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SMARTLESSONS

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FRONTIER FINANCE – MICROFINANCE AS A PRUDENT FIRST INTERVENTION IN POST–CONFLICT COUNTRIES

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While there is growing support for microfinance globally, the unmet demand remains enormous - particularly in Africa, and especially in post-conflict and frontier countries. In Liberia, Sierra Leone, the Central African Republic and the Democratic Republic of Congo (DRC), less than 1 percent of the population has access to a bank account. Yet as these countries continue to stabilize, the demand for secure financial services is exploding. The post-conflict nature of these countries magnifies the need for microfinance services, as micro and small enterprises (MSEs) operating at a subsistence level are often the only surviving businesses after a conflict.

Background: The access to finance problem in Africa is multidimensional. One dimension of the problem is physical access: bank branch networks in Africa are generally small and concentrated in urban areas. The global average outside of Sub-Saharan Africa is one branch for every 6,500 persons, while it is one branch per 40,000 persons in 35 Sub-Saharan countries. In Liberia and the DRC, there is one branch per 200,000 and 1.8 million persons, respectively. The spatial density of the branch network in Sub-Saharan Africa is similarly limited, with only six branches per 1,000 square kilometers compared, with 34 for countries outside of Sub-Saharan Africa.[1]

Access to Financial Services in 35 Countries in Sub-Saharan Africa

	Population with Formal Bank Accounts (%)	Branches per 1,000,000 Inhabitants	Branches per 1,000 sq. km.
Sub-Saharan Africa	12.6	2.6	4.3
Low-Income Countries	7	1.2	1.1
Middle-Income Countries	25.3	5.6	11.4
Without South Africa	21.9	5.6	12.4

Another dimension of the problem is the type and range of financial services provided to poor populations. Data from Sub-Saharan Africa are sobering: Household surveys show that in 29 countries for which data are available, only 11 percent of households had access to savings accounts, compared with 25 percent in other low- and middle-income countries and 90 percent in industrial countries. In Liberia less than 1 percent of the population has access to deposit accounts, while in the DRC the number is less than 0.5 percent. Not surprisingly, access to credit is even more limited.

IFC's Response: The Microfinance Program for Africa aims to increase the number of commercially viable microfinance institutions in the region, with a focus on frontier and post-conflict countries. This is achieved by working with sponsors that have demonstrated expertise in managing microfinance institutions (MFIs) in frontier markets. Key elements of the program include: (i) focusing on greenfielding new MFIs with a strong commercial orientation, targeting sustainability in three to five years; (ii) designing strategic IFC lead projects for appropriate early engagement in frontier countries; (iii) engaging with government and a broad range of stakeholders in the design of a project; (iv) leveraging advisory funding to make an early stage venture bankable in the medium term.

[1] IMF, Regional Economic Outlook Sub-Saharan Africa, May 2006.

MICROFINANCE LESSONS LEARNED in POST-CONFLICT AFRICA

Designing appropriate first response interventions requires early IFC engagement. *In IFC's Africa microfinance program, the responsibility for early stage project development and scoping is often spearheaded by sponsors and technical partners who propose projects to IFC for funding. However, in frontier and post-conflict countries, where IFC has a strategic priority, the responsibility for early stage project development shifts to IFC. For the Africa microfinance program, the availability of early stage funds from FMTAAS[2] strategic initiative funding was key in supporting our ability to mold a project in the earliest stages of development.*

In the aftermath of an armed conflict, the obvious temptation is to follow the "wait and see" approach before entering an uncertain market. While a level of stability and certainty is clearly necessary for a viable intervention, waiting too long to act can be a distinct disadvantage later on.

In October 2006, when IFC first decided to intervene in Liberia, the standard calls for information were made to partners internally at the Consultative Group to Assist the Poor (CGAP) and the larger World Bank Group, as well as externally to partners working in other microfinance projects on the continent. The responses were almost unanimous – no one really knew the situation on the ground, and the only formal study that even partially focused on microfinance had been done by the UN well over a year before. With strategic initiative funding from the Africa region, the microfinance team fielded one of the first IFC missions to Liberia to draft a feasibility study. This early mission provided information about the market, costs, security, and the degree to which the economy was changing; providing information necessary for IFC to engage with potential co-investors and sponsors on a substantive level.

Acting early can preempt the proliferation of poor practices and also provide significant first-mover advantages. These include the opportunity to shape the sector with appropriate best practice demonstration models and build a strong relationship with key stakeholders. In Liberia, IFC entered the sector in October 2006 when conventional wisdom held that the market was far from ripe for a greenfield commercial microfinance bank. In fact, one of the largest UN military peacekeeping forces in the world was still on the ground during IFC's feasibility study mission. However, IFC's early-stage work with the Central Bank of Liberia (CBL) and the government to build confidence and establish the appropriate regulatory and supervisory framework were ultimately crucial in the CBL's acceptance of the license application and laid the groundwork for a vibrant and sustainable microfinance sector. In fact, by the time AccessBank Liberia's license application was submitted in early 2008, a provisional license had been granted to UBA (a commercial bank from Nigeria) there was a line of other banks clamoring to enter the market.

