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Microfinance Institutions' Response in Conflict Environments:

Eritrea – Savings and Micro Credit Program
West Bank and Gaza – Palestine for Credit and Development
Haiti – Micro Crédit National, S.A.

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Abstract

Minimizing the constraint of sustainable access to finance through the services extended by micro finance institutions has increasingly enabled poor entrepreneurs to improve their source of revenue and reduce their economic vulnerability over the years. The experiences of the Savings and Micro Credit Program in Eritrea, the Palestine for Credit and Development in the West Bank and Gaza, and Micro Crédit National S.A. in Haiti demonstrate that micro finance institutions with positive performance records could play an important role during and post conflict periods. Through their services, microfinance institutions are called to assist the most disadvantaged sector jump-start the economy and to facilitate the resumption and reconstruction of local business activities. In responding, the institutions featured here exacted the same disciplined practices that served as the foundation for their success under normal environments: commercial practices, streamlined operations, incentives for timely loan repayments, and financial sustainability. As they implemented decisions to operate under conflict environments, it became clear to them that their institutional development and progress toward self-sufficiency had to be delayed and exposed to continued high risk and unforeseen challenges as conflict issues remained unresolved. They recognized that their continued operations were contingent upon their ability to: respond in a flexible manner to rapidly changing political and economic situations and subsequent difficulties faced by their clients; obtain committed support from their management, staff, Board of Directors, and development partners so a balance could be struck between the impact of the microfinance program on the country's development agenda and the institution's commercial operations; and receive assurances on the availability of financial support to cover conflict-related increases in operational expenditures and ongoing institutional capacity building requirements.

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ABBREVIATIONS AND ACRONYMS

CGAP	Consultative Group to Assist the Poorest
ECDF	Eritrea Community Development Fund
FATEN	Palestine for Credit and Development
GGLS	Group Guaranteed Lending and Savings Scheme
IDP	Internally displaced person
MCN	Micro Crédit National, S. A.
MF	Micro finance
MFI	Micro finance institution
NGO	Non-governmental organization
OPT	Occupied Palestinian Territories
SMCP	Savings and Micro Credit Program
WBG	West Bank and Gaza

FOREWORD

This study is one of four Africa Working Paper Series on the development of microfinance institutions in African countries being published as part of a collaborative research effort between the World Bank's Financial Sector Operations and Policy Department and the Financial and Private Sector Units of the Africa Region (with funding from the Financial Sector Board and Africa Regional Programs). It documents the practical experiences of the Savings and Micro Credit Program in Eritrea as it operated during and after the border conflict between Eritrea and Ethiopia from 1998 through 2000. In addition, a comparison of their performance with two other microfinance institutions that also remained operational in crisis environments, the Palestine for Credit and Development in the West Bank and Gaza and the Micro Crédit National, S.A., in Haiti, is presented to illustrate that institutional and financial outcomes may depend on the underlying socio-economic conditions, the characteristics of the microfinance institution, and the decisions they make. This comparative review is intended to disseminate lessons from practical experiences to better understand how the framework and guiding principles for providing microfinance assistance, developed by the Consultative Group to Assist the Poorest, can be effectively applied in crisis situations.

The provision of sustainable financial services to the poor is an important element of the World Bank Africa Region's strategy for supporting the Millenium Development Goals for poverty reduction. Microfinance is the application of innovative methodologies that make financial services accessible to relatively poor and low income households and microenterprises through business transactions that suit their economic conditions. Under normal development context, microfinance institutions have evolved and successfully provided financial services that enable microentrepreneurs worldwide to save and acquire productive assets and skills allowing many to generate increased income, promote their financial empowerment, and reduce their economic vulnerability. The success of microfinance institutions in reaching growing numbers of poor clients, especially in rural areas, has prompted governments, non-governmental organizations, and international finance and development institutions to resort to the provision of microfinance services even during risky periods when countries face crisis or are coping with the aftermath of conflict. These services are deemed necessary to facilitate the resumption and reconstruction of local business activities and to provide the most disadvantaged sector with essential inputs to play an important role in rebuilding the economy.

Important lessons can be learned by other practitioners, governmental and non-governmental organizations, and donors from the responses made and decisions taken by the three institutions presented here when pressured to respond to short-term political and economic goals that were not consistent with their long-term sustainability objectives. It is clear that firm and continued commitment from microfinance institutions' management, staff, Board of Directors, and development and finance partners is required to enable them to respond flexibly to the difficulties faced by their clients under rapidly changing conflict conditions and to balance the impact of their program on the country's development agenda with their own commercial operations.

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I. INTRODUCTION AND STUDY FRAMEWORK

Over the past four decades microfinance programs have increasingly been established in a number of countries as a means to mitigate the key constraint of sustainable access to financial resources faced by micro and small enterprises. Microfinance programs extend financial services ranging broadly across savings, loans, payment services, money transfers, and insurance to enterprises generally owned by poor and low income households, a group long thought not to have the ability to save nor to utilize credit productively and repay loans at non-subsidized interest rates. Armed with a better understanding of the microfinance field and the presence of a number of successful microfinance institutions (MFIs) worldwide, international development and finance institutions and non-governmental organizations are increasingly resorting to the provision of microfinance services even during risky periods when countries face crisis or are coping with the aftermath of conflict. Microfinance services, especially credit, are seen to facilitate the resumption and reconstruction of local business activities and enable the most disadvantaged sector to play an important role in jump-starting the economy.

However, microfinance practitioners find themselves in challenging situations as they are pressured to respond to short-term political and economic goals that may not be consistent with their long-term sustainability. Recognizing that conflict situations pose threats to the sustainable operations of an MFI, they face two competing scenarios:

- that MFIs are able to adapt their strategies, systems, introduce new products, and manage their operations to take advantage of the resources that may be available for coping with or recovering from conflict so as not to compromise their long-term sustainability; and,
- that MFIs may be severely damaged by the negative effects of conflict situations on the conditions for microfinance and on their operations so that other grant-based programs would be preferable to assist the poor in such conflict situations.

The Consultative Group to Assist the Poorest (CGAP) developed a framework and guiding principles[1] for providing MF assistance including in post-crisis situations. What is needed is the dissemination of lessons from practical experiences to better understand how these principles can be applied effectively. This paper seeks to illustrate that MFIs that have been established and remain committed to provide financial services to a large number of poor clients on a sustainable basis will operate not only under normal development contexts but, more likely, will decide to function also under the precarious conditions of conflicts and crisis. Outcomes may depend on the underlying socio-economic conditions, the characteristics of MFIs, and the decisions they make. The documentation of the practical experiences of the Savings and Micro Credit Program in Eritrea from 1996 through 2001, and comparison of their operational aspects with that of the Palestine for Credit and Development (FATEN) in the West Bank and Gaza and the Micro Crédit National, S.A., in Haiti during 1999 through 2001, is designed to extend the validity of the CGAP framework. These institutions were selected to: (i) have an organizational representation of MFIs (government-run; non-profit organization that spun off from a non-governmental organization; and a private-run organization with backing from banks, a multi-lateral organization, microfinance experts); (ii) analyze the similarities and differences of MFI

[1] CGAP, "Microfinance, Grants, and Non-Financial Responses to Poverty Reduction: Where Does Microcredit Fit?", Focus Note No. 20, May 2001

responses to different crisis situations; (iii) have a geographic representation from conflict affected areas (Africa, Middle East, Caribbean); and (iv) include organizations that operated during extended conflict and post conflict periods.

This study will document the decisions the different stakeholders took to shape the objectives and strategies of their institution based on an understanding of their country's situation. An analysis of the effects of these decisions and the mitigating measures taken on the MFIs' outreach and sustainability, including the impact on their total assets, loan balance, number of clients, average loan size, distribution of loans, return on assets, profit margins, operational and financial self-sufficiency, will be covered. It is expected that the additional information will be useful to the industry as practitioners try to formulate best practices and refine broad guiding principles applicable to the sustainability of microfinance institutions operating during crisis situations, and to donors in designing assistance programs in such situations. Among prior work on this topic, the most prominent is the documentation of other practitioners' experiences globally made by Karen Doyle in her paper "Microfinance in the Wake of Conflict: Challenges and Opportunities".[2] This paper is essentially a desk review of available literature on this topic and on the MFIs, and, to amplify and deepen the understanding of the information provided in the survey, is supplemented by responses to a survey instrument, a brief field visit to SMCP and MCN and an interview with a consultant who had been working with FATEN over a few years.

This paper is organized as follows: (i) a brief review of microfinance as a development tool under normal development context provides some perspective on basic considerations microfinance institutions and their development partners have to make when assessing their role in rebuilding communities devastated by man-made conflicts; (ii) a descriptive summary of the economic and political environment the three microfinance institutions operated in and the main characteristics of each microfinance institution provides an understanding of the challenges and opportunities each institution faced to meet the unique consequences of conflicts; (iii) a presentation of the decisions the institutions' leaders took and an analysis of the impact on the organization's outreach objectives, operational efficiency, profitability, and self-sufficiency will serve as the basis for determining the validity of current guidelines; and (iv) a formulation of the lessons learned and their relevance to current guidelines concludes the study.

It is to be noted that the terms "conflict", "post conflict", and "crisis" are used interchangeably in this paper because sometimes there is no clear distinction between conflict and post-conflict situations and country conditions remain precarious between sporadic outbursts of crises.

II. MICROFINANCE – A DEVELOPMENT TOOL

Microfinance programs have increasingly been established in a number of countries as a means to help poor entrepreneurs fund lump sum requirements, finance investments in economic activities, minimize exposure to sudden income changes, smooth consumption expenditures, and enable the unemployed to rely on self-employment when wage employment opportunities in the formal sector of the economy are limited. Financial services, which include savings, loans, payment services, money transfers, and insurance, are provided to poor and low income households long thought not able to save, utilize credit productively, and repay loans extended at non-subsidized interest rates. Institutions providing MF services are reaching thousands (millions

[2] Doyle, Karen, *Microfinance in the Wake of Conflict: Challenges and Opportunities*, Microenterprise Best Practices, Development Alternatives, Inc. and US Agency for International Development, July 1998.

in Asia) of poor, micro and small businesses that would otherwise not have any access to small loans ranging below $100 to a few thousand dollars. Their successes are attributed to the adoption of microfinance core principles based on commercial practices, streamlined operations, incentives for timely loan repayments, and financial sustainability (see Box 1).

Box 1: Principles that Lead to a Successful Microfinance Program

Commercial Practices. Demand-driven financial services are provided at prices clients are willing to pay for continued access to these services. Credit services translate to short-term loans with amortization schedules that are well-matched to the business and income patterns of micro entrepreneurs. Savings services provide safety and liquidity at low transaction costs.

Streamlined Operations Quality services are delivered on time, efficiently and cost-effectively to clients of MFIs. Simplified and standardized procedures support decentralized operations conducted in modest and welcoming outlets to poor clients. Local community leaders and members play an important, supportive role in the MFI's credit administration process.

Incentives for Timely Loan Repayments. Clients are motivated to repay on time through repeat loans often in increasing sizes, partial interest refund based on a perfect repayment record; penalties and financial disincentives including compulsory savings, mutual guarantee group systems to provide peer pressure and installment payments.

Financial Sustainability. MFI programs attempt to cover all their operational and financial costs through scaling up their outreach and maintaining a high quality and performing loan portfolio.

Increasingly, microfinance stakeholders recognize the importance of applying collective wisdom, experiences gained, and lessons learned in microfinance under normal development situations to conflict environments. With good records of effectively passing on the benefits of growth and external injections of resources more equitably throughout a community, MFIs are being tapped to become instrumental in facilitating the resumption and reconstruction of local business activities and jump-starting the economy. However, many are called to support enterprises when the MFI and its client enterprises' financial requirements are at a critical stage, i.e. either at the brink of their own survival or attempting to respond to business opportunities during risky periods when the political and economic environment is highly volatile.

