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# MICRO-FINANCE IN CONFLICT: STRATEGIES FOR DEVELOPMENT AND PEACE IN THE ESCWA REGION

**2009**

## ABSTRACT

This report tackles microfinance amid conflict in the ESCWA region through a review of the main issues, such as the provision of microfinance services, the role of microfinance in development and the unique challenges faced by conflict-affected countries concerning microcredit and the development of financial markets. It also surveys microcredit providers in ESCWA's conflict-affected countries, with an overview of the Arab World and a country level analysis of Iraq, Lebanon and Palestine. The report also analyzes effective strategies for microcredit programs amid conflict, while focusing on the role of microfinance both in development and peacebuilding. It concludes with recommendations based on international best practices, and the experiences of different countries in the region and worldwide, specifically those in conflict.

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## ACCRONYMS

| | |
|---|---|
| UN | United Nations |
| ESCWA | Economic and Social Commission for Western Asia |
| MFI | Microfinance Institution |
| IMF | International Monetary Fund |
| GDP | Gross Domestic Product |
| NGO | Non-Governmental Organisation |
| MDG | Millennium Development Goals |
| USAID | United States Agency for International Development |
| ACSI | Access to Credit Services Initiative |
| WWI | Women for Women International |
| CHF | Cooperative Housing Foundation |
| CAP | Community Action Programme |
| IMMDF | Iraq Middle Market Development Foundation |
| ACNI | Access to Credit in Northern Governorates of Iraq |
| ICBG | Iraqi Company for Bank Guarantees |
| IFC | International Finance Corporation |
| UNOPS | United Nations Operations Support Services |
| LSC | Local Steering Committees |
| MIS | Management Information System |
| AMEEN | Association d'Aide au Developpement |
| ESFD | The Economic and Social Fund for Development |
| PARC | Palestinian Agricultural Relief Committees |
| MSEs | Micro and Small Enterprises |
| CWEP | Center for Women's Economic Projects |
| CGAP | Consultative Group to Assist the Poorest |
| GTZ | Deutsche Gesellschaft für Technische Zusammenarbeit |

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## EXECUTIVE SUMMARY

This report examines Microfinance in general and the provision of microfinance services in conflict afflicted areas in the ESCWA region in particular, and offers recommendations on the best practices of microfinance during and post-conflict, specific to this region. Information in this report was compiled from secondary reports and data from different national and international institutions, think tanks and UN agencies as well as the MIX Markets database which contains detailed microfinance indicators.

The first part of the report tackles microfinance amid conflict through a review of the main issues. It starts with stating the role of microfinance in development, and placing the context of post conflict and the microcredit challenges during conflict situations. As stressed by the United Nations' Secretary General in his report on "the role of microcredit and microfinance in the eradication of poverty" [1], the well targeted provision of microcredit to the poor has a direct positive impact on their lives. Indeed, it is widely recognised that countries with low income would benefit from microfinance services in order to achieve the Millennium Development Goals. Microfinance gives access to financial services such as savings, credit, insurance and money transfer to people that otherwise would remain underserved. This definition of target beneficiaries differs between one institution and another. While some benefit the entrepreneurial poor which can sustain themselves, other benefit the upper poor or even the lower poor which can be targeted by different mechanisms before they are ready for the financial services which regular microfinance institutions offer.

Microfinance contributes to micro-and small-scale enterprise development, which in turn is conducive to economic growth and therefore sustainable development, thus making the poor economically active in the societies they belong in. It has been noted that only sustainable Micro Finance Institutions (MFIs) that can attract commercial sources of funds will be able to grow and serve more poor people. The ESCWA region in particular is full of experiences; both positive and negative, on how institutions, mainly MFIs, coped with harsh conditions of conflict. The constraints facing the micro and small enterprises industry during conflict are mainly those than stem from the instability and the political turmoil. This drives up risks and increases uncertainty which has negative effects on investments and especially on credit institutions. Compared to countries which are not affected by conflict, those emerging from conflict face unique challenges in developing their financial markets. Post-conflict countries need institutions which can work in an initial environment characterized by lack of security, trust and infrastructure, psychological distress of the refugees and war returnees, and high population mobility.

The second part of this report surveys microcredit providers in ESCWA's conflict-affected countries. The analysis provides an overview of the Arab World and a country level analysis of Iraq, Lebanon and Palestine. Providing credit to the micro-enterprises in these countries will develop human resources; improve the poor's ability to generate income and thereby improve their livelihood. The microfinance industry in the ESCWA region has witnessed much progress, mainly with regards to market penetration which has increased remarkably, with the active clients almost up by five times between 1997 and 2002 (source). The sector is said to have good exposure and a good understanding of good practices and regulation which are largely applied in the region.  To promote the microfinance culture in the region, governments, NGO's and the general public need to have more information about this sector. A further step is to

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[1] United Nations Report of the Secretary General on the Role of Microcredit and microfinance in the eradication of poverty, General Assembly, A/63/159, 29 July 2008

encourage commercial banks' participation in micro-lending. In addition to that, there is a need to empower women and increase their productivity, as the region has the one of the lowest rates of female labour force participation. The main challenges in the region remain however the absence of stability and the increased uncertainty of ongoing and protracted conflicts.

The report proceeds to analyze effective strategies for microcredit programs amid conflict, while focusing on the role of microfinance both in development and peacebuilding. From essential and preferred environmental conditions to governance and institutional characteristics of MFIs to outreach, financial concerns, efficiency and productivity issues. The report also discusses how MFIs coped and should cope with default risk especially in conflict situations, and how technical assistance and training needs are crucial during conflict. Also in this section is a discussion on donor policies and criteria.

The report concludes in Part four with recommendations based on international best practices, and the experiences of different countries in the region and worldwide specifically those in conflict.

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## Part 1. Microfinance in Conflict: A Review of the Main Issues

### 1.1 The role of microfinance in development

Microfinance is the offering of financial services to the entrepreneurial poor. Although the most notable of these services is the provision of credit, many other offerings are a part of microfinance including credit for business activities and credit for emergency and life cycle needs. Savings and deposits services are also an important service which microfinance facilitates for the poor and a source of funding which is crucial for microfinance institutions to promote their sustainability, decrease their dependence on donor money, and strengthen their resilience. While microfinance was originally conceived to target the poor, an in-depth study by the Consultative Group to Assist the Poor of the client base of seven microfinance institutions in Asia and Africa, found that a large majority of microfinance clients were moderately poor (those in the top 50 percent of households below the poverty line), few were from extremely poor households (those in the bottom 10-50 per cent below the poverty line) and none were destitute (those in the bottom 10 percent)[2], hence reference above to the "entrepreneurial poor".

The United Nations Secretary General's report on the role of micro-finance in the eradication of poverty in 2008 clearly states that there is ample evidence that access to credit has given many poor people the means to increase, diversity and protect their sources of income to come extent[3]. This view was reiterated by the UN General Assembly in a resolution adopted in March 2009 stating that microfinance, in particular microcredit programmes, has succeeded in generating productive self-employment and proved to be an effective tool in overcoming poverty and reducing the vulnerability of poor people to crisis and has led to their growing participation, in particular, the participation of women, in the mainstream socio-economic and political processes of society.[4] Indeed, microfinance efforts directed towards the financing of women help poor women increase their incomes and savings, improve nutrition and health, and increase their empowerment. This explicitly satisfies the objectives of three MDGs related to poverty eradication, maternal health, and women empowerment, and trickles down to affect other goals.

Through microfinance, developing countries will help their local private sector to grow and sustain itself, and create wealth for people with low income. As highlighted by the UN Millennium Project, the recommendations related to microfinance seek to direct countries' focus towards building inclusive financial sectors that will help these countries reach the MDGs[5].

Microfinance gives access to financial services such as savings, credit, insurance and money transfer to people that otherwise would remain underserved. These people are usually denied access to commercial loans because they do not have enough means to be able to repay[6]. This is where microfinance comes in to provide this part of the population which is underutilized, and jumpstarts their productivity through offering services that would help them increase their

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[2] Helms, B. "Access for All: Building Inclusive Financial Services". Consultative Group to Assist the Poor, World Bank Publications, 2006, p.20

[3] UN SG's report on Microfinance, Op Cit, para. 15, p.6

[4] United Nations General Assembly Resolution A/RES/63/229, Role of microcredit and microfinance in the eradication of poverty, 10 March 2009, p.1

[5] UNCDF. *Microfinance and the Millennium Development Goals.* UNCDF, 2005. *http://www.yearofmicrocredit.org/docs/mdgdoc_MN.pdf*

[6] Elia, Marco. *Microfinance: Text and Cases.* Turin, Italy: SAA, School of Management – University of Turin, 2006.



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household income and employment opportunities and consequently create demand for other goods and services including education, nutrition and health[7]. This is true in the case of the entrepreneurial poor who, unlike the extremely poor, have the ability to sustain themselves but only lack the means by which they can increase their income and improve their business activities. Clearly, Micro Finance Institutions (MFIs) do not only serve in raising the living standards of the poor, they also generate employment and eventually add to GDP growth and the economic cycle as a whole.[8]

Core principles of good microfinance include providing financial services beyond credit and savings facilities; improving the regulations regarding the legal form of the institutions permitting the transformation of non-regulated MFIs into specialized, regulated, or licensed rural finance and microfinance intermediaries. In addition to that, services include promoting awareness towards transparency in financial accounting and transaction reporting and encouraging the exchange of clients' credit histories.

Through providing an access to credit and savings, MFIs help poor people take on productive activities, and cross the poverty line. This explains the popularity of microfinance among donors. Nevertheless, according to the IMF, this approach involves the risk of funds being deviated from other prominent investment areas such as education and healthcare projects[9]. For example, if a donor institution is interested in development work in a certain community, it has different options to choose from, and choosing microfinance has an opportunity cost which derives from other choices to help a community such as building a school or a hospital.

It is worth noting that having access to finance is not always synonymous with generating income. Nevertheless, micro-credit is a crucial input in developing small enterprises. Microfinance triggers the efficient use of underutilized resources kept idle in poor societies due to the lack of knowledge and capabilities essential to properly invest in them. These resources could include both labour and capital. MFIs are not only working on allocating resources which could have otherwise been used on other projects, they are utilizing resources which were neglected both by the public sector and by big financial institutions.[10]

Only sustainable MFIs that can attract commercial sources of funds will be able to grow and serve more poor people. Profitability is seen as evidence that microfinance is a successful practice, and self-sufficiency is essential for the industry to grow without the burdens tied with donor-dependency.