Starting up a new institution in a post-conflict environment will have a tremendous demonstration effect, and as such the institution must embody best practices and the most up-to-date methodology. *This is an incredible opportunity to leapfrog both older methods that have not succeeded and relief programs that are not designed to be sustainable in the long run.*

In many cases the first microfinance interventions in post-conflict countries are secondary projects associated with relief programs designed to meet immediate needs of conflict affected populations. While well-intentioned, these projects often fail to follow industry best practices, have short-term, transitional outlooks, and can leave a weakened commercial attitude and a contaminated credit culture in their wake. For example, in the Central African Republic, microfinance funding has already flowed for several years through multi-sector social development and recovery programs that mix grants with loans and do not focus on sustainability.[3] Specifically, the microfinance group at IFC and in Africa has identified two critical components to address these issues:

1) Work with microfinance sponsors specialized in the creation and early stage management of new MFIs. To do this, the Africa microfinance program has leveraged wholesale microfinance holding companies that IFC has helped to create. While IFC is already invested at the holding company level, IFC Africa will also invest at the subsidiary level in frontier countries. IFC's dual level of shareholding provides comfort to other investors, signals a clear commitment to the host subsidiary country, and facilitates the relationship with new governments and regulatory bodies. These holding companies have the capacity to provide systems, training, and management

[2] Funding Mechanism for Technical Assistance and Advisory Services
[3] Central African Republic Microfinance Feasibility Study – Trip Report, IFC and Mercy Corps, March 2008.

support, while the local subsidiaries tailor products to the local market and build capacity on the ground. This model allows for both replication and customization, and has proven to be an efficient way to start in a post-conflict environment, where most everything else is uncertain.

2) Start MFIs as full-fledged banks from the beginning, offering both credit and savings products. Starting as a full-fledged bank affords the new MFI the ability to provide customers with both credit and secure savings. While the role of deposit intermediation to provide funding and support institutional sustainability is generally accepted, in a post-conflict environment this is magnified. Secure savings signals to clients, the entire financial sector, and the larger economy that stability has arrived and affords a burgeoning sector of working poor the ability to save for tomorrow rather than focus solely on immediate survival.

The table on the right highlights ProCredit DRC's success in deposit intermediation and AccessBank Liberia's plan to intermediate deposits from the beginning.

	ProCredit DRC Results	Access Bank Liberia Comparative Targets
	Dec-07	Year 2.5
Start date / Target start	Aug-05	2008
Branches	4	3
Staff	188	100
Total Assets	62,000,000	10,700,000
Loan Portfolio	12,900,000	7,000,000
# Loans	4,719	5,480
Aveerage Loan	2,734	1,277
Deposits	52,750,000	5,910,000
# Deposits	44,581	8,200
Average Deposit	1,183	720

Respect the sovereignty (and power) of local stakeholders.

In the early stages of nation-building, the involvement of local stakeholders and newly elected politicians is essential. Just as there is a demonstration effect to the market from starting a new best practice institution, the actions of a new government have a demonstration effect on the newly stable local population as well as on the many global stakeholders.

In the case of AccessBank Liberia, the relationship between the timing of the investment and submission of the commercial bank license application was highly scrutinized. Traditionally, one of IFC's greatest values as a founding shareholder is to support the license application process and bring legitimacy to the start-up bank. While this still holds true in Liberia, timing wise, the government, the Central Bank, and the International Monetary Fund (IMF) all felt strongly that the CBL should confer a provisional license before IFC signs the investment agreement. This sequencing effectively allows the CBL to signal its sovereignty to the market. This was particularly important, given the political pressures surrounding other license applications from neighboring countries with the ability to forgive debt. It is important that IFC's actions support both the actual and perceived sovereignty of the government in a post-conflict country.

Accept that building from the ground up is expensive – but recognize that the impact is proportionate.

While all microfinance operations in Africa necessitate heavy upfront investment to compensate for a lack of local capacity, post-conflict countries face even greater physical and human capacity constraints. The severe lack of the most basic public infrastructure at the end of a conflict forces all private sector companies – including greenfield microfinance banks – to invest disproportionately in infrastructure to ensure safety and access to power, water, and transport. For example, an IFC microfinance partner estimates that the cost of establishing a branch in post-conflict Africa is $300,000, approximately four times the cost of establishing a branch in Eastern Europe. The cost of compensating for lack of human capacity can be equally daunting, as years of conflict have brought education systems to a standstill and few young adults have any significant formal education. The lack of technical skills is often aggravated by social tensions from lingering divisions among communities on either side of the conflict, and extensive training and coaching of local staff are critical to scaling up operations and building local management capacity.

Branch before and after

To address these constraints and challenges, greenfield projects are normally accompanied by advisory services package. These advisory services and related funding allow the introduction, application, and transfer of skills and knowledge necessary to successfully operate a commercially viable MFI. They enable the MFI to internalize appropriate microfinance methodologies, social and environmental standards, internal controls, corporate governance, and so forth. IFC's microfinance team has designed and structured advisory services agreements for post-conflict projects to recognize that a renovated branch building or a trained loan officer is equally as important as the related output of a loan portfolio and clients they produce. Finally, don't let "sticker shock" overshadow the potential impact of post-conflict investments: where conditions and costs in countries like Liberia, Sierra Leone, and the DRC are daunting to most, for IFC they represent an opportunity to dramatically increase financial access and support private sector development.

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