Conflicts erupt for many reasons. These are not discussed in detail in this paper, but some reasons are summarized in Box 2. Conflicts impact a society broadly and deeply (see Box 3); the human cost of suffering from conflicts is immeasurable and the economic costs extremely high.

Conflicts also give rise to operational challenges and often delay MFIs in their ability to attain scale and financial sustainability. MFIs have had to adjust their strategies and operational procedures to manage the following common effects of conflicts on their programs and financial performance indicators:

- increased security risks to staff, clients and assets;
- human resource constraints brought about by the loss of efficiency and know-how when management, staff, or members of supporting groups flee their country or community, are called to support the war efforts, have been killed, or leave for better job or educational opportunities;
- increased operational risks resulting from parallel relief-oriented programs, microfinance programs not motivated by long-term development goals, or political and self-interest motivations of local officials;

- growth in administrative and operational costs brought about by increased monitoring expenses incurred to maintain a high quality portfolio, additional security precautions, higher labor cost, additional investments in advocacy work, training and re-training efforts; and,
- overall increased risk to an MFI's balance sheet and lower returns on investments given the effects of weakened repayment performance as clients are displaced and their productive and operational capacity is reduced, loan funds are decreased as deposits or lending resources are reduced or frozen, and equity values decline because of inflation and currency devaluations.

Box 2: Conflicts – Why They Occur

There are a number of reasons conflicts occur. [1]Historically, the common legacies of imperialism and colonialism are: struggles for government control to fill a power vacuum when government systems are disbanded; border conflicts resulting from imposed and forced artificial boundaries; clashes when inequalities among ethnic groups exists because one group had been favored by previous colonizers; and weak human capital as, earlier, nationals were not allowed the opportunity to manage and plan government policy or play a lead role in productive sectors of a country.

Poverty, illiteracy and unemployment are basic ingredients that stimulate a wide array of social tensions.

Economic conditions that contribute to the development of conflicts are the prolonged existence of economic stagnation and protracted declines in income; unequal growth that increases the relative deprivation of certain segments of society; competition from a growing population for scarce, non-renewable resources and environmental assets; sudden shifts in the distribution of assets and government subsidies, and failed agricultural development schemes.

Politically, conflicts stem from the unequal representation of political ideologies, military dominance, or the uneven distribution of wealth as a result of the globalization of economies.

The social exclusion of individuals or groups from full participation in a society on regional, religious, ethnic, or social grounds combined with inequalities kindle frustrations and tensions.

A country neighboring a conflict can also slide into war as often the host country experiences pressures on local natural resources and heightened social tension from large numbers of refugees. Refugee camps also serve as havens for rebels and the grounds from which they launch attacks against their own government's forces. Raids from foreign troops into the host country and dangerous cycles of border incidents and fighting may then ensue.

[1] *World Bank, May 2000.* The Transition from War to Peace: An Overview, *World Bank Institute.*

MFIs, non-governmental organizations (NGOs), governments, donors, and development agencies and non-governmental organizations face countless daunting effects of conflicts as they attempt to play a critical role in post-conflict reconstruction. To assist those increasingly interested to extend support during these difficult periods, a number of papers have been written in the past, the most significant being that prepared by Karen Doyle, *Microfinance in the Wake of Conflict: Challenges and Opportunities.*[3] Her findings and other lessons from MFI experiences contributed to the development of a framework and guiding principles by the Consultative Group to Assist the Poorest (CGAP) in their paper, Microfinance, Grants, and Non-Financial Responses to Poverty Reduction: Where Does Microcredit Fit?" (Focus Note 20).[4] The key points of this Note are highlighted below:

[3] Doyle, Karen, *ibid.*

[4] CGAP, "Microfinance, Grants, and Non-Financial Responses to Poverty Reduction: Where Does Microcredit Fit?", Focus Note No. 20, May 2001.

Box 3: The Prevalence and Impact of Conflict on a Society

In the post-cold war era, conflicts had been increasingly undermining development in a wide range of countries, threatening the stability of societies and diverting scarce resources from other critical development issues. By 1998, [1]

- more than 50 countries experienced long periods of conflict since 1980, often resulting in complete breakdown of states;
- of the 20 poorest countries in the world, 15 had a major conflict since the early 1980s and every country in Africa had been directly or indirectly affected by conflicts;
- thirty countries had more than 10 percent of their population displaced and in 10 countries more than 40 percent. In these conflicts, more than 90 percent of the casualties were civilians;
- whole generations are growing up in cultures of armed warfare and violence; and
- decades of economic and social development achievements are eradicated and impoverishment follows.

Despite the unique nature of each conflict, societies that survive conflicts display common features:

- elites, particularly the military, an oligarchy of government, or the wealthy emerge to dominate society;
- fragile peace-consolidation processes and continuing local rivalries between former enemies continue to breed political instability;
- long-term development are disrupted and economic relations break down as political stability, mutual trust, respect for property and the rule of law are lost;
- the absence of security, the collapse of infrastructure, planting of land mines seriously hamper access to agriculture and trade;
- important socio-economic actors manifest their lack of confidence by a reluctance to invest, rebuild or replace damaged or obsolete physical capital and productive facilities to revive economic health;
- judicial, financial, fiscal, administrative and regulatory capacities of the state are weakened by the destruction of physical assets or the devastating loss of human capital or, conversely, these systems may be unnecessarily created and strengthened to regulate the economy;
- a large shadow economy, parallel markets, or criminal activities surface to protect certain groups' common, vested interest particularly if the conclusion of the war or the realization of peace is to their economic or political detriment;
- a state's macroeconomic record declines with high inflation, large budget deficits, low tax bases, balance-of-payments in deficit, and heavy debt burdens;
- conflicts leave a legacy of widespread unemployment and the creation of a vacuum for skilled labor; and
- rural area residents turn to a subsistence economy and households that do not have access to the informal economy or to a social safety net are most negatively affected by conflicts.

[1] World Bank, 1998. *Post-Conflict Reconstruction: The Role of the World Bank*, Washington, DC: The World Bank.

- Microcredit is an appropriate response to assist the poor and low-income households when they are already engaged in an on-going economic activity, entrepreneurial, and possess managerial skills.
- Lack of infrastructure, services and markets may inhibit the sustainable presence of these pre-conditions after conflicts or in areas facing severe difficulties.
- In spite of the existence of sufficient economic activities, markets, and entrepreneurial capacity, the sustainability of MF programs can still be threatened by high operational costs to regularly reach widely dispersed clients; covariant risk when the institution relies on a single economic activity; the inability to transact business using cash; populations that are highly mobile or that face instability; future crisis such as civil violence or hyperinflation; absence of law and order; serious depletion of social capital or social cohesion undermining the ability to use non-collateral credit methodologies; and the presence of laws, regulations, or monitoring and enforcement requirements that significantly limit microenterprise and microfinance activities.
- In operating under these precarious conditions, MFIs have had to experiment with modifications to their products and procedures, which can significantly increase their risk and costs.

- When conditions for microcredit are conducive, it is best to select an existing institution, or develop a new one, that is driven by a long-term commitment to the sustainable provision of financial services to a large number of poor clients.
- Microcredit support is not the ideal instrument to assist high-risk, low-experienced and non-enterprising groups; these groups would best be helped through other financial instruments and non-credit services including savings, insurance, termination payments, and micro grants.
- Other initiatives should also be explored to assist the poor to benefit from financial services; these include food-for-work, other public works programs, capacity building efforts and business development services to prepare the poor and marginal groups to take advantage of economic opportunities.

The practical experiences of the Savings and Micro Credit Program in Eritrea from 1996 through 2001, in comparison with both the Palestine for Credit and Development (FATEN) in the West Bank and Gaza and the Micro Crédit National, S.A. in Haiti during 1999 through 2001, are presented in this paper in an attempt to discern how their post-conflict outcomes were affected by the underlying socio-economic conditions, the characteristics of the MFIs, and the decisions these institutions made. These MFIs' experiences extend the validity of the CGAP framework and give MFIs and donors additional information expected to be useful in designing and operating programs during crisis situations. A comparative and summarized picture of the effects of the crises is provided below and, where applicable, an index was utilized to compare the results across the three cases. The year prior to the conflict or the program commencement year was set as the base year and given a100 percent rating.

III. COUNTRY AND MICROFINANCE INSTITUTIONAL CONTEXT

ERITREA AND THE SAVINGS AND MICRO CREDIT PROGRAM

Eritrea, with a population of about 4 million had to face conflict situations now and then for over 40 years. The country became independent in May 1993 and five years later open conflict between Eritrea and Ethiopia erupted again as a consequence of a dispute over their common borders. While little fighting took place in 1998, the war escalated in several border areas after January 1999 and in May 2000 hostilities intensified and resulted in widespread destruction of physical infrastructure and a humanitarian crisis with a massive and sudden internal displacement of approximately one third of the population. By June 2000, agreement to cease all hostilities was reached, a peace accord was signed by end-2000, and, with the full deployment of a UN peacekeeping force by March 2001, a temporary security zone was established allowing for the restoration of civil administration and the return home by internally displaced persons (IDPs).

Subsequent to Eritrea's independence, the Eritrea Community Development Fund (ECDF) Project was launched (mid-1996) to, among others, support the pilot Savings and Micro Credit Program (SMCP) of the Ministry of Local Government. The SMCP follows the village banking model and has three loan products. First, group-guaranteed loans are extended to individual members of solidarity groups (Tier I loans) and range in size from US$75 to US$1,000 equivalent. Second, loans to individual borrowers or associations (Tier II loans) are over US$1,000 to US$10,000. The third product enables solidarity group members who demonstrate a track record of perfect repayment performance in four prior Tier I loan cycles to borrow following agreement by, but without the guarantee requirement of, solidarity members. Loan size

limits are the same as for Tier I loans. The interest rate is set at 16% for all products; Tier II loans have a 2% refund feature if installments are consistently paid in a timely manner.

WEST BANK AND GAZA AND THE PALESTINE FOR CREDIT AND DEVELOPMENT

The Occupied Palestinian Territories (OPT) consist of the West Bank and the Gaza Strip. Following the 1967 Arab-Israel war, Israel occupied the West Bank and Gaza (WBG) and, as the occupying power, administered the areas except for Eastern Jerusalem, which it formally annexed to the Israeli State. This annexation was not recognized by the United Nations. Israel and the WBG continue to be in the midst of decades of confrontation and conflict over their territories. The resulting undetermined outcome of the peace process continues to create political and economic vulnerabilities as unanticipated acts of political violence, border closures, and major changes in government policies persist. Resolving territorial arrangements has been very complex and unwieldy and has severely complicated Palestinian institution-building and administrative and economic development.

The 1990s saw the WBG economy fluctuate from an economic boom year in 1994, a severe depression in 1995 and 1996, stagnation in 1997 and economic recovery and growth in 1998 and 1999. Since the commencement of the second Palestinian uprising, the Al-Aqsa *Intifada*, in September 2000, WBG continues to experience a downward economic trend for reasons including Israel's policies on closures, which restrict the movement of goods and negatively affect people's employment and trading activities, and declines in exports. Structural imbalances in the WBG economy have emerged over time and continue to be apparent in several areas, including a heavy dependence of the WBG labor force on outside sources of employment; a very low degree of industrialization; a trade structure that is heavily dominated by links with Israel; and inadequate public infrastructure and services. The serious delays in the peace process and structural economic disparities continue to seriously handicap the future economic prospects of the WBG.

