Innovative Approaches to Microfinance in Post-Conflict Situations: Bosnia Local Initiatives Project

Social Development Best Practice Elements

- Institutionalized mechanisms for participation and decentralized implementation
- Ongoing monitoring and evaluation of social development outcomes by the government and community
- Multidimensional approach to poverty reduction aimed at enhancing opportunities, empowerment, and security of the poor

Over the past five years, the World Bank has developed useful post-conflict strategies that better meet the unique needs of war-torn countries. The Local Initiatives Project (LIP) in Bosnia presents a new standard of responsive social development in the Bank. While it demonstrates the need to use traditional project cycle practices, it also brings into focus many innovative approaches that may be considered in non-conflict settings as well, especially when pilot projects are used effectively.

Bosnia’s Post-War Context

Bank involvement in post-war situations has substantially increased in the last several years. The Bank has been actively involved in economic reconstruction in Bosnia-Herzegovina, whose economy was devastated by the 1992-95 war. Reconstruction was complicated by the fact that Bosnia had inherited all the inefficiencies of the prior socialist system. The economic deterioration of the country in the late 1980s and then the dismantling of Yugoslavia left the country even more particularly fragile.

In the early 1990s, the government made efforts at privatization to ease the economic crisis. With the outbreak of war, the industrial basis for production was severely curtailed by the destruction of factories throughout the country. In addition, agriculture suffered inordinately with at least 70 percent of farm equipment and 60 percent of livestock destroyed. Moreover, 15 percent of the farmlands became inaccessible due to landmines. In addition to farms and industries, the war destroyed half of the country’s housing. With unemployment hovering between 50 percent and 60 percent, redeveloping an infrastructure and energizing the economy were particularly challenging in Bosnia.

Social and economic exclusion is frequently the basis for conflicts. Post-conflict situations tend to exacerbate social exclusion since there is little or
no social support for the poor. The Bosnia Local Initiatives Project (LIP) sought to overcome social exclusion by targeting groups such as war widows, demobilized soldiers, and other uprooted individuals. In a post-conflict situation, loans typically are earmarked for larger governmental reconstruction projects and rarely for grassroots, private microcredit. In Bosnia, microfinance proved to be a worthwhile investment as it rapidly created local jobs, which in turn contributed to the rebuilding of the financial infrastructure, particularly for smaller borrowers.

**Intended Clients of Bosnia Local Initiatives Project Microcredit**

- Low-income micro-entrepreneurs or would-be entrepreneurs who do not have access to financing and who require limited amounts of capital
- Persons most affected by the war, such as demobilized soldiers, displaced persons, returning refugees, war widows

**Pilot Project as a “Greenhouse” for a National Microcredit Project**

In 1997, war-torn Bosnia was beset with high unemployment, weakened institutions, the lack of start-up capital, and large numbers of war-affected groups, particularly war widows and demobilized soldiers. With no tradition of nongovernmental organizations (NGOs) or microcredit, Bosnia presented the initial challenge of developing a pilot project that could build sustainable local and national institutional support for microcredit in a fragile economy.

The Tuzla Pilot Project set the groundwork for the larger project because it was designed to (1) test the demand for microcredit; (2) test different lending methodologies using three different NGOs; and (3) determine whether NGOs have the capacity to manage a loan fund.

The pilot project tested lending methodologies by using three NGOs that used different lending methodologies:

- **Individual lending.** One person secures the loan (pilot emphasized urban borrowers).
- **Solidarity group lending.** Mutually guaranteed individual loans (focused on women).
- **Membership-based village credit association.** These could potentially evolve into something more permanent such as a rural credit union.

After only six months, the Tuzla project proved not only that there was a demand for micro-loans, but also that NGOs were excellent vehicles to disburse loans. Furthermore, the pilot project found that the repayment performance was excellent. Individual loans were found to be the most successful, followed by solidarity group lending to women. Cooperative lending through village credit associations was also tried but did not take hold. The pilot project also allowed the government time to carefully weigh the merits of microcredit and to gain the support of key officials, who in turn championed the effort to the larger bureaucracy.

**Instituting the National Project**

The next challenge was replicating the Tuzla success at the national level. One of the critical challenges at this point in the project cycle was designing the institutional arrangements to implement the project. The Bank needed to lend to the government, but microcredit work is usually done independently in the private sector. The challenge was how to channel money through the government without its controlling the project.

