervention in financial markets only to supplement provision of financial services in terms of regulation and supervision of financial intermediaries. Debt right-off and infusion of funds into non-performing state banks through soft-budget constraints should be avoided at all transition stages of a post-conflict country. Private credit information bureaus may be encouraged to emerge to collect information that can be accessed by the financial intermediaries to screen loan applicants.

### B. Role of the Donors

The role of the donors and NGOs is more prominent in a post-conflict country compared to a normal developing country. NGOs are active during the conflict and continue to be active in post-conflict stages in providing social services and in helping to build capacity. Several of the donor supported NGOs in the post-conflict countries make the transition from providing emergency services to offering financial services. Often, they are the only type of agents able to provide financial services in the early stages of a country emerging from conflict.

Financial services should be accessible for all clients in a post-conflict country since the destruction of physical, financial and social capital is widespread. While targeting a specific population may be important for social services, it may not be recommended for financial services. Limited targeting of a specific group such as ex-combatants implemented to stabilize peace must have clear exit options and should not undermine financial markets or disrupt the reconciliation process. Whereas donor subsidies are essential for capacity building in a post-conflict country, they may not be used to cover the NGO loan losses and to subsidize borrower interest rates.

Combining financial and non-financial services may be attempted only when scale and scope economies can be realized. At the least, non-financial programmes may not jeopardize the financial programme in terms of increased staff time and financial costs. NGOs may offer business training especially in book keeping and cash flow management at a reasonable cost to their clients until sufficient supportive institutions emerge. But the services may not be provided free of cost or cross subsidized by the financial programme. NGOs providing financial services should definitely avoid combining non-financial services such as provision of health and educational services under the same programme; such services need to be clearly separated from the financial activities.

It is important for donors to insist on maintenance of clear and transparent accounts by the NGOs supported by them. The NGOs must be made accountable for the funds received by them and may be evaluated based on their current performance and future projections. This is very crucial for NGOs providing financial services since it improves their prudential responsibility which is important when mobilizing local deposits to make loans. The NGOs may be encouraged to provide services on a sustainable basis with a business like manner. Development of donor dependency syndrome at NGO and client levels should be avoided. Donors may help NGOs in experimenting with use of special loan officers trained at dealing with the psychological behavior of special clients such as ex-combatants and refugees who have suffered war related trauma to speed up the reconciliation process and improve loan repayment.

The international donors are at an unique advantage in obtaining information on best and worst financial practices in various countries. They may disseminate information on best practices to their affiliates in the country.

The most important implication for donors is to improve coordination among themselves and between the government and local organizations and indigenous financial mechanisms so that they do not undermine the financial market. Donor coordination may facilitate financial market development in at least three ways: (i) sharing information about their clients, (ii) avoiding duplication of services, and (iii) devising mechanisms to provide services efficiently. However, donor coordination may not lead to a collusive behavior and oligopolistic markets, and inhibit the coordinating members from being competitive and from experimenting with new ideas to improve their services.

### C. Role of the Financial Intermediaries

The financial intermediaries, including formal, semi-formal and informal ones, need to be cautious in designing their programmes to avoid undermining of financial markets with cheap credit and ad-hoc methodologies.

The objective of the intermediaries needs to be attaining maximum outreach on a sustainable basis. The mechanisms followed to reach the objective may vary from group to individual technology, from credit first/only to credit and savings technology, and from collateral based to information and character based technology. But the mechanism should involve minimum transaction costs to the borrower and the financial intermediary.

The intermediaries need to be adept and innovative so that designs and products can be adopted to suit the demand. They should strive hard to improve their portfolio quality and to move towards financial independence by reducing their dependence on donor grants and subsidies.

## VII. Research Areas

There are several areas of interest to researchers and policy makers in conflict affected countries including the following:

**Normal vs. Post-conflict countries**: How important are the macro, meso and micro environment of post- conflict countries in influencing financial market development compared to normal developing countries and how can the environment be used to the advantage of post-conflict countries? Comparisons regarding the environment need to be made with normal developing countries to devise strategies to adopt or adapt successful methodologies from normal developing countries into post-conflict countries. For example, issues in bank privatization, guidelines for prudential regulation and supervision and standards for evaluating financial performance of financial institutions are important areas where research still needs to be carried out.

**Financial intermediaries**: Role of informal financial arrangements and services provided by them; Feasibility of credit unions; Feasibility of second-tier organizations.

**Role of alternative financial technologies and instruments**: Role of venture capital; Role of leasing options; Use of collateral vs. information intensive technologies; Effect of group vs. individual lending technologies and methods of group formation; Maximalist vs. minimalist methodologies; Rural and urban financing methodologies; Enterprise and agriculture financing methods; Long and short-term financing methods.

**Role of local initiatives**: The role of local deposits, and local human and physical capital can be explored in capacity building and sustainability of the institutions. Feasibility of client involvement in decision making and client owned financial institutions can be assessed.