Despite these difficult political and economic realities, donors and NGOs supported measures aimed to bridge the gap on the availablility of financial services to microenterprises. One program, the Palestine for Credit and Development (FATEN), has its roots in the Small Enterprise Development Program, started in 1986 by a US-affiliated NGO, Save the Children. FATEN commenced in January 1995 as a pilot group guarantee lending and savings program. While maintaining strong MF standards, it spun off into an autonomous MFI in 1999 and is the only MFI in the OPT. Focusing on providing financial services to women, FATEN extended small loans on commercial terms through four loan products to rural and semi-urban (refugee camp) populations: (i) Group Guaranteed Lending and Savings (GGLS) Scheme for women groups; (ii) fast loans, which are repeat loans for groups that have been clients of FATEN for more than one year; (iii) individual loans that are extended to existing clients who have completed at least Phase I of the GGLS and whose businesses have grown to require loans larger than JD1000; and (iv) staff loans.

HAITI AND THE MICRO CRÉDIT NATIONAL, S.A.

Haiti continues to experience low intensity conflicts. Political crisis and intermittent violence prevail in the country. Despite the international community's efforts to help Haiti's fledgling democracy since the 1986 fall of President Jean Claude Duvalier and several subsequent short-lived military regimes, civilian rule has been blighted by poor governance, frail or absent

institutions, political gridlock and a government unable to meet the basic needs of an overwhelmingly poor majority or to create an enabling environment for sustainable growth. Since 1997, electoral disputes, political fall-out and a persistent lack of commitment to good governance at the highest level have resulted in a significant decline in much-needed external financial assistance and private investments in Haiti. Economic improvements are not foreseen as long as the public sector's capacity and accountability remain weak, education levels are low, infrastructure continues to deteriorate, and arable land relative to the population is scarce.

Haiti's microfinance sector is large, diversified but increasingly facing volatility as borrowing levels drop, entrepreneurs' preference for savings instruments intensify, and MF opportunities to expand outreach and increase revenue remain limited given the difficult economic conditions in the country. Micro Crédit National S.A. (MCN) is a commercial MFI with shareholders including Unibank, Haiti's second largest commercial bank; Internationale Micro Investitionen AG (IMI); the International Finance Corporation; Nederlandse Financierings-Maatschappij Voor Ontwikkelingslanden NV (FMO); and the International Cooperation and Development Fund. MCN was established in 1999 to respond to the projected demand for loans from micro and small enterprises. At that time, more than 60 percent of the working-age population did not have steady employment, and micro and small enterprises were becoming an important source of the country's value added and more than 90% of total non-agriculture employment. Adopting the same credit technology that IMI utilizes throughout its network of 18 international MFIs, MCN offers various loan products to individuals: micro, mini, small (the distinctive feature being loan size), and investment loans. The investment loans were intended to meet the demand of clients with a stable income who were also interested in having their own business. Additional loans are also extended to clients who have an outstanding loan, an excellent repayment record, and require more resources to seize a market opportunity. MCN is piloting another loan product, small US dollar-denominated loans, designed for entrepreneurs who would benefit from borrowing in foreign currency and who can support the exchange rate risk.

IV. THREE MFIS' RESPONSE TO CRISIS SITUATIONS

The SMCP, FATEN, and MCN were established, and remained committed, to operate programs that provide financial services to a large number of poor clients on a sustained basis. Under the precarious conditions of conflicts and crisis, in continuing to be faithful to their mandate, they felt the need to: (i) respond to the opportunity to deliver financial services, mostly credit, when demand was high; (ii) meet their obligation as a partner in a relationship built on trust when no other options for financial services existed for their target clients; (iii) support economic activity and employment creation during crisis and contribute to providing their clients with a better, longer-term option of remaining self-sufficient rather than dependent on continued and limited humanitarian assistance; (iv) be actively functioning when resolution to crisis situations were found and normality resumed; and (v) remain active business agents that can influence future policies governing the development of financial and business services when their country would be undergoing rapid and broad development changes. Like any ongoing business concern cognizant of the importance of their role in economic development, they each adopted measures to mitigate various risks that significantly limited microenterprise and microfinance activities, matched impact potential with solid programming, and actively managed their increased risk and operational costs to thrive and grow.

In line with experiences of other practitioners, their operational policies were centered on quickly recovering resources lent as soon as they were due; closely monitoring loan and business performance; limiting, if not stopping, new lending; decreasing loan sizes for those that qualified

for one but had been negatively affected by the conflict; and temporarily curtailing lending activities in response to unstable economic and political conditions in local areas. To support these policies, these MFIs focused on three key activities:

(i) assessments of the country's environmental conditions to determine the preconditions essential to continue their operations and the mechanisms they need to adopt under volatile environments;
(ii) evaluations of their market for financial services and subsequent adjustments to their products and services to increase their responsiveness to their clients; and
(iii) modifications to program features including institutional goals, strategies, operational procedures, and institutional set-up to address inadequacies in the infrastructure and significant risks to personnel and assets and to protect the viability of the microfinance program.

EXTERNAL ENVIRONMENTAL CONSIDERATIONS

Essential Conditions. Doyle (1998) found that very few environmental conditions are essential for practitioners to maintain their operations or to initiate microfinance programs under crisis circumstances. These are that conflict intensity is low, markets have reopened and, if internally displaced people (IDPs) are the target clients, that their displacement is long term. Under these conditions and with sufficient security, the potential for MF outreach increases. Practitioners use the resumption of around 30-40 percent of businesses that operated prior to the conflict as a practical basis to determine acceptable business normality and to assess the demand for financial services. Also, the settlement in one area of clients displaced from their homes for about 18 months or longer has been utilized as the benchmark for clients to initiate and maintain their business operations and commit to their debt obligations. Under these conditions, MFIs are better able to assess the security measures it must take and judge its viability by the performance of its clients in affected areas.

In Eritrea, in the absence of extensive, full-out conflict and with stability and sufficient security prevailing in many areas, the SMCP was able to continue operating in most village banks until the massive and sudden internal displacement in 2000. Communities near border areas were displaced and many group and individual clients were either called to national service or moved to camps and resettlement areas. This prompted SMCP to curtail their operations in four village banks in the most war-affected areas. As communities were moved mostly together and some for only a short period of time before they were allowed to return back to their home town at the conclusion of the fighting, much of the community structure and many SMCP solidarity groupings were preserved. Eritrea did not face security problems characteristic of countries devastated by war. SMCP was therefore able to continue taking action to improve the performance quality of its loan portfolio through continued close monitoring of clients and re-commencement of business relationships with others when war conditions allowed it, the border areas were clear of dispute, the ceasefire agreements were observed, and the UN peace keeping forces were fully deployed. With records in the village banks in the conflict areas intact, a relatively quick spring back ensued as clients regrouped. A special force of credit officers from other regions was also temporarily formed to quickly assess the market requirements for credit services and the borrowing and repayment capacity of existing and potential clients in areas where economic activities were rebounding. SMCP responded by extending an increasing number of individual loans and establishing new village banks when about 40 percent of the original target number of village bank membership was reached.

FATEN's circumstances were very different from that of the SMCP. Prior to the failure of the Oslo Agreement, closures at the West Bank and Gaza were random and for only one to two weeks. Following the declaration of the second *Intifada*, Israel imposed more permanent closures, making movement of people and goods between the West Bank and Gaza to Israel and other external markets difficult. Although closures increased and business operations were progressively hampered, leading to the decline in FATEN's performance, FATEN decided to keep operating. Security levels allowed economic activities to persist, demand for FATEN's services still remained strong, and contact with clients was possible. The decision to remain operational, however, meant that FATEN's management, staff and clients were obligated to take more risks to circumvent the difficulties brought about by the closures and increased security checks in certain areas. As political and economic conditions deteriorated, operations and performance between branches varied. In Gaza, FATEN modified its strategy to primarily collect on past loans. Very few new loans were granted and mainly to enterprises that relied on the local market and less on Israel and neighboring countries for revenue. Endowed with natural resources, a manufacturing industry, and greater access to water resources, enterprises in the West Bank exhibited better resilience to the political difficulties and were able to support slightly larger loans than those in Gaza, build reserves, and diversify their sources of income. FATEN expected to rely on its West Bank branches to carry through its overall operations and subsidize the weaker Gaza branches.

MCN was established when the country faced political crises and, over the years, continued to deal with intermittent absence of law and sporadic threats of violence. Recognizing that security was a continuing issue to contend with, the program designers addressed early on security-related challenges and incorporated supplementary safeguards in the institution's operating procedures. These were regularly reviewed and updated primarily in Port-au-Prince, where conflicts were frequent but usually lasted only a few hours or a few days. To diversify the institution's risk and lower its operational costs, MCN also undertook to expand its market in the provinces, where political conflicts and lack of security were less of a problem.

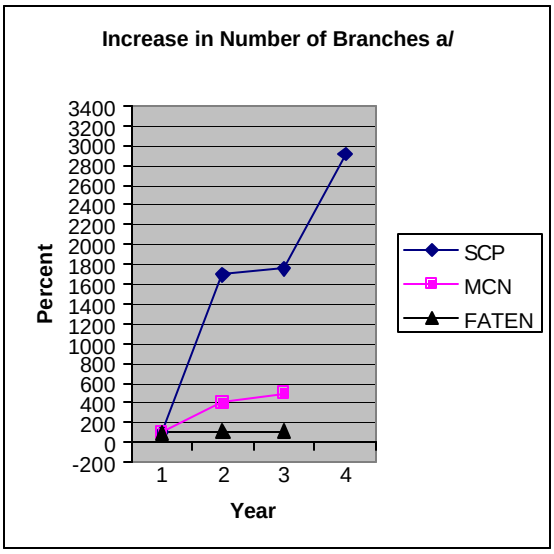
The expansion rate for branches of the SMCP was over 1700 percent in the first two years and over 2900 percent by the third year after the conflict ceased (Figure 1). As for total active loans, SCP increased only by 17 percent two years after the conflict before registering a growth rate of 112 percent by the end of the conflict. Operating in six regions and 146 village banks, SCP 's total outreach by 2001 was over 11,000 clients or about three times as high as other African community banks [5] that have operated for an average of 13 years. For MCN, their branch expansion in four municipalities and regions allowed the organization to spread their risk outside Port-au-Prince (decreasing their risk exposure in the capital city to approximately 65 percent of MCN's total portfolio) and increase active borrowers by over 1000 percent and 2400 percent during the last two years of the study. With 2,209 active borrowers at end-2001, MCN compared favorably with the performance of Latin American MFIs [6] averaging four years in operation. In the case of FATEN, although outreach increased in the West Bank despite the steady increase in conflict intensity, the increase was insufficient to counter the limiting effect on the expansion in the Gaza. FATEN did not open new branches and its total outreach decreased by an average of

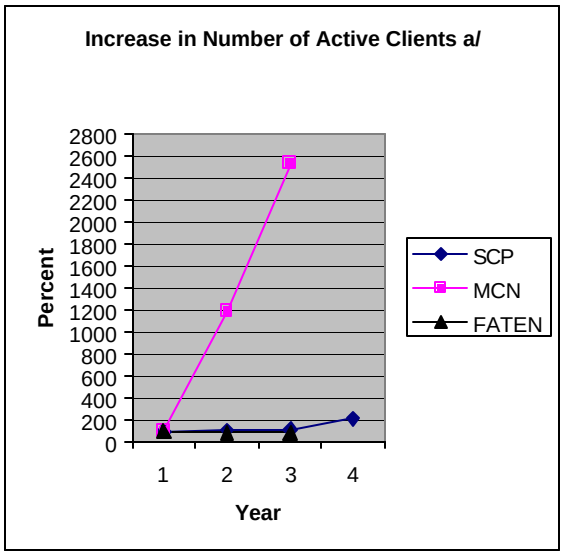
[5] The MicroBanking Bulletin, MicroBanking Standards Project of the Consultative Group to Assist the Poorest, Issue No. 7, November 2001.