After years of experience with microfinance, there is no comprehensive data on the sector. The industry has a very large number of institutions but they only serve a very small number of clients, and the percentage of borrowers out of the market potential is still extremely low. Most activities are concentrated in a few countries where a few large institutions engage in the bulk of the transactions[11].

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[7] Brandsma, Judith, and Laurence Hart. *Making Microfinance Work Better in the Middle Ease and North Africa.* World Bank, 2004.
[8] Brandsma, Judith, and Deena Burjorjee. *Microfinance in the Arab States: Building Inclusive Financial Sectors.* United Nations Capital Development Fund, 2004.
[9] IMF. "IMF Survey." *International Monetary Fund-IMF.* March 21, 2005. www.imf.org (accessed August 19, 2009). ***https://www.imf.org/external/pubs/ft/survey/2005/032105.pdf***
[10] Boynioughnian, Hagop Krikor. "Microfinance in Lebanon." *American University of Beirut*, 2005.
[11] IMF 2005, Op Cit.

### 1.2 The context of conflict and post-conflict

Today, several environmental factors affect the functioning of microfinance institutions worldwide in general, and in the ESCWA region in particular. Internal conflicts and inter-country wars have been detrimental to economic activities and have resulted in incurring developmental losses. The region is full of experiences; both positive and negative, on how institutions; mainly MFIs, coped with harsh conditions of conflict. Functioning in a conflict environment can be very stressful, difficult and costly. This section identifies some trends specific to conflict economies and the constraints MFIs are faced with during these specific conditions.

Conflict and post-conflict environments can be defined by three main characteristics, first in the psychosocial context, there is loss of trust, geographic separation from families and fear of violence. Secondly, the economic situation is weak and distorted, there is a loss of household and business assets, lack of trust in the financial system and a small pool and high cost of skilled human resources; and thirdly, the infrastructure is damaged while many have lost access to basic services such as schooling, sanitation and healthy care.[12]

There are microfinance trends which are specific to post-conflict situations. Most MFIs attempt product modifications and alter certain procedures for example rescheduling loans or providing new products that would be suitable for reconstruction after conflict, which can sometimes highly increase risk and cost. Post-conflict MFIs are faced with major human resource limitations and therefore as opposed to non-conflict situations where MFIs compete with the private sector to attract talented staff, the limitations of post-conflict situations with regards to human resources accelerate operational costs as a result of hiring foreign staff, or training locals[13]. Security considerations also affect post-conflict MFIs by limiting operations and raising costs. These include both the staff's security as well as that of the clients. In addition, conflict environments limit the opportunities for entrepreneurship and launching of new ventures, which are highly risky and costly. These factors which are specific to conflict affected economies impede the sustainability of MFIs at both the financial and institutional level.

The constraints facing the micro and small enterprises industry during conflict are mainly those that stem from the instability and the political turmoil. This drives up risks and increases uncertainty, which has negative effects on investments and especially on credit institutions. Furthermore, increased operational risk can also result from parallel relief-oriented programmes, short-term oriented micro- finance projects, often implemented by humanitarian organisation, and political or self-interested motivations of local officials. The reason for the increase in administrative and operational costs could be attributed to rising monitoring expenses to maintain high-quality portfolio, additional security precautions, higher labour costs, additional investments in advocacy work, and training and re-training efforts.

Challenges during conflict increase MFI's overall risk especially that related to their balance sheet. Conflict also lowers the returns of investments. This is due to weakened repayment since the clients are displaced and suffer from a reduction in their productive and operational capacity. Furthermore, loan funds are decreased since deposits or lending resources

[12] CGAP Supporting Microfinance in Conflict Affected Areas, Donor Brief no.21, 2004, p.1
[13] USAID and DAI, "Environmental Preconditions for successful post-conflict microfinance" Microenterprise Best Practices Project Brief no. 5

are frozen or reduced, and equity values decline as a result of inflation and currency devaluations.

### 1.3 Micro-credit and Peacebuilding

Microfinance can be a useful tool in post-conflict recovery, both for development and for building sustainable peace. By providing access to financial services, it can restart and boost local economic development. In addition, it can play a major role in immediate post-conflict rehabilitation assistance. Beyond these economic benefits, microfinance can be highly effective at social mobilization, empowerment, stabilization and enhancing solidarity, through social capital enhancement.[14]

One of the five core objectives to achieve peace and post conflict recovery, according to the 2009 Report of the UN Secretary General on "Peacebuilding in the Immediate Aftermath of Conflict" in 2009 to support economic revitalisation, including employment generation and livelihoods particularly for youth and demobolised former combatants, as well as rehabilitation of basic infranstructure.[15] All areas of development which benefit from microfinance.

As stated by Marino (2005), violent conflicts mostly affect the poor because they are physically vulnerable, live in hazardous conditions, and lack strong social safety nets. The social capital of the poor is eroded as a result of the constant feelings of insecurity that come after conflict. Conflict also weakens the poors' organizations, constrains their social and physical mobility, and prolongs poverty's vicious circle.[16]

Most importantly, studies show that microfinance encourages reconciliation and conflict resolution[17] by involving cross-ethnic cooperation; for example producers and consumers interact across ethnic borders. According to Larson (2001), microfinance efforts smooth the transition to a 'normal life' after conflict by developing social capital through solidarity mechanisms.[18] In addition, microfinance can encourage the reintegration of refugees, returnees and demobilized soldiers, by facilitating the development of economic activities, collaboration with local populations and fulfillment of entrepreneurial spirit. Indeed, when people need to earn a living to survive, conflict becomes secondary.[19]

By empowering members to establish their own organizations, microfinance integrates democratic procedures that help people surmount conflicts. For communities divided by conflict or caste, developing credit and savings associations could be a way to bring people together, focusing on economic activities and cooperation rather than differences. Providers of microfinance services have found that group-based activities contribute to empowerment by allowing people to regain trust and confidence in each other. Groups can also discuss issues of tolerance and conflict resolution, and become catalysts in wider peacebuilding. Thus, the benefits

[14] Marino, Pascal. *Beyond Economic Benefits: The contribution of microfinance to postconflict recovery in Asia and the Pacific.* Brisbane, Australia: The Foundation for Development Cooperation, 2005. *http://www.gdrc.org/icm/country/fdc-afgan.pdf*

[15] UN Report of the Secretary General on Peacebuilding in the Aftermath of Conflict, A/63/881, 11 June 2009, para. 17, p.6

[16] Ibid.

[17] See Doyle, Karen. *Microfinance in the wake of conflict: challenges and opportunities.* Microfinance Best Practices, 1998. *http://www.microfinancegateway.org/gm/document-1.9.28945/1234_01234.pdf*

[18] Larson, Dave. *Microfinance Following Conflict, Briefs* . Microfinance Best Practices, 2001. *http://www.gdrc.org/icm/disasters/microfinance_following_conflict_main_brief.pdf*

[19] Marino 2005, Op Cit.

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of microfinance in post-conflict situations go well beyond the economic, to the intangible, enhancing social capital and empowerment, and ultimately, contributing to peacebuilding and reconciliation.[20]

## Part 2. Micro-Credit Providers in ESCWA's Conflict-Affected Countries

### 2.1 Overview of micro-credit in the ESCWA region

While there is a significant lack of accurate and timely data on micro-credit at the regional level, some studies show that in 2005, more than 60 active microfinance programs were implemented in the region, of which 40 have been run by non-governmental organizations (NGO's) with microfinance activities lodged as part of their larger social operations and quasigovernmental organization- including state-owned banks operating under government oversight and serving merely as windows for credit delivery[21].

**Table1: Number of Borrowers, Volume and Average of Loans by Country**

| Country | Number of Participating MFIs | Number of Active Borrowers | Loan Portfolio (USD) | Average loan balance per borrower (USD) |
|---|---|---|---|---|
| Egypt | 13 | 666,300 | 116,602,018 | 175.00 |
| Jordan | 6 | 100,206 | 93,595,303 | 934.03 |
| Palestine | 6 | 24,699 | 43,616,249 | 1765.91 |
| Yemen | 5 | 18,354 | 2,079,131 | 113.28 |
| Lebanon | 3 | 17,730 | 15,260,580 | 860.72 |
| Syria | 2 | 16,297 | 14,050,128 | 862.13 |
| Sudan | 2 | 6,858 | 1,708,036 | 249.06 |
| Iraq | 1 | 5,268 | 8,341,706 | 1583.47 |
| | | | | |

*Source: Microfinance Information Exchange, Inc., 2007 Benchmarks*

Taken from the MIX Market benchmarks of 2007, the country level data on the number of firms participating in the study, the number of borrowers, loan portfolio and average balance per borrower in Table 1 reveals that the highest number of active borrowers is in Egypt which also has the highest loan The highest average loan balance goes for Palestine with 1765.91 USD per borrower, while the lowest figure is in Yemen with 113.28 USD per borrower which can be explained by the fact that Yemen is one of the two least developed countries (with Sudan) in the ESCWA region and therefore has significantly lower living standards and GDP per capita.

[20] Marino 2005, Op cit.
[21] Boynioughnian, Op Cit

The microfinance industry in the Arab region has witnessed much progress since the first microfinance survey in 1997[22], whereas market penetration has increased remarkably, with the active clients almost up by five times between 1997 and 2002. The sector has had good exposure and an increased understanding of good practices and regulations which are largely applied in the region. The industry contains a high number of fully financially sustainable institutions which are providing services to a large part of the market. According to Brandsma and Burjorjee (2004), signs of product diversification are starting to appear in the industry as MFIs are tending to be more oriented towards the clients and increasing competition[23]. The market has also been entered by some commercial banks and new MFIs which are transforming into single-purpose MFIs depending on their countries' legal framework and regulation that permit this kind of organizational change.

Numerous initiatives have been taken to promote the need for specialized laws and regulatory frameworks regarding microfinance, which is essential to the development of the sector. These laws also include effective regulation by the Central Banks of the respective countries. In addition to these initiatives, a regional network dedicated to advocacy and capacity building for good practice microfinance is facilitating learning and exchange of know-how in the region. Applying microfinance is a easier than ten years ago due to the massive empirical experience which many countries in the region underwent.