**Costs and Demand for financial services**: Transactions costs of financial intermediation; Demand assessment for financial products and design; Supply of and demand for financial services by small and microenterprises; Importance of finance for firm survival and growth.

**Role of support institutions**: Role of bankers association and NGO forum; Developing secondary markets for securitization; Tracking system to identify best and worst practices (institutions and products); Credit information bureaus; Business development and counseling centers; Coordinating agency to coordinate agents providing financial services; Regulation and supervision unit.

**Role of macroeconomic conditions**: remittances and reverse capital and human flight; Effects of de-dollarization; Sequencing of reforms; Human capital formation; Privatization and private sector growth.

**Role of policies**: Role of subsidies, targeting and grants by governments and donors in financial market development, and role of microfinance as a safety net mechanism in a post-conflict country compared to normal developing countries; Policies to integrate the objectives of economic development and reconciliation to achieve peace and establish a civil society.

**Framework**: A comprehensive framework to examine post-conflict countries needs to be developed to help donors design and sequence/time their assistance in building institutions.

Continued research in the above areas will help widen the knowledge on the evolution of financial markets in post-conflict countries shaped by the changing socio-economic and political processes since the conflicts.

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**Table 1: Transition from Conflict to Development: Activities, Participants and Characteristics of Financial Services**

| Transition Stages | Activities | Major actors | Characteristics of financial services |
|---|---|---|---|
| **1. Emergency stage** | Relief aid (food and medicine); Basic supplies (water and clothes); Peace keeping | United Nations; Red Cross; NGOs; Peace Keeping Force; Limited informal lenders. | Relief grants with social goals aimed to reach entire population. |
| **2. Rehabilitation and Peace and Reconciliation and Early developing stage.** | Demobilization of army; disarming of insurgent groups and ex-combatants; continued relief services and peace keeping to an extent; reintegration of demobilized soldiers, ex-combatants, and displaced persons into civil society through reconciliation; establish a working political structure and justice. Increased investments in infrastructure,institutions,productive activities that generate income and employment, research, education, technology and development, public and private banking by primarily the government and secondarily by private sector and foreign investors. | NGOs; Local and national government welfare agencies; State banks and emergence of private banks; Limited informal lenders; Emergence of financial sector supervisory and regulatory unit. | Grants and concessionary credit for employment generation, primary education, training and skill development, poverty alleviation, building infrastructure and local institutions; establish social safety nets; formal banks inefficient; uncoordinated and heterogenous NGO financial activities combined with non-financial activities; cheap credit to targeted population such as women and poor; informal financial agents are active and provide small, short-term loans. |
| **3. Matured developing stage, developed stage.** | Increased foreign and private sector investment in support services including infrastructure, institutions, education, research and development, technology transfer, private banking and insurance industry. | Multiple agents: NGOs; Government; Public and private banks; Informal lenders; Financial sector supervisory and regulatory unit; Coordination unit; Credit bureaus; Strong private sector. | Multiple credit agents; Move toward market oriented and less suppressed financial markets; Less targeting; Innovative programmes and products are introduced; Institutional sustainability insisted upon; Informal financial agents are active and linked with formal agents; Improved formal-semi-formal and informal linkages; Less market fragmentation; Voluntary savings mobilized. |

## List of Acronyms

| | |
|---|---|
| ACLEDA | Association of Cambodian Local Economic Development Agencies |
| BPD | Banco Popular de Desenvolvimento (Development Bank in Mozambique) |
| CALPIA | Financiera in El Salvador which was previously called Servicio Crediticio - Association de Medianos y Pequenos Empresarios Salvadorenes (AMPES-SC) |
| CEE | Central and Eastern Europe |
| CERUDEB | Centenary Rural Development Bank |
| CGAP | Consultative Group to Assist the Poorest |
| CRS | Catholic Relief Services |
| FINCA | Foundation for International Community Assistance |
| GRET | Group de Recherche et d'Exchanges Technologiques |
| GTZ | German Agency for Technical Cooperation |
| IADB | InterAmerican Development Bank |
| IFAD | International Fund for Agricultural Development |
| ILO | International Labour Office |
| IPC | Interdisziplinare Projekt Consult |
| LEDA | Local Economic Development Agency |
| NGO | Non-Governmental Organization |
| PRODERE | Programmea de Desarrollo para Desplazados, Refugiados y Repatriados en Centroamerica (Development Programme for Displaced Persons, Refugees and Returnees in Central America) |
| RoSCA | Rotating Savings and Credit Associations |
| SDI | Subsidy Dependency Index |
| UNHCR | Office of the United Nations High Commissioner for Refugees |
| UNDP | United Nations Development Programme |
| UNICEF | United Nations Children's Fund |
| UNRISD | United Nations Research Institute for Social Development |
| USAID | United States Agency for International Development |
| WHO | World Health Organization |
| WOCCU | World Council of Credit Unions |