[6] The MicroBanking Bulletin, *ibid.*

about 15 percent annually. At this rate, FATEN was serving only about half the number of active borrowers that a Middle East and North Africa peer group had been serving.[7]

Figure 1: Increases in Branches and Number of Clients Following Conflicts
(%)





[a]/ In this and succeeding figures, an index was utilized to compare the results across the three cases, where applicable. The year prior to the conflict or the program commencement year was set as the base year and rated 100 percent.

Preferred Conditions. Practitioners also prefer that other enabling conditions exist, including the presence of a functioning commercial banking system, a relatively dense population, legislation for MFIs, skilled workforce, social capital, trust in the local currency and financial institutions, and the absence of hyperinflation. However, Doyle notes these are not required for MF activities to thrive in the short term and during the emergency or reconstruction phases post conflict. Also, MF technology has developed over the years so that new and flexible approaches exist to compensate for the absence of these conditions. An examination of these conditions is presented here, however, because during crisis alternative solutions to these preferred conditions may have deteriorated and the time devoted to counter the negative effects of their absence lessens the available time a MF program utilizes to make and monitor loans and to offer savings services and mobilize deposits. These functions are key to facilitating the implementation, growth, and sustainability of MF programs.

Favorable macro-economic conditions and basic financial systems. MF programs have allocated considerable resources to protect the value of loan funds and savings when macro-economic conditions are unfavorable and lead to hyperinflation and sharp devaluations of the local currency or the banking system is weak or not functioning. MFIs sometimes denominate their transactions in foreign currency, exploit barter as a means of exchange, or convert cash to a commodity as quickly as possible. In addition to keeping cash in safes to counteract weak banking systems, MFIs also immediately recycle loan funds back into the program.

[7] The MicroBanking Bulletin, *ibid.* FATEN is part of the Middle East and North Africa peer group covered in this statistical analysis.

In Eritrea, when commercial bank branches were lost in the war-torn areas, the SMCP transported cash from other areas of the country as they had to do prior to the resurgence of the conflict with Ethiopia. Although sometimes this meant transporting cash over long distances, in the absence of corrupt behavior by authorities or prevalent theft, SMCP's security measures were sufficient to protect staff and financial resources during and after conflict periods. The Program also continued to disburse funds the same day repayments were received. A more significant effect the absence and/or the destruction of commercial banks had on SMCP was to increase the demand for individual loans and larger ones from entrepreneurs with viable projects. For a brief period, a commercial bank asked the SMCP to step in, manage additional loanable funds, and lend to new clients that met SMCP's lending criteria primarily for individual loans.

FATEN actively used the commercial banking infrastructure to disburse funds to and collect repayments from clients. When closures prevented staff and clients from getting to the banks or having regular meetings, FATEN began to adjust disbursement procedures, removing important verification steps and piloting decentralization methods sometimes even before they felt a branch was ready for increased responsibilities. While FATEN felt these steps enabled the Program to maintain their responsiveness to clients under very trying circumstances, they also recognized that having weaker branches operate in a decentralized manner increased the Program's exposure to fraud and its portfolio to higher repayment risks.

In Haiti, to further counter security problems, MCN clients were given the option to avail of the formal banking services of Unibank to repay their loans. However, it was the devaluation of the gourde that affected MCN more intensely. While MCN's profitability in gourde was positive, MCN's equity value decreased by about US$500,000, and returns to its foreign investors continued to deteriorate. Noting that local enterprises increasingly transacted business in US dollars, MCN decided to pilot extending US dollar-based loans to slow down the deteriorating effects on their equity and lending resources. However, because MCN recognized that unless a client's majority revenue base is denominated in US dollars, the currency mismatch of a client's income stream and debt repayment could present a high risk potential for MCN, they extended only five dollar-denominated loans by end-2001.

An enabling *regulatory environment and MF policies* enhances indigenous methods of efficiently allocating resources in the economy and improves MFIs' chances for long-term sustainability. Well-defined savings regulations allow for efficient and reliable mobilization of deposits and their reallocation for investment purposes. With unregulated interest rate policies, MFIs lend at market-determined prices and are better able to sufficiently cover their costs. Supportive legislation and business infrastructures allow MFIs to enforce contracts including taking formal action on defaults and seizing tangible and intangible assets. In the absence of legislation or when the regulatory environment is weak, MFIs find they have to struggle to cut through red tape and decipher which laws are enforced while working with new governments in a changed economy. However, they may be better positioned to prompt government and central bank officials to create a facilitative policy environment during the reconstruction and development phases following conflict.

In Eritrea, a number of government and financial sector policies continued to contribute to keeping the microfinance sector in a nascent stage of development and outside the formal financial sector:[8]

[8] World Bank report, *Eritrea - Financial Sector Study*. October 25, 2000.

- the Civil Code limited commercial lending rates to below 12 percent irrespective of the cost of funds or administrative cost of financial services; microfinance institutions were hampered from reaching financial sustainability and functioning competitively;
- with land being solely government property, the inability of private enterprises to own land limited their access to this most common form of collateral, particularly for the poorer, rural populations;
- the legal framework governing the microfinance sector (licensing, supervision and monitoring of MFIs, savings mobilization requirements) was yet to be developed;
- inter-linkages and cooperation between microfinance institutions and commercial banks had to be developed to stimulate growth in the microfinance sector;
- the Government remained in control of, or heavily involved in, key microfinance activities and programs; although it strongly supported well-focused, best-practice based provision of micro credit services, its policies often directly contradicted market-driven policies, limiting the expansion of viable microfinance institutions' operations.

Although the SMCP was allowed to pilot a MF program and exceed interest rates governed by civil law, SMCP was limited in its ability to raise revenue levels, introduce incentive mechanisms, and sufficiently cover all its actual costs. The Government remains committed to the development of the MF industry, however. Under a Government-sponsored demobilization program funded by the World Bank, support will be extended to modify the civil code regulating the interest rate structure, introduce regulations governing deposit mobilization by MFIs, and change SMCP's legal structure.

The absence of enabling legislation for MFIs in the West Bank and Gaza and Haiti also affected the operations of FATEN and MCN. FATEN had difficulty graduating into a bank because minimum capital requirements to establish a bank were very high. With the further deterioration of the political environment in late-2001, a review and update of the banking regulations, financed by USAID, was not completed. In Haiti, the weak regulatory and supervisory environment made it difficult to enforce contracts and implement loan default policies. Also, as the demand for savings instruments increased, some savings and loan cooperatives pushed pyramid schemes offering high returns, which could not be sustained by the assets of the cooperatives and by the economy over an unreasonably short period. MCN was concerned that its clients would fall victim to such fraudulent practices and continued to mitigate this risk through tighter loan assessment and monitoring processes.

The other preferred conditions cited above, including the *presence of a dense population of potential clients, skilled and educated workforce, and social capital* are discussed in the sections on markets for financial services and program features below.

MARKET FOR FINANCIAL SERVICES

In times of conflict, Doyle documents the fact that the economic status of the general population weakens, changing quickly and drastically the characteristics of the target client base of MF programs. Although, initially, entrepreneurs' confidence and motivation in doing business and their trust in others is greatly reduced, practitioners find that the informal sector responds to transformed conditions quickly and, in attempts to recover from the negative effects of conflicts, require financial services almost immediately. New categories of clients emerge including, for example, returnees, refugees, internally displaced people, demobilized soldiers, landmine survivors, war widows, and rape victims. Entrepreneurs that earlier had some means and access to formal banking services can no longer support large loans to rebuild their businesses or need

support from an MFI until the formal banking system is re-established. New entrepreneurs spring up, as self-employment is the only recourse to earning an income to subsist. To respond to a variety of clientele, MFIs have to: understand how the market has transformed; assess and modify products and procedures to account for the new characteristics and unique issues of a diverse client base; and recognize that the pace an MFI can reach scale and operational efficiency may be reduced. Guarantee mechanisms weaken and enterprises experience greater difficulties in observing mutual obligations and contract terms. Practitioners find, however, that by adopting a broad-based client targeting mechanism in conflict areas, they are better able to diversify operational risks and more effectively carry out financial services. Also, tension and ill will between client groups and those left out of the program are avoided and the process of reintegrating war-affected client groups into society is enhanced.

Credit is usually the first sought-after financial product and often an initial consideration used by MFIs when deciding whether a MF program should be established or continue operating. Once an assessment of the circumstances surrounding the conflict and the state of the economy returns favorable opinions, practitioners find that an early response to credit demand positively reduces the emergency and grant assistance mentality of the people; stimulates broader participation in the reconstruction process; and generates for the poor self-sufficiency and employment options. Experience shows that once coping mechanisms to counter the distresses of conflicts are in effect and the reconstruction phase is in full swing, the demand for credit dramatically increases and generates problems for MF programs relating to lack of loan capital, limited implementation capacity of MF program staff, and the ability of clients to service their debts on a sustained basis.

In reviewing practitioners' experience with savings services, Doyle documents that the demand for MF savings services is not as clearly evident as that for credit during and after conflict situations. While practitioners find that people tend to save rather than invest during these periods, MF programs are not able to access these savings because they are not permitted by law to accept deposits given their non-bank status. Those MFIs that do collect savings are limited to the levels that comply with their guarantee mechanisms, or close management of their loan portfolio prevents them from developing and experimenting with savings products. From the standpoint of clients, many find themselves cash poor and, if they are members of solidarity groups, they increasingly are unwilling to risk their little savings to guarantee repayment of other people's loans. This often leads to a drop in demand for group-based lending products and also prompts some MF programs to either lower or eliminate their savings requirements so as not to jeopardize their ability to assist those constrained by the savings requirements.

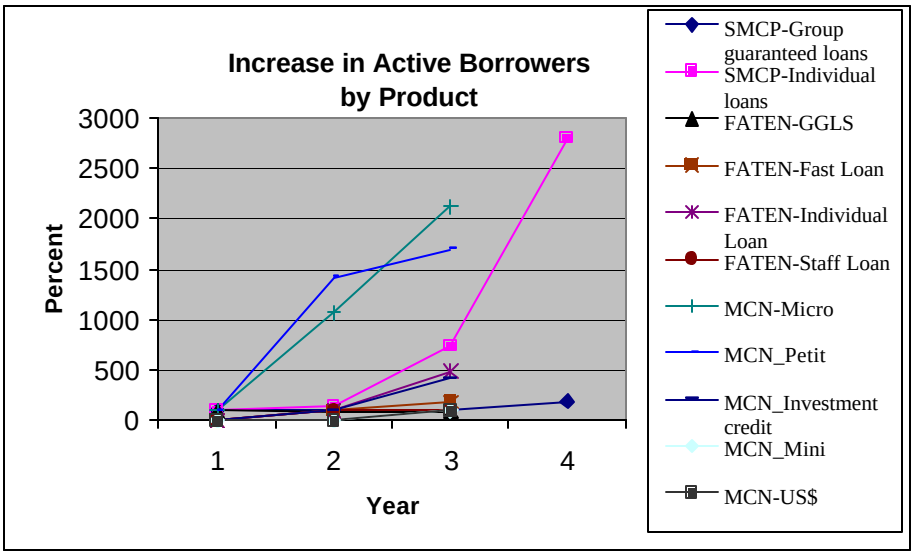
SMCP's responses in a fast-changing market environment weighed down by war matched those described by other practitioners. It introduced and expanded its program in camps and newly resettled areas and adopted a broad-based outreach strategy. The Program was available to IDPs, refugees, returnees, and demobilized soldiers but not to those yet to complete their national service duties (an offshoot of having to freeze this group's loans) and in areas where the potential for non-payment was high because of wide access to grants.