Considerable work still needs to be done to move the microfinance industry in the Arab region from the infancy stage it is in to more maturity and consolidation. The challenges the industry had to face were inefficient systems and procedures, excessive donor and reporting requirements and the lack of management information systems. Today, there is a need for product diversification: introducing savings, leasing, insurance and for considerable capacity building since MFIs are becoming more service oriented, and are offering a wider range of products while other MFIs progressively seek transformation to overcome the legal constraints brought about by the NGO laws in their countries since for example, NGOs are not granted rights to hold savings. In addition to these challenges, donor dependency continues to be an issue, as only few microfinance institutions have been successful in gaining access to commercial capital in the ESCWA region. This also stresses on the need for enhancing the regulatory framework. Programs subsidized by the government are providing cheap credit to big numbers of people among the region, and this has a distortionary effect on the industry's overall performance.[24]

## 2.2 Micro-credit in Iraq

Before 2003 the Iraqi banking system was dominated by two state-owned banks, the Rafidain and Rasheed banks. The two banks provided basic banking services and their main focus was to provide cash payments for government employees, pensioners and welfare recipients. Some small private banks were registered with the Central Bank of Iraq but these banks had few branches and provided very few services with almost no lending.

[22] Brandsma and Burjorjee 2004, Op Cit
[23] Ibid.
[24] Ibid.

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In 2003 the United States government provided grants worth $30 million so that two international NGOs could develop microfinance institutions (MFI) across the country. One NGO received $21 million and operated in the north of the country, the other NGO received the remaining $9 million and operated in the south. USAID contributed a further $20 million in 2005 through the Izdihar project so that the microfinance industry could be further rebuilt through training and technical assistance[25]

Demand for microfinance has continued to grow ever since. By June 2007 the total loans surpassed the $100 million mark of funds disbursed for the first time since microfinance activities were launched in Iraq. On the whole MFIs operating in Iraq had "over 19,000 active clients and managed an outstanding loan portfolio of $26,800,000 by mid-2007[26]".

While the majority of loans were made to men, approximately 13% of the loans were made to female clients[27]. This percentage of loans made to women is however significantly lower than in other countries in the region with more developed and consolidated microfinance industries like Morocco or Egypt. Some experiments involving women have however already been implemented. Women for Women International for example established a microfinance program with the help of Global Giving funds. The program promotes basic lending policies and practices, offers business planning training for potential clients and makes zero-interest equipment and raw materials loans to program participants. The objective of the program is to provide the training required for 100 women which would enable them to develop an income-generating activity. The program focuses on the importance of solidarity: in order to join the program a client must form a group of three to seven women, all of whom must agree to make any missed payment of any member of the group. Women for Women International (WWI) considered that loans for equipment and raw materials constitute the best ways to stimulate during the initial phases of the microfinance program: loan recipients make regular payments to WWI for the value of the equipment or materials, which are purchased on their behalf. Business plans are assessed and approved by the program manager and loan officers. Graduates of the plan are encouraged to develop income-generating plans using the new skills learned. The Iraqi Widows Organization also received a grant with similar purposes. The grant achieved its objective of improving 120 widows ability to recover their economic capacities by providing micro-credits with an overall success of 116 micro-credits (97%)[28].

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CHF (Cooperative Housing Foundation)[29] began working in Iraq in June 2003 at the request of USAID. CHF has been carrying out three main projects: the Community Action Program (CAP), the Access to Credit Services Initiative (ACSI) and the Iraq Middle Market

[25] "The Iraqi Microfinance Strategy", publication produced by the United States Agency for International Development (prepared by the joint venture of The Louis Berger Group Inc and The Services Group), February 27th, 2007. Section 2 Iraqi Microfinance

[26] Greg. G.Howell "Microfinance in Iraq: a surge in Lending to Iraqi Entrepreneurs", Sept.17th, 2007

[27] ACDI/VOCA. http://www.acdivoca.org For an explanation on ACDI/VOCA see footnote 34 below

[28] State- and Peace-Building Grant Database, Micro Credit to Iraqi Widows

[29] CHF International was originally established as the Foundation for Cooperative Housing (FCH) in 1952, a 501c(3) non-profit corporation seeking to help low- and moderate- income families in rural America and low-income urban neighborhoods to achieve improved economic standing and quality of life through the construction of affordable housing. Information on CHF International can be found at http://www.chfinternational.org/chfhistory. CHF/Iraq employs 460 locally-hired and trained Iraqis.

Development Foundation (IMMDF). The CAP program directly engages Iraqi community leaders and elected local councils in restructuring essential infrastructure in their own cities and towns. This represents a holistic effort that apart from creating new employment serves to build a foundation for democracy. CAP I and II focused mainly on building the capacity of community action groups to fill the gap of local government. The newest version of the program, CAP III is based on the premise that local community needs are best met by ensuring active participation of all stakeholders in identifying priorities and setting out courses of action[30]

The ACSI initiative provides low-income Iraqis access to capital and financial services. ACSI hands out loans to Iraqi individuals that do not otherwise have the same capital. These loans are used for home improvement or to expand small-businesses. They may also be used to restock or repair equipment or to open stores. ACSI has ten branch offices in Baghdad and seven other cities in southern Iraq. Loans are compliant with Islamic principles which prohibit the taking of interest when lending money[31] As a policy goal ACSI seeks to assist entrepreneurs in strengthening their businesses, create and sustain jobs and contribute to the economic revitalization of Southern Iraq. ACSI has become the largest microfinance program in the country and has also become a self-sustaining local institution. ACSI has over $25 million in portfolio outstanding[32].

The USAID-funded Izdihar project has provided technical assistance and funding to several projects. The Al-Thiqa program was created in 2004 and has already become operationally self-sustainable, and thus has been able to cover costs through its revenue. Since its inception Al-Thiqa has disbursed more than 32,000 loans at over $84 million. 16 percent of its recipients are women. The institution has had an all-Iraqi management since January 2006. Another similar project is the Al-Takadum project, which concentrates in the province of Al-Anbar[33]. ACDI/VOCA[34] also has implemented the Access to Credit in Northern Governorates of Iraq project (ACNI).

Through six strategies the Izdihar program has tried to promote outreach and sustainability. The six strategies are the following:

1. Promotion of awareness of microfinance and its benefits.
2. Creation and strengthening of a legal and regulatory environment that supports the establishment of new MFIs and the integration of MFIs into the financial community.
3. Capacity building

[30] This information can be found on CHF's webpage http://www.chfinternational.org/iraq

[31] In order to be compliant with Islamic principles, the institution charges fees on all loans up front.

[32] According to CHF International ACSI represents approximately 80% of the microfinance market in Iraq. See website reference above

[33] See article "Iraq reconstructs thanks to Microfinance industry". August 20th, 2009. IMFI (Iraq Micro-finance industry) website. www.imfi.org

[34] ACDI/VOCA is a private, nonprofit organization that promotes broad-based economic growth and the development of civil society in emerging democracies and developing countries. According to its website ACDI/VOCA "fosters broad-based economic growth, raises living standards and creates vibrant communities. Its practice areas are agribusiness, food security, enterprise development, financial services and community development." ACDI/VOCA was founded in 1963, as a 501c(3) non-profit corporation and it has 792 employees, 132 in the US and 660 overseas. It currently runs 80 projects in 42 countries. More information can be found in the website http://www.acdivoca.org

4. Emphasis on transparency
5. Support of industry development through formal and informal networking opportunities
6. Increase of business opportunities with the banking industry in order to provide MFIs with needed banking services and promote partnering arrangements between MFIs and banks[35].

Particularly important among these strategies has been the enhancement of the legal framework. The key legal and regulatory issues affecting microfinance are the Central Bank of Iraq Law of 2004, the Banking Law of 2004, CPA Order No.45 and Company Law No.21 of 1997. Burdensome requirements remain under the Company Law, like the difficulties revolving around the registration of a company that is not 100% Iraqi-owned. Difficulties also exist when registering a MFI with the NGO Assistance Office or when registering a for-profit MFI with the Trade Ministry. Cumbersome reporting and registration requirements under the NGO law and Company Law and the inconsistent application of law from region to region constitute additional problems. Some suggestions for overcoming these shortcomings may be proposed. Development of the industry could be promoted with a clear mandate from the Central Bank of Iraq concerning MFIs. The sensitivity of the legal and regulatory issues affecting microfinance should also be promoted at the Central Bank and within the government. The base of products MFIs could offer should also be expanded to include savings products, equipment leasing, secured financing or real estate lending. Anti-money laundering, information sharing and Islamic financing could also be further developed[36].

With respect to capacity building (Strategy 3 of the Izdihar project under the Iraq Microfinance Strategy) the brain drain to neighbouring countries has created the need to promote trainings of competent staff. Trainings should be conducted in MFI growth planning and strategic development, product development and marketing, financial and risk management and corporate governance.

Transparency (Strategy 4) would make the gathering of useful information possible that would serve to increase the efficiency of the industry. Outreach indicators such as gender, age or location would permit an assessment of which target groups are being served. This would serve to collect reliable information on poverty reduction, employment generation or community stabilization. Information should be transparently collected about MFI Financial and Portfolio performance and on the expenditure of grant funds. External and internal audit capacities should also be strengthened.

The development of a microfinance network (Strategy 5) would help serve as an advocate to disseminate information about microfinance practices. Microfinance networks have the potential to be important in crisis-affected environments. They serve to overcome issues like lack

[35] The Iraq Microfinance strategy, 25 February 2007 supra

[36] Elbayar, NGO Laws in Selected Arab States, International Journal of Not-for-Profit Law, Vol 7, Issue 4, September 2005, pages 11-12, citing Shea, Comments on the Regulation of NGOs Issued by the Coalition Provisional Authority, Order Number 45, International Center of Not-for-Profit Law, page 1, as cited in The Iraq Microfinance strategy, 25 Feb. 2007, supra.

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of information, uneven application of best practices, an inappropriate policy environment or uncoordinated donor intervention, deficiencies which tend to be exacerbated in crisis situations.

Strategy 6 proposes to increase the relationships between MFIs and banks in Iraq. MFIs offer products not offered by banks and conversely banks offer many products not offered by MFIs. Thus several types of linkages could be considered. The Izdihar project proposes several initiatives to increase the collaboration between banks and MFIs. These would include the loan-capital financing, the partnership model between MFI and banks, the bank “outsourcing model”, the MFI-Bank “correspondent model” or the possibility for the Iraqi microfinance industry to consult with the Iraqi Company for Bank Guarantees (ICBG) about developing a guarantee program that would support loan capital financing for MFIs.