Initially, the Ministry of Finance wanted direct control of the project, whereas the Bank wanted an autonomous entity. A compromise was found by using the existing Employment and Training Foundations (ETFs) to create the Local Initiative Departments (LIDs) in both the Federation and Republika Srpska as semi-autonomous offices. After viewing the success of the Tuzla project, the government agreed to channel funds through the LIDs.

A competition was held among NGOs and banks to become partner organizations under the project. From about 70 applicants 25 were considered for the “short list.” These applicants were then invited to a “rapid workshop” in which the basics of micro-lending were discussed. Each NGO was required to prepare a proposal for becoming a microcredit partner.
The proposals of the NGOs were based on the following criteria:

- Does the applicant understand microcredit?
- Does the organization know its clients and have prior experience with its potential clients?
- Does it know how to target clients?
- Does the organization/director have a vision?
- Does the organization have the capacity to administer the project?

Seventeen finalists were chosen as Microcredit Service Providers (MCSPs). These NGOs set up shop and began to disburse loans. The MCSPs received one year of financing, normally in three tranches, and a 100 percent subsidy in the first year, a 50 percent subsidy in the second year, and no subsidy in the third year. To ensure project success, the project used **strict lending and repayment terms** and intensive monitoring of the loan portfolios.

The Bank also funded important Technical Assistance (TA) to the MCSPs. TA included seminars; study tours of microcredit programs in Bangladesh, Bolivia, and Poland; and one-on-one consultations by experts on topics chosen by the MCSPs. By May 1998, over 6,000 loans had been disbursed at an average size of US$1,800.

**Mid-Term Review**

At the Mid-term Review (MTR) it was determined that **sustainable** microcredit financial institutions needed to be in place by the end of the funded project. Through the MTR, both the staff and the organization directors met together to evaluate the progress of the program. It became clear to all that the goal for the newly envisioned program had to be redirected from an emphasis on loan disbursement to an up-front emphasis on institution building. The working concept to which all agreed was “If you want to lend not only to your current clients, but also to their children, you need sustainable institutions.”

**Flexible Project Design Yields Benefits**

The “open architecture” of the project design proved to be a highly effective approach toward measuring the project against its own goals, then redesigning and refining the project’s sustainability over time. Even the choice to deliver microcredit on a sustainable basis beyond the life of the project initially was not in the project’s design but became a conscious choice by the stakeholders.

The flexibility in the program design was also demonstrated when a radical proposal was suggested to eliminate partners who were not viable long-term NGOs. This proposal was considered and adopted with the support and consultation of all the partners. By consulting with key stakeholders throughout the process, the project effectively managed the potential risk of resentment among implementing partners that were eventually dropped from the project. Such transparency set up a healthy arena for competition, without leaving anyone behind since the partners that were dropped recognized the superior management systems of the remaining four partners and opted to merge into their organizational structures.

**Evaluation**

Through the evaluation process, only the partners that met agreed criteria of sustainability would continue to be supported. After developing the criteria in conjunction with all the partners, all but five MCSPs were dropped. Those that met performance criteria were given capital, part loan and part grant. Once the legal framework was in place, the former MCSPs that qualified became known as Microfinance Institutions. These institutions are now responsible for generating enough money to pay their administrative overheads.

**Responsive Social Development Practices**

Post-conflict countries must deal with a great number of problems in short order. But such difficult predicaments also can yield important opportunities that should not be overlooked. The **Bosnia Local Initiatives Project** was able to cope with the problems and take advantage of the rapidly changing economic terrain.

One advantage of the LIP was that the task manager (TM) was based in the field. The TM was able to track changes in attitudes and behavior of government officials and take advantage of opportunities for adaptive learning to redesign the project and create sustainable institutions.
Because the economic and political arenas in a post-conflict country are fluid, having a task manager on the ground who was aware of both the local and national situations proved very useful.

Extensive beneficiary and stakeholder involvement at design and implementation phases enabled the project to benefit from local leadership, experimentation, diversity, and mutual learning. Through the training components, alliances were also built among NGO partners, so that when it came time to downsize the original 17 NGOs to 5, a constructive process ensued that focused on the long-term success of the country’s microcredit goals versus the NGOs’ short-term ambitions.

Transforming a pilot project into a national project required intensive stakeholder involvement at both the local and national levels. These types of coalitions for change need time to grow, but also need to see positive results as a way of mobilizing action for change. The use of a pilot project to initiate and test a national project enabled the team to work productively and quickly outside the bureaucracy of a skeptical government until the success of the pilot project was evident.