While the basis for client access to SMCP services remained essentially unchanged, downward adjustments were made to the number of solidarity group members when implementation of the guarantee mechanism was threatened by a higher number of drop outs and the loan size levels within the group varied too widely. Loan size and mandatory savings adjustments, among others, were also made to their loan products. Also, a new product was introduced to allow solidarity group members with a long track record of excellent performance to borrow on the basis of character references from their solidarity group members but without

the joint liability obligation. While SMCP adjusted upward the minimum loan size in one region because large grants were available to potential clients who also could access the grants there, generally clients were encouraged to get smaller loans and service their debts more frequently through monthly installments.

The war had a temporary declining effect on the outreach to women clients, supporting the findings in other MF programs that women experience higher sensitivity to adverse economic and political conditions. This level recovered to over 30 percent of total clients starting in 2000 when male members of the family who were called away to actively participate in the conflict did not return home or were disabled, prompting women to fill in for earlier male-led roles. Compared with the 42 percent level that other African community banks have achieved in reaching women, SMCP will have to develop other strategies to improve their performance on this aspect. As for voluntary savers, SMCP's experience reflected slow growth since its inception. At end-2001, there were 126 voluntary savers with an average savings balance unchanged at about $200. On borrowings, once aggression ceased, the demand for loan products increased. This was most notable for non-group based loans which increased (utilizing the index) by over 600 percent and 2700 percent in 2000 and 2001 compared to the 12 percent and 94 percent growth, respectively, for loans to solidarity group members (see (Figure 2). The average balance per client decreased by 5 percent the first year after the commencement of the conflict before rising by 8 percent and 61 percent in 2000 and 2001, respectively. It was about $262 at end-2001 (GDP per capita was about $164; see Figure 3).

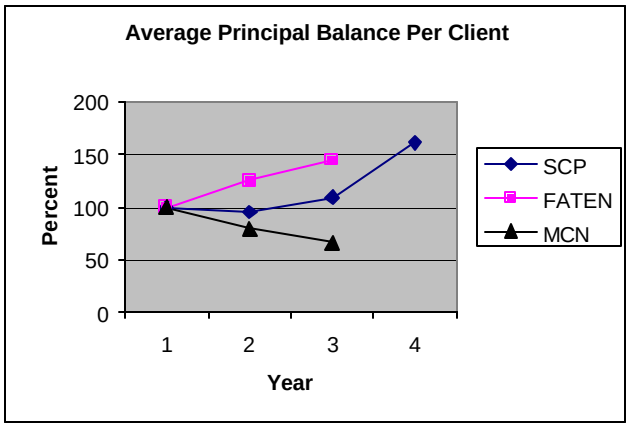
Figure 2: Increase in Number of Active Borrowers by Product
(%)



Driven by the observation that micro entrepreneurs were highly resilient and active in spite of crisis situations, FATEN and MCN expected entrepreneurs to reshape certain aspects of their lives and adjust their business activities to cope with prevailing political and economic uncertainties, violent confrontations, and personal insecurity. In continuing to operate to serve micro entrepreneurs under increasingly riskier market conditions, FATEN and MCN were required to: focus on the quality of their loan portfolio, introduce new products to enable a broader set of clients to respond to market opportunities; and take a more conservative approach in their credit approval process. MCN also: (i) raised the maximum loan size of its small loans to keep old clients whose track records were good, businesses were stable, and loan requirements

had grown; (ii) introduced a new product, mini loans, in order to reach further down the income levels to the poorer, small-scale enterprises that MCN judged to be more resilient to the changing, difficult economic conditions because of their informal nature, small size, light business structure that tended to focus on basic living requirements; and (iii) expanded its presence in the provinces to diversify their risks since political instability, security, and repayment defaults (given greater effectiveness of social cohesion) were less problematic in these areas compared to Port-au-Prince. On its second and third operating years, MCN's increase in number of active micro loans was about 1,000 percent and over 2,000 percent, respectively, and over 1,300 percent and 1,600 percent, respectively, for petite loans. The average balance per client decreased by 21 percent and 34 percent, respectively during these two years; at end-2001 it was about $85 (GDP for 2001 was $644). For FATEN, its group lending declined by about 15 percent and its fast loans and individuals loans, increased by about 87 percent and 390 percent respectively, in 2001, the second year these products were offered. FATEN's average balance per client increased by 24 percent and 44 percent in 2000 and 2001, respectively; at end-2001 it was about $316 (2001 year-end GDP was estimated at $980).

Figure 3: Change in Average Principal Balance per Client (%)



PROGRAM FEATURES

Goals. Under normal conditions, MF programs are primarily set up to meet economic goals, i.e., to facilitate the establishment and sustained operations of profitable micro enterprises and small businesses so they play an essential role in reducing poverty, generating income, and creating employment. With the onset of man-made conflicts, Doyle found that MFI's goals may shift to meeting the immediate basic concerns and providing direct relief to enable survivors, victims, and the very poor households to subsist. Some practitioners found that these measures can create goodwill and increase client loyalty. On the other hand, they also can create an entitlement mentality. MFIs that do not extend grant assistance may attempt to provide timely financial services to enable their borrowers to access opportunities stemming from various reconstruction activities, the need to fill shortages of goods and services, and the availability of international funds for economic renewal. Experiences demonstrate that the commercial focus of financial services would not be adversely affected if clear distinctions are made between these services and emergency relief.

MFIs are often called upon to contribute to resolving societal issues requiring them to complement their primary goals with secondary ones. Secondary goals are generally social and

political in nature and take the form of advocacy education (on health, human rights of women and children, attainment of peace, ethnic integration and reconciliation, for example). Organizations that respond to both economic and humanitarian development needs do not believe in giving priority to secondary goals over the economic revival of enterprises. MFIs capitalize on the need for strong collaboration with other partners in development so new initiatives addressing societal and economic issues in challenging areas are developed, the private sector can directly benefit from the ripple economic and psychological effects of business creation, and MF programs maintain self-sufficiency standards. MFIs, therefore, continue to face challenges in balancing their role in resolving larger societal goals while maintaining cost recovery standards, particularly at a time when they too are not immune from struggling to stay afloat under difficult conflict conditions.

The SMCP did not abandon its primary goal nor introduce secondary ones. As a government-run program, it was driven by the need to demonstrate the support of the Government and local authorities in correcting the economic problems arising from the conflict and enabling the private sector to reach self-sufficiency. SMCP, FATEN and MCN did not modify their primary objectives, nor did they take on secondary goals.

Strategies Faced with changes in security levels and market conditions, Doyle found that MFIs that function during and post conflict make strategic adjustments justified by the need to: respond to emergency situations, accommodate changed levels of trust among clients and shortages of physical collateral or assets, recognize a weakened human resource complement in the MFI itself, educate new partners or steer away political manipulation by local representatives, and incorporate social objectives. Some examples of strategic adjustments include the implementation of rapid market assessments of emerging financial needs in crisis-affected areas rather than carrying out thorough feasibility studies. In more volatile areas, MFIs would curtail or modify services and financial products. Where social capital or the performance of certain economic sectors were deeply affected, changes would be made to the required group membership numbers, guarantee mechanisms, and other eligibility requirements. Loan products would be developed and offered and interest rates and the frequency of installment payments would be adjusted to increase the responsiveness of MF programs. MFIs would cast a wider net to attract new staff or build new, local partnerships as their human resource structure weakens. Also, training programs would be adjusted not only to deepen the knowledge of staff and development partners in new technologies and innovative responses to the fluid conditions in times of conflict but also to steer away political manipulation by local representatives.

Principally during the reconstruction phase, SMCP had to meet organized challenges, fueled by local leaders in a number of communities, to provide loans at highly subsidized rates. To remain steadfast in meeting its sustainability goals, SMCP intensified communications on the features of the program, capitalized on the effective delivery of its services, stressed client participation in the sustained delivery of financial services, broadened and strengthened the role of the community leaders and members as their development partners, and collaborated with other donors and NGOs even in areas where the SMCP was not going to provide loans, much less grants. SMCP, FATEN, and MCN also made other similar adjustments to their strategies as described in the paragraph above.

Operations. Doyle's findings that practitioners take a very proactive role to increase their impact on clients and to enhance their clients' ability to meet loan repayment schedules is very much supported by SMCP, FATEN, and MCN. Operational flexibility is introduced and additional expenses are incurred to cover the deteriorating effects on security, infrastructure (banking system, roads, transportation system, etc.), labor, and the institution's sustainability.

Adjustments reflect a willingness to be receptive to changing client circumstances and a determination to undertake a more conservative approach to protect the MFI's financial assets.

During crises, the business attitude of the SMCP, FATEN and MCN stressed the importance of building long-term client relationships; raising the morale of their clients; assessing the physical and material damages sustained by the client's enterprise to determine the viability of the client's business activity; determining the capacity of their clients to repay existing loans and make new ones; and defining collection steps to realize repayments. The SMCP had to find ways to strengthen its presence in communities when staff turnover was high as credit officers and accountants left the program for national service, to respond to competing job offers, or to benefit from other donor-funded training opportunities. To augment its staff complement, SMCP introduced a new staffing level, resident program promoters; tapped the Government's National Service Program; and widened the ethnic representation of its workforce. While the employment expansion served the program well, it also brought with it new, and not until then experienced, problems of fraud and theft. Under pressure to improve their portfolio performance and expand, new staff and village bank officers had not been as carefully selected or trained as the original work force, and some new entrants did not display the same level of honesty and commitment to the Program. SMCP dealt with the fraud and theft cases swiftly and exposed its staff, clients, and local leaders to an enhanced training program. Its training program was also updated to inform local government representatives and community leaders of the features of the SMCP, to win the support of the community leaders and members for the sustainable development of the SMCP, and to increase the partnership role of local government officials, village administrators, and solidarity groups in the credit process. SMCP also increased staff salary levels (though these continued to remain below competing positions in the job market).

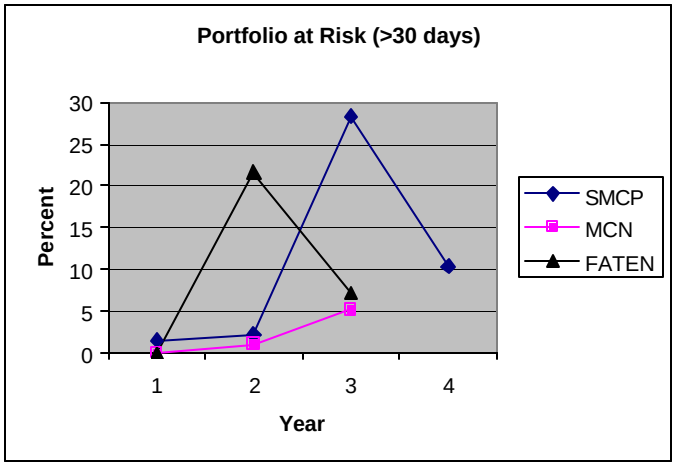
To further improve the performance of its portfolio, FATEN had to change its zero tolerance policy for non-repayment. While balancing enforcing its policies and responding sympathetically to clients' sudden life changing circumstances, FATEN agreed to allow some loans to be rescheduled; these were monitored closely and separately from the rest of the portfolio. For other loans, the repayment policy was enforced either through stepped-up collection or court procedures. In addition, a more conservative provisioning policy was adopted and non-performing loans that were over 180 days late were written off on a monthly basis; this reflected improvements in FATEN's portfolio at risk levels. Staff, however, continued to pursue repayments on these loans and were motivated to make collections by commensurate bonuses against their collections and a ban on their ability to obtain a staff loan while written-off loans under their care still had uncollected balances.