The United Nations has also been involved in microfinance activity. In 2008 a survey conducted by the ILO and UNOPS showed that a majority of Iraqi entrepreneurs considered limited access to credit as the major barrier to economic development. To address this shortcoming ILO and UNOPS launched three programs to provide micro-loans to MSEs in the Marshlands, Hillah and the rural areas of Sulaimaniyeh[37]. International NGO Cooperative Housing Foundation was selected as the implementing partner. The Local Steering Committees were briefed about the activities under consideration and about the terms and conditions of loans disbursement and repayment procedures. The LSC provided recommendations on target districts and groups of local population to be given preferential access to loans. As a result of the program 960 small Iraqi entrepreneurs received average loans of $1,334. 22 % of the recipients were women. The program created almost 150 new jobs in economically depressed areas and the pay-back rate was 100%[38] .

The average loan size in Iraq amounts to $1,350, which is substantially larger in Iraq than in other countries. The nominal interest rate of 16% is about half the global average of 35%. It is quite likely that because MFIs in Iraq have higher cost structures than their counterparts in other developing countries, fees will increase in the future. A major issue for the development of the industry is that Iraqi MFIs will need to strike a balance between alienating their customer base and reaching operational and financial sustainability. The repayment rate for microloans in Iraq has been as high as 98 %[39].

In terms of the legislative framework the only requirement for MFIs in Iraq is that they are officially registered as NGOs. However some authors[40] consider that the lack of legal guidance from the Government of Iraq has likely contributed to the impressive growth of microfinance in Iraq as the general laissez-faire political environment has allowed the industry to expand and mature. Many actions have also taken place at the local level, as managers and technical advisors have been educating local officials (mayors in cities where branch offices are located) on the objectives and achievements of microfinance in Iraq. Thus courses have been conducted in areas such as financial analysis, accounting and auditing or risk management.

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[37] The value of the loans was of $700,000 in the first case and $400,000 in the last two .
[38] UNDG ITF 2009 Third Quarter Newsletter July-September 2009, p.6
[39] Data borrowed from Howell 2007.
[40] Discussed at “The Iraqi Microfinance Strategy”, supra. Section 2.7. The Legal and Regulatory Environment

Four problems remain however for the development of this industry in what concerns the government of Iraq. First, the registration requirement of entities as NGOs through the Ministry of Civil Society remains long and cumbersome. Secondly, because of the still unstable security situation many MFI offices do not want to hold cash. As a consequence MFIs hold their funds in accounts with state-owned banks in Iraq and this creates many logistical challenges (since sometimes the banks run out of cash). The lack of customer service at these banks also leads to inefficiencies: the ability to transfer funds electronically between Iraqi banks remains low, which further limits the scope of MFI's operations. Thirdly government intervention through the development of a legal framework could impose excessive regulatory constraints, which may hamper the growth of the industry in Iraq. The last issue remains the need for donor diversification[41]. Lastly good governance will remain a top priority in post-conflict Iraq. Governance policies will need to be directed at fomenting entrepreneurship, balancing economic activity and enforcing market mechanisms. The most critical part of good governance with respect to MFI operations will involve the banking system[42]. It will be necessary that participants in the MFI trust the banking system.

The main problems thus facing the microfinance industry remain the enhancement of the legal framework, capacity building and training, transparency, standards and reporting, the development of a microfinance network and increasing bank linkages as well as the ongoing instability in Iraq.

**2.3 Micro-credit in Lebanon**

Since the early 1990s, Lebanon has been in a reconstruction phase after a 15-year civil war, which paralyzed the Lebanese economy and devastated local businesses. Yet, Lebanon has succeeded in fostering one of the most advanced commercial banking sectors in the region. Over the past few years, many commercial banks in Lebanon have begun to offer microfinance products either through strategic alliance with microfinance institutions (MFI), by developing their own microfinance products, or by offering loans to small enterprises with partial guarantees provided by specialized domestic and/or international funds. The use of formal banking services among micro and small entrepreneurs is quite high, especially in Beirut[43]

The concepts of microfinance and microcredit were introduced to Lebanon in the mid-1990s. The microfinance sector has seen substantial growth in recent years in Lebanon, and is expected to continue to expand. Yet the industry remains underdeveloped and suffers from lack of regulation. Measurement problems and lack of reliable data make matters worse. Some of the only reliable and recent figures were published in "*Lebanon: A Diagnostic Study on the Demand for Financial Services by Micro and Small Enterprises"* (henceforth referred to as the IFC study), a study released by International Finance Corporation (IFC), a member of the World Bank Group and Grameen-Jameel Pan-Arab Microfinance Limited. According to this study,

[41] An example could be the partnership created between an Iraqi MFI and Kiva.org, a website linking microfinance clients directly with individual lenders which allows anyone to send funds to Iraqi entrepreneurs online.
[42] This is discussed in the paper Sameeksha Desai, "Post-conflict Microfinance: Assessment and Policy Notes for Iraq", Jena Economic Research Papers, 2007-060.
[43] (International Finance Corporation (IFC)/The World Bank Group and Grameen-Jameel Pan-Arab Microfinance Limited 2008).

Lebanon's microfinance market is relatively small (about $286 million), yet only 11.5 percent of the demand is met by existing financing sources.[44] A recent study indicated that the total supply of micro credit in Lebanon has been steadily increasing over the years, and reached approximately $27 million in 2003.[45] Despite the increasing supply, there is a large gap in the market. In order to address this gap, the microfinance industry in the country needs to build capacity, which would entail an increased number of employees, staff training, and the development or improvement of Management Information Systems (MIS).

The microfinance industry in Lebanon is increasingly dominated by three institutions: Al Quard al Hassan Association, Access to Microfinance and Enhanced Enterprise Niches (AMEEN), and Al Majmoua. Other major players are: Association d'Aide au Développement Rural, Association d'Entraide Professionelle, Al-Tamkeen, Hariri Foundation, Makhzoumi Foundation, and the United Nations Relief and Works Agency. According to the IFC study, as of September 2007, approximately 29,420 microfinance clients were being served by NGOs, microfinance programs, and MFIs; together, they had an outstanding portfolio of roughly $23.9 million, with an average loan size of $1,118[46]. These institutions are not licensed to accept deposits. Most Lebanese microfinance providers offer individual loans; group loans do not appear to conform to local cultural norms, as Lebanese people generally do not like sharing information or talking about financial problems.

The study also shows that, as result of the July war, about 5 percent of business borrowers experienced direct losses, and 50 percent of all borrowers experienced indirect losses. Various donors and multilateral development organizations provided emergency loans and other funding to Lebanese banks and small businesses following the conflict in order to rehabilitate, refinance, and reschedule destroyed businesses. Though greatly affected by the war, MFIs in Lebanon contributed to providing loans to finance the reconstruction efforts, and showed that MFIs can be resilient and function properly under conflict: they were able to remain in the market, provide needed services, modify their products to meet the needs of their clients and sustain themselves[47].

The Lebanese government adopts a laissez-faire attitude concerning microfinance. There are no laws concerning the microfinance industry, and the government has no clear role in the sector (Mamari and Ghaleb, 2002). The only form of government support has come from the Central Bank, which issued a directive allowing local banks to use 5 percent of their required reserves for microfinance initiatives. However the Central Bank has been unresponsive to requests to use this liquidity.[48]

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[44] This study is part of IFC's overall strategy to create a commercially viable microfinance sector in the Middle East and North Africa. It is also part of Grameen-Jameel's efforts to ensure that demand for microfinance services in the Arab world is met. The study was funded by IFC and Grameen-Jameel and conducted by the Frankfurt School of Finance and Management, Bankakademie HfB. This initiative is part of an agreement signed with Grameen-Jameel and CGAP (the Consultative Group to Assist the Poor) in May 2007, to help the Lebanese government scale up microfinance and microenterprise development (IFC, 2008).
[45] Microfinance Institutions in Lebanon - SME Inception Plan 2007, p.1)
[46] IFC 2008 Op Cit
[47] Ibid,
[48] "Financing Cedar Seedlings – Access to small-business credit could lift thousands of Lebanese out of poverty", in A Special Report on Microfinance, Executive, Issue 123, pp 138-141. October 2009

Relatively recently, however, the government has implemented two initiatives: the Economic and Social Development Fund, and "Kafalat".

The Economic and Social Fund for Development (ESFD), which was established in 2005, is funded by the European Union. The ESFD stimulates the outreach of Lebanese MFIs and supports income generation, employment creation, and poverty reduction. Among other activities, ESFD funds contractor banks to grant loans to unbankable entrepreneurs, which may be used for start-up or business development purposes. ESFD has also mobilized two microcredit funds; one is managed by non-governmental organizations and the other is managed by banks[49].

Kafalat is a Lebanese financial company with a public concern, established by the Lebanese government in 1999, that assists SMEs in accessing commercial bank funding. Kafalat's loan guarantees help SMEs in Lebanon to access commercial bank debt financing. However, the establishment of Kafalat does not address the structural problems of banks and their policy-makers.[50]

Non-governmental organization (NGO) have inherent weaknesses in terms of microcredit providers. They are bound by the legal provisions and restrictions applied to charities, and consequently have limited access to funds since Lebanese charities are not allowed to take deposits. Their legal structure also makes it difficult to access funds from the financial sector in the form of loans. NGOs therefore depend greatly on donor funds, which translate into lack of stability in access to credit, and they face a greater financial risk in case of default with the lack of regulation. These factors greatly contribute to their limited of their growth potential.[51]

The environment is made even more ambiguous by the fact that micro lending is not explicitly regulated by any legal text of authority[52]. No law has been passed by any government in Lebanon to allow the industry to be regulated. The Ministry of Interior, rather than the Ministry of Finance or the Central Bank currently supervises all NGOs that work in the sector[53].

Due to the high and growing poverty rate and the fact that 30 percent to 40 percent of the population is unbanked, microfinance would seem like a good sector to invest in[54]. However, it remains undernourished. Several main factors impede growth prospects of the microfinance industry in Lebanon:

- The sector is hampered by lack of legislation specific to microfinance, and, with some exceptions, is generally inefficient.
- Donor money is in short supply due to the global economic downturn. It is therefore becoming increasingly difficult for MFIs which depend on donations to get money. The number of international investors has plummeted, therefore MFIs are now looking more to the local banking sector. Unfortunately banks are not very interested in adopting

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[49] IFC 2008, Op Cit

[50] Mamari, R. and Ghaleb, J. "Micro-Finance in Lebanon – Al Majmoua", presented at the WBI MENA Debates, Session 4: Making Markets Work for the Poor (microfinance). March 2002.