MCN took several measures to protect its clients, staff, and financial assets. One measure to counter the effects of political clashes and robbery was the procurement of services from a security contractor. This enabled MCN to receive early warnings on areas where political activities were threatening to staff security and where clients potentially would be prone to experiencing repayment problems. MCN also assessed all loan applications, new or repeat loans, to carefully consider possible over-estimation of the viability of new or existing opportunities within a declining economic environment. The additional time to analyze each borrowing unit negatively affected their outreach and efficiency levels. Before granting loans, it also required that the income level of guarantors for new clients cover at least one installment payment of the borrower. For repeat loans, MCN allowed lowering either the collateral requirement from the client or the guarantor's cover, but both requirements still had to be met. In addition to utilizing more reliable vehicles and various means of communications to deal with poor road conditions and unreliable communications systems, MCN opened counters in Unibank branches, staffed by a desk officer, and had mobile loan officers maintain close contact with clients in provincial towns.

Loans continued to be approved from MCN's headquarters, however. In addition, MCN established an arrears committee to enforce the institution's collection policies and procedures. It also accessed a central database of MF clients available to MF practitioners in Haiti to determine the credit histories of their clients (while the database was useful, MCN remained skeptical about it, since other MFIs did not follow the same standard classification for loan performance). To repay loans, MCN's clients had an additional choice of paying installments in cash or through authorized automatic debits on their (or, on rare occasions, from a guarantor's) Unibank account to be credited to MCN's account.

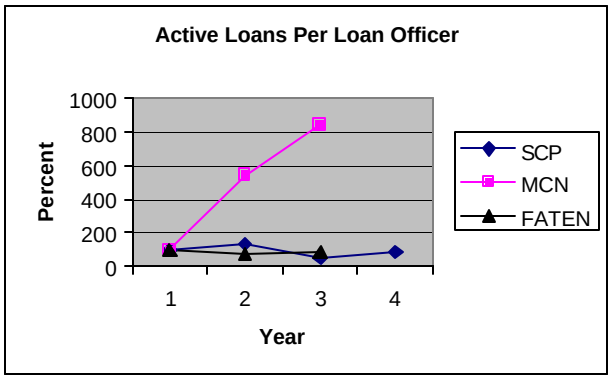
The strategic and operational changes adopted by the SMCP and support from citizens on national service kept the administrative costs of the program within acceptable MFI levels. On the quality of its portfolio, SMCP had not made any decisions yet on the outstanding frozen portfolio of clients called to national service and military duty nor did the Government inject funds to cover the associated non-performing portfolio. Adjusting for it and considering the entire frozen portfolio a loss, its 2001 portfolio at risk ratio (>30 days) was high at about 10 percent but declined from over 28 percent the year before when hostilities were at its height (Figure 4). Examining the portfolio at risk (> 90 days) ratio with that of the African community banks, SMCP's at less than 10 percent compared unfavorably with the African banks' ratio at 2.9 percent. Excluding the frozen portfolio, SMCP's portfolio at risk (>30 days) rate was above 2 percent and its portfolio at risk (>90 days) was about 1.5 percent.

Figure 4: Portfolio at Risk (>30 Days)
(%)



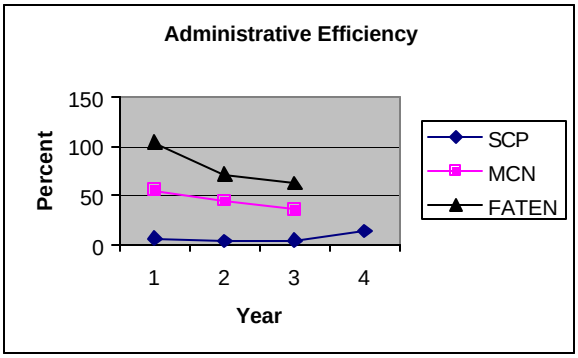
FATEN's outreach was negatively affected by the unresolved political problems with Israel in that its growth in number of loans was small. Resources devoted to loan performance led to a decline in FATEN's portfolio at risk (> 30 days) ratio to about 7 percent in 2001 from about 22 percent in 2000. Its loans per loan officer and staffing complement levels remained below that of its peers in the region, and its administrative cost as a percentage of its net portfolio, though improved, was still far above the Middle East MFIs' level. A comparison of the three programs' performance on active loans per loan officer is provided in Figure 5.

Figure 5: Change in Active Loans per Loan Officer
(%)



MCN faced difficulties in preventing a deterioration of its portfolio at risk (>30 days) ratio, which increased to about 5 percent in 2001, up from 1 percent in 2000). With an increase in staff levels (at levels higher in comparison to a peer group in Latin America), its total active loans and outstanding loan portfolio per loan officer increased, though at end-2001 they still were lower than the Latin American MFIs' average levels. MCN's administrative efficiency levels were at par with the Latin American MFIs. Figure 6 provides a comparison of the changes in administrative efficiency for the three programs.

Figure 6: Change in Administrative Efficiency
(%)



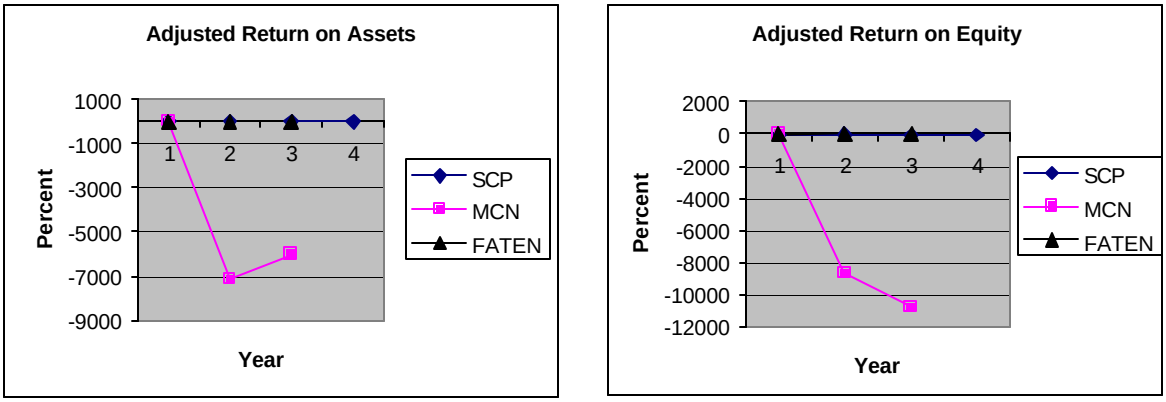
***Sustainability*.** Doyle's findings attest to the fact that practitioners, established to be sustainable economic agents, are determined to maintain best practices and standards in product pricing, outreach, operational and financial efficiency even during crisis situations. Also during these periods, MFI clients continue to place a high value on access to financial services and generally accept interest rate increases for these services. However, the sustainability of MF programs remains jeopardized by unforeseen threats resulting from high operational costs, insufficient institutional capacity, and unresolved conflict issues. Exposure to additional security requirements and the cost of coping mechanisms that mitigate operational risks result in delays toward self-sufficiency. Institutional development, characterized as being home grown, staffed by locals, and guided by a vision that fully incorporates economic development objectives to sustain the organization through crisis and transition periods, is cited by practitioners as an

ongoing, major challenge during and post conflict. MFIs in crisis-torn countries that have little or no experience with decentralized, private sector economic activity need on-going technical assistance from partners that understand the effects and lessons from conflicts and are willing to be innovative with their support in crisis environments. MFIs' chances of success are enhanced when donors enable them to be proactive and to introduce flexible responses to immediate, complex post-conflict situations; broaden their mandate so as to obscure the difference between relief and development; eliminate the unrealistic timing requirement for disbursing funds; and align their expectations on the achievement of self-sufficiency to conflict realities.

The experiences of SMCP, FATEN, and MCN demonstrate that the distortionary effects on an MFI's operations are magnified as the intensity and persistence of conflicts affect a country's economy, security, and social cohesion. As the war in Eritrea was more intense than the conflicts in the West Bank and Gaza and Haiti, SMCP had greater difficulty covering their operational costs than MCN and FATEN. However, the relatively early resolution of the war in Eritrea and the sporadic nature of the crisis in Haiti and the West Bank and Gaza supported the retention of social cohesion, key to enabling the SCP, FATEN, and MCN to increase their outreach. The increases were not sufficient, however, to bring up all the financial performance ratios to pre-conflict levels for SCP and MCN, however. In addition, the high inflationary and currency exchange pressures in Haiti negatively affected MCN's profitability far greater than either FATEN or SCP. Although the political crisis in the West Bank and Gaza remained sporadic and unresolved, with changes in macro-economic indicators less drastic than in Haiti (during the period under review), FATEN's focus on a performing portfolio and a slowdown on expansion allowed it to better their financial ratios in comparison to MCN and SCP.

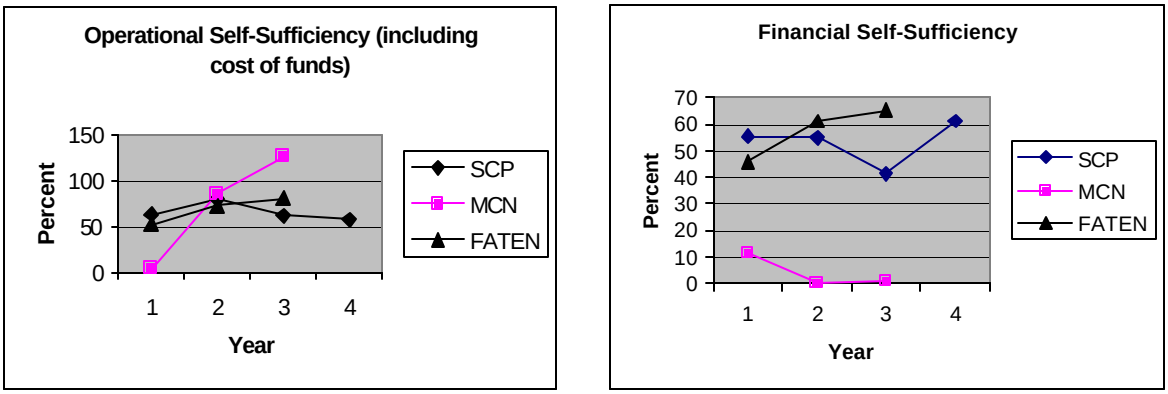
SMCP's profitability improved slightly, as reflected in its adjusted returns on assets and equity levels. SMCP's adjusted return on assets improved from about negative 10 percent at end-2000 to about negative 8 percent at end-2001, and its adjusted return on equity from about negative 81 percent to about negative 66 percent (Figure 7). At end-2001 its operational self-sufficiency ratio was about 58 percent and its financial self-sufficiency ratio about 61 percent, changed from 62 percent and 41 percent, respectively, in 2000 (Figure 8). While the return on adjusted assets was similar to older African community banks' levels, its operational self-sufficiency and financial self-sufficiency ratios were below the banks' levels of 76 percent and 73 percent, respectively. SMCP continued to require government support under World Bank-financed projects. While the program adopted best practices, did not face disbursement pressures, and utilized project funds (allowing some latitude to experiment with loan products), it was also subjected to government bureaucracy and operational and personnel policies (for example, delays in accessing its loan capital, diversion of its work force and physical assets for war-related requirements, inability to introduce salary increases and incentive schemes for staff and village committee members). Leadership with strong business and commercial orientation is still needed to enable the program to realize its full potential as the primary MF service provider in the country. Future assistance from the Government and the World Bank are focused on SMCP's institutional development (including making it an autonomous institution) and the establishment of an appropriate legal structure to foster the necessary links between the community banks and the formal financial sector. While SMCP's presence during economic difficulties enabled the program to retain and attract good clients, thereby decreasing clients' reliance on humanitarian aid, it is also clear that the capacity of some clients to service their debt was negatively affected by their lack of business skills and technical know-how to meet post-conflict demand for diversified products and markets.