[51] Ibid,

[52] Ibid

[53] IFC 2008, Op cit

[54] Special Report on Microfinance, Executive, Op Cit.

microfinance programs, mostly because it requires labor and management intensive work, which means high overhead costs (5 to 8 percent as opposed to the overhead of a normal loan which is 1.75 to 2.5 percent).[55]

- Many of the organizations in the market have a political slant. For instance, the Hariri Foundation, and Al Qard Al Hassan, which is funded by Hizbullah. MFIs supported by political parties and/or subsidized by international institutions have lower interest rates than other MFIs, and may push the latter out of the market[56].

## 2.4 Micro-credit in Palestine

The constraints facing the micro and small enterprises (MSEs) industry in Palestine could be divided into two categories; internal and external. With internal constraints, we can differentiate between impediments on the entrepreneur and those on the enterprise. The Palestinian entrepreneurs, the young in particular, are pressured to emigrate in search of work opportunities and stability due to the ongoing occupation and ensuing deterioration of the economy in the occupied Palestinian territority. Their mobility is severely impeded by Israeli checkpoints, which also affect their access to markets and halts their entrepreneurial spirit placing a large burden on their employment or venture launching activities, although a general spirit of determination and perseverance exists mainly in the youth.[57] The enterprise is characterized by a low level of organization, technology, quality of assurance and control, has small capital investment and lacks capital accumulation as well as proper work place and space. As for the external constraints, the Palestinian MSEs suffer from the lack of finance, supporting policies, information, training programs, an increasing economic hardship and decreasing demand, the lack of proper infrastructure especially in camps (electricity, transportation), as well as difficult access to raw materials. The sector is faced with increased competition, which forced enterprises to decrease their prices in order to maintain their competitive power. The main issue of concern to the enterprise remains the political instability and the occupation, which affects the overall enterprise performance.[58]

Given the importance that the informal sector and micro-enterprises have played in preventing the onslaught of absolute poverty among Palestinians, the development of this sector

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[55] Harout Samuelian, vice governor of the Lebanese central bank, said one of the main challenges to the microfinance industry in Lebanon is that banks usually do not like these kinds of programs because they are very expensive. But, he added, the technologies that are available in banks nowadays make it easy for them to perform a variety of transactions in seconds. Fadi Asrawi, dean of the faculty of business administration and economics, said rapid innovations have made it possible to conduct banking operations via mobile phone and this means a real breakthrough for microfinance. "Operational costs can be as high as 15 to 20 percent of loans, compared to less than 5 percent for banks in industrialized countries. The introduction of mobile-phone banking now makes it possible to reach millions of people in the fraction of a second and without the high costs of establishing an extensive network of offices. Such cost savings are important for microfinance institutions, as they allow them to reduce interest rate margins while not impairing profitability," he added. (Hallawi, 2009 – DS Staff writer)

[56] Special Report on Microfinance, Executive, Op Cit

[57] USAID. "Microfinance, Youth and Conflict: West Bank Study." microReport # 41, 2006. *http://pdf.usaid.gov/pdf_docs/PNADF657.pdf*

[58] "Microfinance in Palestine." *Micro Finance at the University.* *http://www.saa.unito.it/meda/ppt/Micro_Finance_In_Palestine.ppt*.

currently represents the most important source of employment for poor Palestinians, a trend which is expected to continue.[59]

Development in the MF industry in the occupied Palestinian territory can be evaluated in the context of the Second Intifada, which began on September 28, 2000. The following period was characterized by intermittent clashes, invasions, closures, and curfews, resulting in the widespread restriction of movement, massive destruction of personal property, lack of access to markets, and severe curtailment of economic activity. While to this date, the micro-finance sector has shown the ability to cope despite periods of crisis, the magnitude of the current crisis – which affects the whole society – has begun to impact the capacity of the institutions to sustain operations and continue to lend[60]. Many of the MFIs have reduced their levels of lending or even nearly stopped making new loans[61].

According a 2007 IMF microfinance market survey in West Bank and Gaza, the Palestinian microfiance sector unlike others in the middle east has not been able to continue its growth in the last years; ongoing military occuption and current political and economic crisis have prevented it from increasing its portfolio. Unlike other arab countries where the microfinance sector has shown in many cases remarkable expansion, consolidation and evolution, microfinance in the Palestinian territories has somewhat diminished, calling into question the sector's ability to work effectively in such difficult context and in its current form[62]

The key challenge for the Palestinian MFIs is how to survive and grow in an environment lacking peace and stability. If peace is not forthcoming in the near future, MFIs may wish to consider whether credit is still the appropriate response.[63]

The Palestinian microfinance market hosts many initiatives. CHF's Ryada is considered one of the first credit programs in the Palestinian territories. The program has worked throughout Gaza since its inception in 1994 with support from the United States Agency for International Development (USAID). The program expanded in 2001 to three governorates of West Bank, added additional services in Gaza in 2003, and in 2005 expanded to three additional cities in the West Bank. In 2006 Ryada experienced significant difficulties- when the Palestinian Authority, whose employees were Ryada's main client base (either directly as clients or indirectly as guarantors), were no longer able to pay salaries. The portfolio at risk over 30 days shot up to over 76%. Despite this, Ryada overall continues to improve. The portfolio recorded a substantial annual growth by 66% in terms of outstanding gross portfolio & 40% in terms of active clients, while the portfolio at risk over 30 days at the end of the Sept 2008 was 11%, down from 35% by December 2007, and down from 47% by the end of September 2007 and this trend is expected to continue. Ryada has also been able to recover 54% of the written off loans as of Sept 2008 (MIX Markets 2009).

Next, PARC, the Palestinian Agricultural Relief Committees is a cooperative union of cooperative savings and credit associations presenting the legal umbrella that covers all licensed cooperatives in Palestine which have been working in the field of savings and credit according to

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[59] IFC and PNSMF "Microfinance Market Survey in the West Bank and Gaza Strip" International Finance Corporation, Washington DC, May 2007, p.18
[60] IFC market survey WB G, p.19
[61] Ibid.
[62] Ibid
[63] Brundsma and Burjorjee 2004, Op cit

the principles and values of the cooperation. PARC aims at developing and protecting these associations by empowering and enhancing their economic and social role in achieving sustainable development in rural and urban areas. PARC's services include loans and voluntary savings (MIX Markets 2009).

Another player in the market is ASALA – The Palestinian Businesswomen's Association which has been active providing loans to women since 1997 when it was first established under the name of the Center for Women's Economic Projects (CWEP). In January 2001 it was registered with the Palestinian Ministry of Interior as Non-Profit NGO under the name: Palestinian Businesswomen's Association (ASALA). ASALA's main chalenge is working in unstable political environment and unfair competition (Best practice is not followed in Palestinian other MFI's) (MIX Markets 2009).

At present, Palestinian MFIs are not regulated as financial intermediaries by the financial authorities and therefore limited in their product offer, which includes individual and group mico-lending for microentrepeneurs, agricultural loans, Islamic loans and consumer and housing loans. Due to the regulatory environment, Palestinian MFIs may not offer saving products to the general public or services linked to remittances and payment transfers. The provision of savings products is legally restricted by PMA authorised institutions, i.e. to banks.
The regulatory environment has however been subject to reform since 1994 in an effort on legal harmonisation regarding the Law on Palestinian Monetary Authority, the Banking Law, the Law on the Capital Market Authority and the Securities Law.[64]

## Part 3. Effective Strategies for Micro-finance amid Instability

### 3.1 Creating an enabling environment for micro-credit in conflict

Before engaging in microfinance activities, one should study the environmental propensity to absorb these financial products. This should include market research, demand studies as well as a comprehensive analysis of the operating environment. MFIs can only function if certain environmental conditions are met. This section enumerates these conditions and explains their prominence in making microfinance work better and more effectively. The list of conditions to a successful implementation of Microfinance in post-conflict environments is not a long one. Post-conflict microfinance can prove to be a viable choice particularly if the implementing institution is willing to face higher costs and higher risks.

The essential conditions for a post-conflict microfinance environment include three main points. Political stability is a must. Areas where the programs are operating should offer a certain degree of security and safety to potential MFIs and their clients. The area should not be suffering from chaos, and clients need to be assured that it is both safe and profitable to take on their business activities. On the other hand, MFIs must feel that they are able to operate without any threats to their staff, assets and clients. From another direction of causality, microfinance and other developmental approaches may help in obtaining stability after conflict. Jumpstarting

[64] Ibid. p.20-21

people's economic activity will create opportunities, and reduce unemployment hence decreasing people's motives to engage in conflict; mainly poor people[65].

Another essential condition is the presence of economic activity and the existence of demand for financial services. As mentioned in the previous sections, microfinance only works when people are already engaged in business activities. This is not always the case in environments immediately following conflict. Conflict could result in migration and population displacement. These people may lose access to their physical assets or their rights to engage in economic activities. The way to deal with this is through the 'rule of thumb': if local markets are active, then the population is economically active enough to benefit from appropriate credit products[66]

The third essential component is population stability. The key goal to any functioning MFI should be loan recovery for them to become part of the permanent fabric of an emerging post-conflict economy. This goal is hard to reach with mobile populations who may at any time abandon their loans. Thus, it proved better to work on stable populations which led to increased focus on returnees than on refugees. The benefits derived from this include: "higher proportion of repeat customers, higher likely repayment rate, and longer period over which to spread fixed costs"[67]

In addition to the list of essential conditions, experience has shown that there are some conditions which are preferred though not as vital to the microfinance industry. The presence of these conditions definitely makes the post-conflict work easier, but their absence could be overcome. The first condition is the presence of functioning commercial banks to provide MFIs with financial services such as storing loan funds, moving money electronically and thus reducing costs and risks facing MFIs. The second condition is the presence of social capital or trust. Although not impossible to function without, microfinance could be impeded by distrust developed by internal conflict. Last but not least, the presence of macroeconomic stability including a steady currency facilitates the business of MFIs. The key to success is not the MFIs willingness to work in high-risk and high-cost environments, but their institutional commitment to sound principles and practices of MF[68].