Figure 7: Adjusted Return on Assets and Adjusted Return on Equity
(%)



FATEN's continued presence during the *Intifada* remained threatened by the very precarious environment they operated in. Unresolved conflict and political issues seriously delayed institutional development. However, adjustments to strategies and operational procedures, and efforts focused on maintaining a strong loan portfolio, brought about improvements in its profitability, and its operational and financial self-sufficiency ratios. At end-2001, adjusted returns on assets and equity and operational and financial self-sufficiency ratios were about negative 10 percent, negative 11 percent, 81 percent, and 65 percent, compared to about negative 15 percent, negative 17 percent, 73 percent, and 61 percent, respectively, in 2000 (Figures 7 and 8). These ratios were comparable to that of its peers' negative 6 percent for the adjusted return on assets, 87 percent and 76 percent for the operational and financial self-sufficiency ratios, respectively. FATEN remained reliant on donors and contemplated approaching them for additional resources to cover higher operational costs.

Figure 8: Operational and Financial Self-Sufficiency
(%)



MCN and its technical partner, IPC, remained strongly committed to an institution run by local managers. By end-2001, MCN reported that about 90 percent of management requirements were handled by young professional managers motivated to make a difference in their society, committed to the organization's goals, and desirous of making a career at MCN. Local and junior staff participated in defining strategies, policies, and procedures. Incentives incorporated financial and non-financial rewards, including salaries that were at par with commercial banks

and based on productivity (loans issued and rejected plus portfolio quality), intensive training conducted in-country and outside through exposure trips to other MFIs internationally, personal transport, a pension fund, and life and medical insurance for the employees and their immediate family. Staff turnover has been low. Although MCN achieved full operational sustainability in 2001, under the increasingly difficult economic conditions in Haiti, it found it very difficult to continue to meet high standards of full operational and financial sustainability within its early years of operation (it normally takes other MFIs 7-10 years to reach financial sustainability). At end-2001, adjusted returns on assets and equity were over negative 5,000 percent and negative 10,000 percent, respectively. At these levels, MCN compares unfavorably with the Latin American MFIs' levels at negative 9.3 percent and negative 30 percent, respectively. Its operational and financial self-sufficiency ratios were about 127 percent and 1 percent, respectively, compared to about 86 percent and 0.3 percent, respectively, in 2000. MCN still required donor support particularly for capacity building, outreach expansion, and product testing.

V. CONCLUSIONS

Over the years, the provision of MF services has increasingly enabled poor entrepreneurs to improve their source of revenue, promote their financial empowerment, and reduce their economic vulnerability. MF services finance investments in economic activities, fund lump sum requirements, minimize exposure to sudden income changes, and smooth consumption expenditures. With strong performance records under normal economic and business environments, MFIs are often called upon by governments, NGOs, development organizations and donors to assist the most affected victims of conflicts during and post crisis periods. Through their services, expectations are that MFIs would assist the most disadvantaged sector to play an important role in jump-starting the economy and facilitating the resumption and reconstruction of local business activities.

The experiences of the SCP in Eritrea, FATEN in the West Bank and Gaza, and MCN in Haiti provide important lessons for practitioners extending MF services. Their practical experiences demonstrate that MFIs, that are dedicated to the sustainable provision of financial services to a large number of poor clients also attempt to maintain MF best practices to permit credit to be delivered and repaid in environments marked by conflicts. Their decisions to continue operating under volatile conflict conditions were based on a few essential considerations: (i) that conflict intensity was low enough that sufficient security and stability existed and social cohesion prevailed; (ii) that markets reopened and business relationships of their clients thrived; and (iii) that they could reach their clients so loans could be made and recovered (this condition also existed for IDPs or refugees when their displacement in one place was long term). In addition, existing strategies and procedures that were designed to mitigate the absence of other important conditions (including a functioning banking system, absence of hyperinflation, population density, social cohesion, skilled workforce and favorable policy environment) were retained or modified in the interest of enabling the MFIs to respond quickly during crisis situations.

SCP, FATEN, and MCN faced conflict-related operational and financial challenges: (i) increased security risks to their staff, clients, and assets; (ii) human resource constraints as managers, staff, members, or other support groups were lost, left their country, were called to support the war efforts, or left for better job or educational opportunities; (iii) increased operational risks brought about by the effects of other MF programs that were not motivated by long-term development goals or that responded to political and self-interest motivations of local officials; and (iv) growth in administrative and operational costs and lower returns on investments

(when repayment performance declined; lending resources, including deposits, were reduced or frozen; and equity values dropped with high inflation and currency devaluations).

SCP, FATEN, and MCN responded to these challenges by exacting the same disciplined practices that served as the foundation for their success under normal environments: commercial practices, streamlined operations, incentives for timely loan repayments, and financial sustainability. This meant that their operational priorities and policies were, if anything, more conservative and focused upon: (i) re-examining and re-defining debt recovery procedures and collecting resources lent as soon as they were due; (ii) monitoring closely loan and business performance; (iii) limiting, if not stopping, new lending; (iv) decreasing loan sizes for those that qualified for one but whose businesses were negatively affected by the conflict; and (v) temporarily curtailing lending activities in response to unstable economic and political conditions in local areas most affected by the conflict. As they continued to work toward operational and financial sustainability, three key activities supported their operational priorities: (i) assessments of the country's environmental conditions to determine the essential conditions and the mechanisms to be adopted to continue operating; (ii) evaluations of the market for financial services, which served as the basis to adjust products and services; and (iii) modifications to institutional goals, strategies, and operational procedures. These modifications enabled them to respond flexibly to changing dient circumstances by focusing on building trust among clients; de-emphasizing savings as client capacity declined, security weakened, inflation increased, or supportive legislation was absent; strengthening relationships with other support groups (for example, local leaders, other NGOs and financial institutions); and addressing infrastructural inadequacies. None of these MFIs considered participation in grant programs (to meet the immediate basic concerns and relief requirements of survivors, victims, and very poor households) or adoption of secondary goals (generally designed to resolve societal issues on health, human rights, ethnic integration and reconciliation, for example).

As SMCP, FATEN, and MCN implemented decisions to operate under conflict environments, they realized that they had to delay their institutional development and progress toward self-sufficiency, given the continued high risk. Their operational costs were high and they expected to face unforeseen challenges as conflict issues remained unresolved. Also, their continued operations were contingent upon obtaining sufficient latitude and support from their Board of Directors, sponsors, and donor partners to allow them to operate like any other financial institution compelled to closely monitor and control operations so lapses in performance did not become permanent. This meant: (i) a flexible approach in responding to rapidly changing political and economic situations and subsequent difficulties faced by their clients; (ii) commitment from management, staff, Board of Directors, and development partners so a balance could be struck between the impact of the microfinance program on the country's development agenda and the MFI's commercial operations; and (iii) assurances on the availability of additional financial support to cover conflict-related increases in operational expenditures and ongoing institutional capacity building requirements.

ANNEX 1: ERITREA - SAVINGS AND MICRO CREDIT PROGRAM

Eritrea, a coastal country of about 118,000 square kilometers, is situated in the Horn of Africa and bordered by the Red Sea, Ethiopia, Sudan, and Djibouti. Its population of about 4 million had to face conflict situations now and then for over 40 years. Eritrea's struggle for independence began in 1961 after the annexation of Eritrea by Ethiopia and intensified after a military coup in Ethiopia in 1974. The country became independent in May 1993 and five years later open conflict between Eritrea and Ethiopia erupted again as a consequence of a dispute over their common borders. While little fighting took place in 1998, the war escalated in several border areas after January 1999. Until May 2000, the conflict remained sporadic and contained to a relatively limited area in Eritrea. Thereafter, hostilities intensified and resulted in widespread destruction of physical infrastructure and a humanitarian crisis with a massive and sudden internal displacement of approximately one third of the population. By June 2000 the enemies agreed to cease all hostilities and a peace accord was signed. A UN peacekeeping force was fully deployed by March 2001 and thereafter a temporary security zone was established allowing for the restoration of civil administration and the return of IDPs.

Historically, Eritrea is a nation of people with a wealth of experience in entrepreneurship, commerce, and international trade. When it gained its independence, the country rapidly re-established the main functions of government and embarked on an impressive process of reconstruction. It faced promising growth as it fully utilized its many characteristic strengths: a strong sense of nationhood, a well-organized and active community structure, strong ownership of national development programs, and a flexible approach to economic development. Noted for a zero tolerance for bribery and corruption and a strong culture of financial discipline, the new Government supported policies, strategies and investments that promoted rapid and widely-shared economic growth. However, important economic gains eroded as fighting between Ethiopia and Eritrea intensified. Macroeconomic imbalances began to emerge early in the conflict - real GDP fell sharply and inflation accelerated. Once the peace accord was in effect, the central goals of the Government's development program for 2001-2002 were focused on reconstruction, sustainable development of the economy, and poverty reduction.

The microfinance sector has been actively functioning for many decades in local, traditional Eritrean forms of rotating savings and credit clubs known as the *ekubs* and *idirs*. Also, moneylenders have been a common source of funds for rural people, but at high, unaffordable rates ranging between 70–600 percent per annum. Semi-formal and formal microfinance programs were developed only recently; eight microfinance programs exist, including the government-sponsored Savings and Micro Credit Program (SMCP). Since the cessation of hostilities in June 2000, other local and international NGOs have been collaborating with donors to provide direct support to the poor through small loans extended by the SMCP and other programs.

The SMCP was launched in 1996 as a pilot component of the Eritrea Community Development Fund (ECDF) Project of the Ministry of Local Government. With the International Development Association (World Bank) and other bi-lateral donors as its funding partners, the pilot microfinance program aimed to: support the investment activities of enterprises at the village level; create new income and employment opportunities in poor communities; and contribute to the improvement of living standards and increased overall prosperity of these communities. These objectives were to be achieved through the provision of savings and credit services to target beneficiaries including grassroots enterprises, women and poor entrepreneurs

for income generating activities; and capacity building activities aimed at ECDF staff, village administration officers (government officials and private individuals), and government officials at regional offices. The project intended to create and manage a permanent, self-sustaining savings and credit organization that would serve an expanding number of communities.

The SMCP utilized the village banking model and had three loan products: group-guaranteed loans to individual members of solidarity groups (Tier I loans), and loans to individual borrowers or associations (Tier II loans). Tier I loans ranged in size from US$75 to US$1,000 equivalent and Tier II loans were for credit requirements ranging from over US$1,000 to US$10,000. The third product enabled solidarity group members, who demonstrated a track record of perfect repayment performance in four prior Tier I loan cycles, to borrow on an individual basis. Loan size limits were the same as for Tier I loans. The interest rate had been set at 16% for all products; Tier II loans had a 2% refund feature if installments were consistently paid in a timely manner.

The table below summarizes SMCP's performance from its inception in 1996 till end-2001.