The development of financial institutions in conflict-affected countries is challenged by the macro, meso and micro economic conditions that prevail in a country immediately after a long and widespread conflict. At the national level, macro conditions affect the supply and demand for financial services. These include the lack of confidence in the economy as a result of the weak government and the lack of security which negatively affects investments, decreased level of financial capital at the government level dedicated to institutional development, increase in donor funds which are available as grants. In addition to that, there is a large capital flight and dollarization resulting from the low confidence in the local currency coupled with human flight and people looking for safer and better opportunities. Destroyed infrastructure hampers growth and blocks market access[69] .

Meso conditions are those affecting intermediaries (e.g. financial intermediaries). Financial intermediaries are ineffective in mobilizing resources and raising capital through

[65] USAID and DAI, "Microfinance Following Conflict" Microenterprise Best Practices Project Brief no. 4
[66] Ibid
[67] Ibid
[68] Ibid
[69] Nagarajan, Geetha. *Developing micro-finance institutions in conflict-affected countries:Emerging issues, first lessons learnt and challenges ahead.* International Labor Organization, 1997.
*http://www.ilo.org/public/english/employment/ent/papers/conflict.htm*

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lending. Increased non-performing loans mainly to the public sector to finance the conflict render formal financial institutions dysfunctional. As for the semi-formal institutions, they are mostly NGOs which, although have resources to provide grants and credit, and are often trusted by the community, have a problem with the mentality of staff. These organizations usually provide humanitarian relief services, and their clients will not expect them to be tough with loan recovery. There is no strong supervisory and regulatory agency to monitor microfinance in particular[70].

As for the Micro conditions, these directly influence the demand for financial services like the lack of confidence and trust in institutions and society, lack of productive activities and weak local labor, product and input markets, endangered life and safety and diseases which hinder incentives to enter long term investment contracts, difficulty in acquiring fixed assets to use as collaterals mainly due to client displacement which also gives rise to issues related to women and children who need particular outreach efforts[71].

The box below reflects an experience from Bangladesh and how adverse conditions led to the establishment of Grameen Bank Project and how this institution actually serves the extremely poor. Clearly, is no golden rule to follow when choosing microfinance clients, but rather a convenience approach to ensure the institution's survival and sustainability.

**Box 1: We Serve the Poorest: Grameen Bangladesh**

Responding to a devastating famine in 1974, professor Muhamad Yunus founded the Grameen Bank Project in Bangladesh aiming at providing financial services to the poor by 1976.
This segment of society which has no access to institutional credit as it can not provide collateral.
As such, Grameen bank followed certain principles to help change these facts. The bank only lent money to the poorest of the poor in rural areas without collateral. The activities of the bank tried to focus on women (94% of its customers) and the bank granted the borrowers the right to decide the business activities for which the loans will be used for. The bank only charged interest rates to keep it self-reliant as opposed to dependant on donor funding, and used solidarity groups as one of the tools to ensure repayment.
Professor Yunus sees that development should target the bottom half of the population and specifically the bottom half of those below the poverty line. Poor people have the potential to grow and overcome poverty if given access to credit and guided to succeed. Yunus was awarded the 2006 Nobel Peace Prize, along with Grameen Bank, for their efforts to create economic and social development.

*Sources:* Bakhtiari, Sadegh. "Microfinance And Poverty Reduction: Some International Evidence." *International Business & Economics Research Journal*, 2006 *and* [www.nobelprize.org](www.nobelprize.org)

[70] Ibid
[71] Ibid

## 3.2 Institutional characteristics of Microfinance Institutions

All components of the financial system share the same core objectives for the regulatory framework including microfinance activities and institutions. The key principles and standards for the design of a regulatory framework for institutions providing financial services to the rural finance and microfinance sector are likely to be different from those for formal banking and finance institutions, because the design must consider the operational, market, and client characteristics of the microfinance sector.

A good microfinance program committed to providing quality financial services to a growing number of poor people on an ongoing basis should be able to reach a large number of clients, provide financial products and services at competitive prices which implies high operational efficiency and the lowest possible transactions costs to client, and mobilize the financial and technical resources required to achieve its goals.

To perform these functions, a microfinance program must have dedicated and competent managers, well-trained and motivated staff, and internal procedures and systems that enable it to achieve self-sufficiency while providing affordable financial products. A microfinance program constantly needs to build its institutional capacity through internal and external training, learning by doing, and technical assistance. A microfinance program’s learning needs evolve from basic bookkeeping, portfolio management, and loan officer training and incentives to fraud control, internal and external auditing, financial and treasury management, diversification, and accessing commercial funds. Learning needs change but never stop.

Due to the broad range of various types of institutions, it is difficult to make general statements about the specific characteristics of MFIs. These institutions differ significantly from traditional financial institutions in terms of client features, lending technology, loan portfolio features, culture or ideology and institutional structure. According to Gallardo and Randhawa, MFIs can be classified into three rough categories depending on the structure of the liabilities side of their balance sheets.[72]

Category A comprises all MFIs which depend on other people’s money to finance their lending business. This is made up mainly of grants and concessionary loans from donors which can be supplemented by commercial bank loans or also securities issues. These MFIs are described as credit-only institutions as well. They include financial NGOs. MFIs stemming from and still dominated by NGOs with a welfare bias have serious problems with their governance structure. Setting up a viable MFI for the long term requires strict financial discipline. Especially for the microfinance sector the following arguments favor regulating credit-only institutions as well: regulation can act as a ’signal’ to prospective investors that a financial institution is financially sound. Access to certain lines of refinance can be contingent on regulation (e.g. donor funds channeled via second-tier institutions to MFIs). Neither argument necessarily justifies government regulation. At issue here is the self interest of MFIs, which does not involve consumer protection or safeguarding the safety and soundness of the financial system. Nevertheless, regulation may make sense for promoting sustainable financial institutions. In this case, its aim is to raise standards in microfinance and thus contribute to financial systems development. Particularly in countries where the microfinance industry is at a rudimentary stage,

[72] Staschen, Stefan. *Regulation and Supervision of Microfinance Institutions:State of Knowledge.* Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH, 1999

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for example, there is a danger that MFIs may abuse their monopolistic power and resort to exploitative practices, such as usurious interest and improper methods of debt collection. The collapse of individual institutions can also result in credit shortages on the market[73] (Staschen 1999).

In category B, member's money is used to grant loans exclusively to members. Classic examples of this are Rotating Savings and Credit Associations RoSCAs, savings and credit cooperatives and/or credit unions. As for category C, it comprises all MFIs that use the public's money to finance their lending business, i.e. fully-fledged financial intermediaries. These do not include financial institutions that employ forced savings components to secure their lending transactions, however, as long as their clients are net borrowers. Another type is formal banks with a microfinance window. The regulations of banking legislation automatically apply to their microfinance portfolio, but these are usually poorly adapted to the requirements in this area[74].

### 3.2.1 Financial Sustainability

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Financial concerns include standardized information and reporting and accountability. These concerns become more necessary in conflict environments since conflicts bring about a certain level of uncertainty and a good financial institution will be able to address these concerns to prove its resilience and ensure its sustainability. Financial performance of MFIs is evaluated based on the use of appropriate pricing policies which include offering loans at rates which cover the full costs of efficient lending on a sustainable basis, recognizing that poor entrepreneurs are able and willing to pay what it costs an efficient lender to provide sustainable financial services. Interest charges by the retail unit should be set to cover the costs of capital (at the opportunity cost, including inflation), administration, loan losses and a minimum return on equity. Another indicator of sound financial practices is the loan portfolio quality. A loan portfolio is an MFI's most important asset. Its quality reflects the risk of loan delinquency and determines future revenues and an institution's ability to increase outreach and serve existing clients. A good quality portfolio means that an MFI is maintaining a portfolio with low arrears so that late repayments and defaults do not threaten the institution's viability.

For example, organizations with loans in arrears over 30 days below 10 percent of loans outstanding and annual loan losses under 4 percent of loans outstanding satisfy this condition. This is not the case if we take for instance the Palestinian Agricultural Relief Committee (PARC). PARC's estimated portfolio at risk (>30 days) is 72% while the Lebanese AMEEN has a portfolio at risk (30 days) of 1.41% coupled with a write off ratio of only 0.42% (MIX Markets, 2009). Clearly this measurement of risk increases with the incidence of conflict.

In addition to loan quality, self sufficiency is also a pillar to financial performance. It reduces the institutions' dependence on subsidies in order to move toward financial self-sufficiency and achieving operational efficiency, which is covering all administrative costs and loan losses with client revenue within a reasonable time period, given local conditions. International experience shows that successful intermediaries have achieved operational efficiency in three to seven years, and financial self-sufficiency [defined as covering all administrative costs, loan losses, and financing costs at non-subsidized rates from client revenues] within five to ten years. Examples of institutions with high sustainability rates are the Palestinian institution FATEN with an operational sustainability of 84% and a financial

[73] Ibid
[74] Ibid

sustainability of 72% up to 2007. Self sufficiency also means that if a conflict erupts, an MFI would be able to address its own concerns a lot faster; not having to wait for aids or donor funds to resume its operations.

MFIS should work towards financial independence; building a solid and growing funding base with clear business plans, backed by operational capacities that lead to mobilization of commercial funds from depositors and the financial system, and eventually to full independence from donor support. Financial performance standards apply only to activities that are an integral part of providing financial services. If programs also provide non-financial services, such as business advisory services, health, or education, they should account for such services separately from financial services. Standards for financial self-sufficiency do not apply to such services, and defining appropriate standards for non-financial services is beyond the scope of this document.

MFIs earn financial revenue from loans and other financial services in the form of interest fees, penalties, and commissions. Financial revenue also includes income from other financial assets, such as investment income. An MFI’s financial activities also generate various expenses, from general operating expenses and the cost of borrowing to provisioning for the potential loss from defaulted loans. Profitable institutions earn a positive net income (i.e., operating income exceeds total expenses).

### 3.2.2 Efficiency and productivity

Efficiency in MFIs is mainly derived from reduced costs of service delivery. According to the CGAP definitions, efficiency and productivity indicators reflect how efficiently an MFI is using its resources, particularly its assets and personnel. MFIs use different efficiency and productivity indicators, tailoring them to reflect their own organizational structure, product lines, and monitoring priorities. In calculating these indicators, MFIs need to select which denominator they will use. The most common denominators related to assets are (i) average gross loan portfolio, (ii) average total assets, and (iii) average performing assets—loans, investments, and other assets expected to produce income. Using average total assets as the denominator for efficiency/productivity ratios is more relevant for MFIs that manage deposit and/or share accounts in addition to loans. Regardless of the denominator selected, the MFI should be consistent in its use. MFIs must also decide if they wish to use the number of personnel or number of loan officers as their benchmark for human resources. The reason for considering loan officers a separate category is that, in contrast to other personnel, they are usually directly involved in revenue-generating tasks that result in income (i.e., they make and collect loans). However, there is a trend toward using total personnel in productivity calculations, in recognition of the fact that loan-officer tasks may overlap with the tasks of administrative staff.

The efficiency variable *cost per borrower* determines the average cost of maintaining an active borrower or client. It is also useful to compare to GDP per capita to assess an MFI’s efficiency in the local context. Because they count clients rather than amounts, these indicators have the advantage of not prejudicing MFIs which offer smaller loans. When analyzing costs per borrower, the highest numbers go to the Iraqi MFI Al Thiqa, with $298 while the lowest go to the Palestinian PARC with $19 signifying high efficiency levels, although the quality of its portfolio is bad with 72% portfolio at risk (>30 days). A comparative analysis of the Palestinian PARC and the Iraqi Al-Thiqa is provided in Table3 below. The table compares the two MFIs, ranking them based on their performance in the variable costs per borrower. Other variables

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included are borrowers per staff, assets and deposits. Clearly, the borrowers per staff in Al Thiqa are more than twice those of PARC 122 to 53 which either signifies higher productivity in Al Thiqa employees or a shortage in staff in PARC. Al Thiqa's assets are roughly 9 million USD which is more than triple those of PARC (roughly 3 million USD), but it is evident that Al Thiqa does not have any deposits. If we compare them to our sample of 15 MFIs from 5 different countries, PARC performs a lot better than average 19 to 131.79 USD, while Al Thiqa'a assets outperform PARC and the average 9 to 4 million USD (MIX Markets 2009).

**Table 2: Comparative Analysis of Performers**

| | MFI | Cost per Borrower* | Borrowers per staff member | Assets* | Deposits* |
|---|---|---|---|---|---|
| **Best Performer◦** | PARC- Palestine | 19 | 53 | 3,005,012 | 546,714 |
| **Worst Performer◦** | Al-Thiqa- Iraq | 298 | 122 | 9,119,030 | 0 |
| **Average in Sample** | 15 MFIs | 131.79 | 96.33 | 4,027,423.13 | 71,573.16 |

*Source: MIX Markets Database- Sample includes MFIs from Iraq, Lebanon, Palestine, Sudan and Yemen*
**Costs, Assets and Deposits in USD*
◦*Best and worst performance based on the first variable; cost per borrower*

Another variable measuring efficiency is operating expenses which includes all administrative and personnel expenses. Although, analysts must be careful when comparing this ratio among MFIs since MFIs that provide smaller loans will compare unfavourably to others, even though they may be serving their target market efficiently. Also, MFIs that offer savings and other services will also compare unfavourably to those that do not offer these services. Analyzing operating expenses suggests that the Yemeni Aden is the least efficient with 40.83% operating expenses/assets and 62.32% operating expense/loan portfolio while the Palestinian PARC, validating the previous conclusion, has 1.44% and 1.86% respectively (MIX Markets 2009).

As for productivity, it is a combination of outreach and efficiency. Productive MFIs maximize services while using the least resources, including staff and funds. Although different MFIs offer differentiated products, we will take on the analysis and compare the productivity measures of different Arab MFIs. With regards to staff productivity, the variable borrowers per staff member suggests that the Yemeni Aden is the least productive with a figure of 26. This number alone is insignificant as we need to look at the total number of personnel and the number of active borrowers which happens to be 77 and 1,967 respectively which signifies a high number of staff for a small number of clients. Conversely, the Palestinian PASED's (profiled in the Appendix) borrowers per staff member are 200 with 21 staff members and 4,200 active borrowers. This signifies a high level of productivity within the institution.

On efficiency grounds, microfinance may provide an alternative to alleviate frictions in financial markets. It is widely recognized that financial markets are especially vulnerable to failures resulting from information asymmetries between the parties involved in financial contracts. As a result, financial markets may fall short of the socially-optimal outcome, failing to exploit otherwise efficient transactions. Such problems are exacerbated in developing countries,

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and disproportionately affect the poor since their lack of collateral worsens the effects of information asymmetries. By developing new lending and saving technologies, MFIs may help alleviate these market failures and increase the reach of financial services to the poor. Efficiency arguments imply that the private sector has an incentive to develop commercially-viable microfinance activities, but this has proven to be a challenge. To the extent that microfinance activities provide a way to circumvent imperfections in financial markets, they have the potential to become self-sustainable.

At the same time, if MFIs have a technological or informational advantage over traditional financial institutions, they should have been able to obtain access to private funding, perhaps including through various forms of cooperation or vertical integration within the financial system. In fact, enhanced cooperation between existing financial institutions and MFIs could contribute to foster the development of local financial markets. However, most of the external funding to the microfinance industry comes from donor sources, and the integration of MFIs with traditional financial institutions is not widespread.

### 3.2.3 Coping Strategies and Risk

MFIs are faced with various forms of risks. Clearly, these risks, which occur under non-conflict conditions are higher and more striking in conflict environments which are characterised by uncertainty and chaos. Credit risk is the danger that a borrower is not capable of or not willing to service the interest or repay the principle. Credit risk is particularly volatile, as collateral substitutes depend a great deal on confidence, there is a heavy sectoral and geographic concentration of loans and the portfolio turnover rate is higher. The large-scale credit risk is usually low because micro loans are granted.

Another risk is associated with interest rates and stems from the diverging fixed-interest terms in lending and deposit business when the commercial interest rate changes. This risk is particularly large when rising commercial interest rates on the deposit side cannot be offset because of interest caps in lending business. This is more often the case with MFIs due to their higher interest rates.

Liquidity risk is the risk of a temporary cash flow problem because assets can only be liquidated by large discounts. This is high in many MFIs due to poor liquidity management and lack of access to liquidity pools or lender of last resort. This has huge effects on credit risk as access to subsequent loans is often the major repayment incentive.

Management risk is the risk of portfolio deterioration due to management defects (inadvertent due to insufficient qualification and wilful as opportunistic behaviour of fraud). The success of an MFI is particularly dependent on the qualification and the proper conduct of management and staff.

New industry risk is the risk of trying out new, innovative finance technologies. This risk is relatively high because of new products, technologies, markets and institutional design. Ownership and governance risk stems from the fact that an MFI's solvency is dependent on ownership relations and governance structure. This is important due to the frequent lack of external regulation and supervision. Risk can be very high in NGOs and cooperatives. Subsidy dependence risk is the risk of dependence on subsidy donors and a sudden stoppage in subsidies.

One of the most pressing kinds of risk that can impede the healthy functioning of an MFI is default risk, and coping with it has been the target of all financial institutions in general and MFIs in particular. Thus, NGOs and other MFIs should be very cautious in offering credit

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because they cannot take a chance on non-payments, late payments, complete defaults, or other risks (Doyle 1998). Microcredit advocates need to see the contradiction between doing everything to build peace (helping returning soldiers) versus economic development.

Programs could do so through giving individual loans to micro entrepreneur who have qualified guarantors in case of default. It is also notable that healthier clients mean stronger MFIs, and over time, reduced poverty. They can ultimately lead to reduced portfolio losses because fewer clients may be absent or drop out due to illness, or default due to death. Thus, insurance policies may offer emergency loan collateral, as in the case of fires or droughts. Compulsory savings could be required from all micro entrepreneurs so that if something occurs and results in destroying one's crops, default on one's microloan may be lessened, especially if the amount of savings is significant. Thus, poor peasants would at least have their own resources to fall back on. This also would protect the MFI's portfolio.[75]

Built-in loan flexibility is another option for coping with difficult settings especially in conflict situations. This might take the pressure off of clients who, because of a crisis, do not want to move up to the next cycle of a larger loan, with its resulting pressures. Instead, one could take a rest or a break, and then re-enter the microcredit system when feeling ready, without pressure to take on loans the individual may not be able to afford. New insurance tools may be designed and implemented by the MFI, as mentioned earlier: Life insurance, health insurance, credit insurance, funeral insurance, and so on. This is mutually beneficial for both the borrowers and the institutions.

As in the case with other adverse environments like droughts for example, conflict situations need specific measures and efforts on behalf of MFIs. These efforts include tracking the problem's evolution, the number of client dropouts, evaluating client performance and changes, conducting exit interviews and tracking arrears and defaults. All these steps may lead to decreasing the impact of conflict and to better more consistent measures that would make the MFI more sustainable and more resilient against future shocks.[76] These activities need good risk management as well as efficiency in operation on behalf of MFIs. .

Another factor is the need to consider the greater costs of MFI work in post conflict situations—items such as increased security, steeper travel costs and higher compensation for staff. It is important to partner with other NGOs and perhaps government agencies that can give the new MFI insight and the benefits of experience. Not reinventing the wheel may save time and money, as well as help to avoid pitfalls after the conflict has subsided so that potential borrowers are not confused, assuming that microcredit is just one more handout. Another concluding observation is that good MFI practices are even more essential in times of war than times of peace.

MFI should charge market rate interests, build a highly-skilled staff with multiple organizational efficiencies, work toward becoming sustainable, and operate superb portfolio quality. It will not succeed if it is confused with post-war humanitarian aid. Portfolio risks need to be assessed and strategically planned for. Client ambiguity needs to be eliminated and delinquent clients should experience sanctions they were warned about, or the program may quickly unravel. Ground rules must be "imprinted" on all potential clients in order to ensure complete and on-time repayment rates, and the successful growth of the MFI.

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[75] Woodworth, Warner. "Microcredit in Post-Conflict, Conflict, Natural Disaster, and Other Difficult Settings." *http://www.microcreditsummit.org/papers/Workshops/32_Woodworth.pdf*
[76] Ibid

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According to CGAP definitions, variables associated with an MFI's default risk include PAR; portfolio at risk, which is the most accepted measure of portfolio quality. Portfolio at risk is the outstanding amount of all loans that have one or more instalments of principal past due by a certain number of days. When referring to PAR, an MFI should always specify the number of days for example (PAR >30 days) [77].