Annex Table 1: SMCP's Performance, 1996 – 2001

Item	1996	1997	1998	1999	2000	2001
Number of active loans	1,526	2,329	5,318	5,785	6,187	11,229
Number of total staff, end of period	12	18	18	14	35	60
Village (or Communal) Banks	25	39	76	85	88	146
Total outstanding loan balance (US$)	195,267	534,094	1,276,172	1,198,395	1,244,046	2,938,718
Average loan balance	128	229	240	207	201	262
Number of voluntary savings clients	0	16	57	81	88	126
Total balance of voluntary savings accounts (US$)	0	2,931	9,196	16,656	21,607	32,141
Loan loss rate	0.0%	0.0%	0.6%	2.3%	30.8%	15.0%
Delinquency rate (portfolio at risk basis > 30 days late)	0.0%	0.5%	1.5%	2.2%	28.3%	10.3%
Administrative efficiency	4.8%	11.5%	6.5%	4.3%	4.8%	14.0%
Administrative cost per active loan (US$)		21.41	15.25	9.05	7.93	14.10
Personnel costs as % of total administrative costs	75.9%	84.7%	89.3%	89.4%	83.9%	69.8%
Number of active loans per loan officer (end of period)	382	466	1,064	1,446	562	936
Number of loans per village bank (end of period)	61.0	59.7	70.0	68.1	70.3	76.9
Operational self-sufficiency	3.9%	46.6%	63.7%	80.2%	62.0%	57.8%
Portfolio yield	0.3%	9.4%	11.6%	9.5%	9.9%	19.1%
Adjusted return on assets	-16.8%	-10.3%	-7.1%	-5.6%	-9.8%	-8.1%
Adjusted return on equity	-879.2%	-171.6%	-88.9%	-54.0%	-80.6%	-66.4%
Financial self-sufficiency	2.4%	43.1%	55.5%	54.8%	41.4%	61.2%
Year-end free market exchange rate	6.7	7.2	7.4	8.2	9.6	10.9
Per capita gross domestic product (US$)	168.45	172.14	184.04	176.14	152.93	163.86

ANNEX 2: WEST BANK AND GAZA - PALESTINE FOR CREDIT AND DEVELOPMENT

The Occupied Palestinian Territories (OPT) consist of the West Bank and the Gaza Strip. Following the 1967 Arab-Israel war, Israel occupied the West Bank and Gaza (WBG) and, as the occupying power, administered the areas except for Eastern Jerusalem, which it formally annexed to the Israeli State. This annexation was not recognized by the United Nations. Israel and the WBG faced decades of confrontation and conflict over their territories until the signing of the Declaration of Principles (the Oslo Agreement) in 1993 wherein each undertook to "put an end to their conflict, recognize their mutual legitimate and political rights, strive to live in peaceful co-existence and mutual dignity and security to achieve a just, lasting and comprehensive peace settlement and historic reconciliation." They also pledged to begin permanent status negotiations in 1996 on the more difficult and important issues on their borders, Israeli settlements, security arrangements, refugees, and Jerusalem. Progress in the Palestinian-Israeli peace process followed but continued to face very serious challenges to achieving permanency. Although negotiations on permanent status was formally opened, substantive negotiations were postponed to March 1997 under the Hebron Protocol. The extended duration of the transition and the resulting undetermined outcome of the peace process continued to create political and economic vulnerabilities as unanticipated acts of political violence, border closures, and major changes in government policies persisted. Resolving territorial arrangements was complex and unwieldy and severely complicated Palestinian institution-building and administrative and economic development.

Economic growth in the WBG started to slow down at the end of the regional boom in the early 1980s. This situation was further exacerbated after 1987 with the Palestinian uprising, the first *Intifada*, which caused disruptions in economic relations with Israel and the Gulf War. The 1990s saw the WBG economy fluctuate from an economic boom year in 1994, a severe depression in 1995 and 1996, stagnation in 1997 and economic recovery and growth in 1998 and 1999. Since the commencement of the second uprising, the Al-Aqsa *Intifada*, in September 2000, WBG experienced a downward economic trend because of periodic tightening up of the regulatory regime, Israel policies on closures and strikes which restricted the movement of goods and negatively affected people's employment and trading activities, and declines in exports. Structural imbalances in the WBG economy emerged over time and continued to be apparent in several areas including a heavy dependence of the WBG labor force on outside sources of employment; a very low degree of industrialization; a trade structure in deficit and heavily dominated by links with Israel; and inadequate public infrastructure and services. The serious delays in the peace process and these structural economic disparities continue to seriously handicap the future economic prospects of the WBG.

Despite the economic difficulties, measures were taken by NGOs to bridge the gap on the availability of financial services to microenterprises as the formal banking system shunned away from supporting this group they considered unacceptably high risk. The NGO programs, however, remained small, offered loans at subsidized rates, were not business oriented and were far from operating on a sustainable basis. Microfinance programs were slowly building capacity to operate on a sustainable basis but continued to rely on support for their operational and loan fund requirements from donors. However, donors were sometimes unable to respond or remained reluctant to support given the political crisis. The United Nations Relief and Works Agency operated a microfinance program but, being lodged in a larger grant-oriented organization, it faced large repayment problems specially since the second *Intifada.* The Bank of Jordan and the Arab Bank also implemented best practice small business lending programs though these did not target the entrepreneurial poor.

The Palestine for Credit and Development (FATEN) is the only microfinance institution in the OPT. FATEN has its roots in a credit program, Small Enterprise Development Program, which was started in 1986 by a US-affiliated NGO, Save the Children (SC). Working to address the shortcomings of this program, SC initiated a pilot initiative, the Group Guaranteed Lending and Savings (GGLS) Program. FATEN commenced in January 1995 as a pilot GGLS Program that focused on providing financial services to women, who were the majority of the poor and traditionally excluded from formal sources of credit. Very early in its development process, the program was founded on good MF principles. In addition to extending small loans on commercial terms, development approaches incorporated cost-effective policies, strategic planning, and the creation of a proper institutional framework for expansion.

FATEN offered four loan products to rural and semi-urban (refugee camp) populations: (i) Group Guaranteed Lending and Savings (GGLS) Scheme for women groups; (ii) fast loans were repeat loans for groups that had been clients of FATEN for more than one year; (iii) individual loans were extended to existing clients who had completed at least Phase I of the GGLS and whose businesses had grown to require loans larger than JD1000; and (iv) staff loans.

The table below summarizes FATEN's performance from 1999 till end-2001.

Annex Table 2: FATEN's Performance, 1999 – 2001

Item	1999	2000	2001
Number of active loans	5,079	4,352	4,498
Number of total staff, end of period	70	80	85
Branches	8	9	9
Total outstanding loan balance (US$)	1,107,268	1,187,169	1,422,408
Average loan balance	218	273	316
Number of voluntary savings clients	0	0	0
Total balance of voluntary savings accounts (US$)	0	0	0
Loan loss rate	0.0	0.03%	7.74%
Delinquency rate (portfolio at risk basis > 30 days late)	0.05%	21.58%	7.19%
Administrative efficiency	104%	72%	63%
Administrative cost per active loan (US$)	152	158	188
Personnel costs as % of total administrative costs	70%	71%	73%
Number of active loans per loan officer (end of period)	127	97	112
Number of loans per branch (end of period)	635	484	500
Operational self-sufficiency	53%	73%	81%
Portfolio yield		51%	52%
Adjusted return on assets	-25%	-15%	-10%
Adjusted return on equity	-28%	-17%	-11%
Financial self-sufficiency	46%	61%	65%
Year-end free market exchange rate (US$/local currency)	0.71	0.71	0.71
Per capita gross domestic product (US$)	1,500	1,448	980

ANNEX 3: HAITI - MICRO CREDIT NATIONAL, S.A.

Haiti, in the West Indies, shares the western third of the island of Hispaniola with its neighbor, the Dominican Republic. Throughout the 1990s the international community tried to establish democracy in Haiti. The country's first democratic elections were held in 1990 after years of violence and political unrest; Jean-Betrand Aristide took office in February 1991. With political instability continuing, a military coup ousted him later in 1991 but he returned to power in October 1994. Under thirteen governments since the early 1990s, the country does not have a tradition of governance directed at assisting the population or creating an enabling environment for sustainable growth. Poor governance and political instability have hindered Haiti from reaching a sustainable development level. During these periods, the donor community suspended assistance (the most recent one in May 2001 still prevails). Haiti continues to be classified by the World Bank as a post-conflict country given the continuous low intensity conflict and political crisis and intermittent violence. Economic improvements are not foreseen as long as the public sector's capacity and accountability remained weak, education levels were low, infrastructure continued to deteriorate, and arable land relative to the population was scarce.

In Haiti, microfinance has been a large, diversified and potentially competitive industry. Banks, savings and loan cooperatives, NGOs, village banks, and a range of moneylenders and pawnshops provided microcredit services in the nation's capital, Port-au-Prince, other cities, and rural areas for trade, commerce, and farming purposes. Many of the banks and MFIs were characterized as young, without sufficient experience with micro credit technology, and serving clients with a poor track record of following the terms of credit contracts. As Haiti continued to carry a higher-than-average country risk rating, the MF sector seemed to be facing increasing volatility as borrowing levels dropped, entrepreneurs preference for savings instruments intensified, and MF opportunities to expand outreach and increase revenue remained limited.

One actor in Haiti's microfinance sector is the Micro Crédit National S.A. (MCN), MCN is a commercial MFI whose shareholders include Unibank, Haiti's second largest commercial bank; Internationale Micro Investitionen AG (IMI); the International Finance Corporation; Nederlandse Financierings-Maatschappij Voor Ontwikkelingslanden NV (FMO); and the International Cooperation and Development Fund. MCN was established in 1999 when the country faced political crises and continued to deal with intermittent absence of law and sporadic threats of violence. Then, MCN's investors and technical advisors felt that, although security was a major issue to contend with, they expected business activities of micro and small enterprises to persist and grow. The formal business sector continued to weaken, wage earners were losing their jobs in growing numbers, and many of them were resorting to establishing independent business operations, particularly trading, to survive. More than 60 percent of the working-age population did not have steady employment and micro and small enterprises were becoming an important source of the country's value added and more than 90% of total non-agriculture employment.

It was important to its investors that MCN's establishment was conditioned on having institutional investors and technical advisors absolutely committed to the sustainability principles governing MF services. Adopting the same credit technology that IMI utilized throughout its network of 18 international microfinance institutions for loans to individuals, MCN offered various loan products: micro, mini, small (the distinctive feature being loan size), and investment loans. The investment loans were intended to meet the demand of clients with a stable income who were also interested in having their own business. Additional loans were targeted at

customers who had an outstanding loan, an excellent repayment record, and required additional resources to seize a market opportunity. MCN was also piloting another loan product, small US dollar-denominated loans, designed for entrepreneurs who would benefit from borrowing in foreign currency and who could support the exchange rate risk. MCN aimed to play a major role in the country's economic development by becoming one of the largest suppliers of micro credit for Haitian entrepreneurs who lack easy access to traditional credit from the formal banking sector.

The table below summarizes MCN's performance from its inception in 1999 till end-2001.

Annex Table 3: MCN's Performance, 1999 – 2001

Item	1999	2000	2001
Number of active loans	87	1,035	2,209
Number of total staff, end of period	19	41	61
Branches	1	4	5
Total outstanding loan balance (US$)	12,218	100,533	187,333
Average loan balance	140.44	97.13	84.80
Number of voluntary savings clients	0	0	0
Total balance of voluntary savings accounts (US$)	0	0	0
Loan loss rate	3.0%	5.8%	6.1%
Delinquency rate (portfolio at risk basis > 30 days late)	0.0%	1.0%	5.1%
Administrative efficiency	55.7%	44.7%	35.7%
Administrative cost per active loan (US$)	151.79	42.76	30.40
Personnel costs as % of total administrative costs	6.9%	50.2%	65.0%
Number of active loans per loan officer (end of period)	9	47	74
Number of loans per branch (end of period)	87.0	258.8	441.8
Operational self-sufficiency	5.0%	86.1%	126.9%
Portfolio yield	2.8%	45.3%	70.6%
Adjusted return on assets	-2.0%	-7115.1%	-6002.1%
Adjusted return on equity	-4.4%	-8682.0%	-10810.3%
Financial self-sufficiency	11.5%	0.3%	1.0%
Year-end free market exchange rate (local currency/US$)	15.09	17.31	16.50
Per capita gross domestic product (US$)	588.28	563.01	644.40

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