The write-off ratio represents the percentage of an MFI's loans that have been removed from the balance of the gross loan portfolio because they are unlikely to be repaid. A high ratio may indicate a problem in the MFI's collection efforts. However, write-off policies vary, which makes comparisons among MFIs difficult. As a result, analysts may present this ratio on an adjusted basis to provide for uniform treatment of write offs. The adjustments to the write-off ratio may increase or decrease the value of loans written off by removing or adding back delinquent loans to the gross loan portfolio in accordance with an international or national standard for writing off loans. Lastly, we have the risk coverage ratio which shows how much of the portfolio at risk is covered by an MFI's loan-loss allowance. It is a rough indicator of how prepared an institution is to absorb loan losses in the worst case scenario. MFIs should provision according to the age of their portfolio at risk: the older the delinquent loan, the higher the loan-loss allowance. For example, a ratio for PAR > 180 days may be close to 100%, whereas the ratio for PAR > 30 days is likely to be significantly less. Thus, a risk coverage ratio of 100% is not necessarily optimal.[78]

**Table 3: Risk Indicators for Selected MFIs***

| Country | MFI | Provision for loan impairment/ assets | Portfolio at risk > 30 days | Write-off Ratio |
|---|---|---|---|---|
| Iraq | Al-Thiqa | 6.11% | 3.26% | 13.06% |
| Lebanon | Al Majmoua | -0.71% | 3.96% | 3.63% |
| Lebanon | Ameen | -1.28% | 1.41% | 0.42% |
| Lebanon | Makhzoumi | 0.22% | 6.40% | 0.25% |
| Palestine | ASALA | 15.38% | 58.30% | |
| Palestine | FATEN | 1.67% | 6.33% | 0.76% |
| Palestine | PARC | 0.03% | 72.00% | |
| Palestine | Ryada | 14.95% | 46.55% | 31.68% |

*Source: MIX Markets Database*

** Refer to Appendix 3 for a profile of the mentioned MFIs*

Table 3 above provides data on a sample of MFIs in Iraq, Lebanon and Palestine, An expense set aside as an allowance for bad loans (customer defaults, or terms of a loan have to be renegotiated, etc).

To cope with risk, MFI should most importantly monitor their activities through keeping track of the following indicators and making sure they are employing their efforts towards minimizing any risk related factors which hinder their performance.

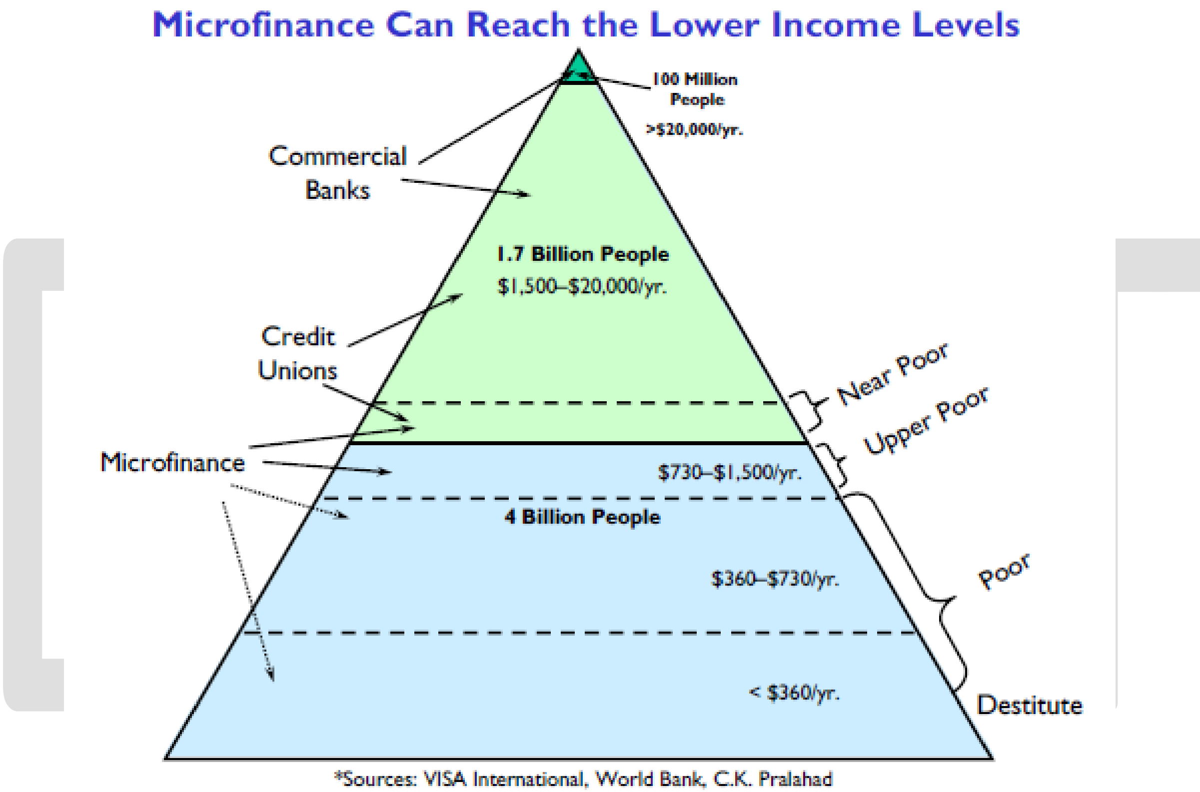
[77] CGAP. "Good Practice Guidelines For Funders of Microfinance." 2006. *http://www.cgap.org/gm/document-1.9.2746/donorguidelines.pdf*

[78] Ibid

### 3.3 Maximizing micro-credit programmes' outreach and social impact for Peace

Outreach is defined as the efforts put in extending microfinance services to those who are not served by financial institutions. It can be measured in two ways; breadth which is the number of served clients and the volume of services (for example total portfolio), or depth which is the socioeconomic level of clients which the MFI can serve[79].

**Figure 1: Outreach of different institutions**




When it comes to outreach directed towards the poor, figure 1 suggests that the bulk of the world population which earns less than 1,500 USD/year including the upper poor, poor and destitute do not get any financing through the traditional practices of commercial banks and credit unions since these institutions only finance people who have means to repay their loans. . Clearly, microfinance can reach the lower levels of income which commercial banks are either not interested in or are not willing to take the risk of financing. Microfinance gives this underserved component of the population access to financial services to help them retain their economic activities, generate income and sustain themselves. When it comes to the Arab region, as mentioned earlier, there is no clear definition to the targets of MFIs. Different institutions have different targets some targeting upper poor others focusing on poor and others even

[79] Lafourcade, Anne-Lucie, Jennifer Isern, Patricia Mwangi, and Matthew Brown. "Overview of the Outreach and Financial Performance of Microfinance Institutions in Africa." 2005.

investing in the destitute although best practices of microfinance propose the deviation from these segments as they are not bankable.

The main focus of MFIs should be the poor. As we can see in figure 1, there are 4 billion people who are not benefiting from the services offered by commercial banks and other financial institutions. This massive market, which, without microfinance, would be unexploited, should be served to create opportunities, and make use of abandoned resources. Although mainly directed towards the upper poor and poor, microfinance could trickle down to the destitute through capacity building and job creation.

Intermediaries should focus mainly on the entrepreneurial poor, and should engage in client-appropriate lending thus tailoring to the needs of the specific market they are serving. Savings mobilization facilitates small deposits and provides ready-to-access funds when they are legally permissible. Significant progress in expanding client reach and market penetration should be reached, demonstrating both strong client response to services offered and competence in service delivery management.

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### 3.4 Training and Technical Assistance

To help MFIs build their institutional capacities it is important to provide them with easy access to training and technical assistance. The region obviously lacks suitable training in microfinance best practices, and needs a more tailored technical assistance. Training needs vary widely given that new microfinance programs need basic training while older programs are facing second or third generation issues associated with larger, more complex organizations. Older programs need far more tailored training and specialized technical assistance.[80]

Many of the region's microfinance programs are part of larger institutions such as international NGOs or governmental or quasigovernmental organizations (such as social funds or state-owned development banks). Such structures can limit growth, and after reaching a certain level of development a microfinance institution should consider spinning off or transforming into a separate legal entity. The reasons to that include the need for internal rules or procedures that might conflict with the parent organization's other activities or objectives as well as the need for a clear identity, separate from the parent organization, to avoid sending clients mixed signals.[81]

Several training initiatives have been undertaken to bolster microfinance training in the region. On the international level, to date more than a hundred individuals from the Middle East and North Africa have attended the Boulder course, and in the summer of 2000, 35 of the program's 120 participants were from the region. Thus donors are willing to help microfinance institutions access best practices. Regionally, several initiatives have emerged; some have been tested and implemented while others are still at the embryonic stage.[82]

In addition to these initiatives, the Consultative Group to Assist the Poorest (CGAP) has been forging partnerships with training institutes around the world to provide financial management courses to microfinance institutions since 1997. Having identified the insufficient skills of microfinance managers and staff as the main constraint to the industry's development, the CGAP initiative seeks to enhance performance through training. Moreover, many institutions in the

[80] Brandsma and Hart 2004, Op cit
[81] Ibid
[82] Ibid

Middle East and North Africa are developing local training directed at loan officers and mid-level staff .[83]

Training and technical assistance programs cross-subsidized by financial programs may increase costs of the operation with no consequential improvement in effectiveness of the financial services. Programs that provide exclusive financial services are as effective as programs that provide loans and compulsory credit-related training, and financial programs combining only minimum non-financial with financial services are more likely to attain self-sufficiency than programs that provide an integrated assistance package to micro and small entrepreneurs.

If training programs are offered by NGOs offering financial services, they should be demand-driven, provided on a cost-covering basis and preferably provided separately from financial services. “In Ethiopia, training in tailoring by a NGO financed by GTZ was less successful since the market was already saturated with tailors while training in construction was in high demand. Training provided free of cost along with loans in El Salvador was less effective in increasing loan repayment since loans were considered as payment for the participation in the training programs[84].

The challenges remain in that most of the region’s best practice programs have managers with a private sector or banking background which generally enhances a program’s business orientation and quest for sustainability. But getting such managers is hard, and keeping them is often harder. Thus microfinance institutions face two major human resource challenges: attracting suitable candidates and investing to improve their skills, and retaining them[85]

### 3.5 External Support and Donor Standards

The purpose of setting common standards for donor agencies supporting broader access to financial services for micro and small enterprises so that donors can work in concert to ensure that lessons of success are translated to the institutions they support. Donor support to MFIs revolves around two main pillars; outreach and sustainability. The first aims at a wider cliental base, and the second provides the means expand outreach. There are numerous types of micro and small enterprise clients who have different characteristics and demand different services. As a result, it is important to encourage a range of specialized institutions which use focused methods to serve their particular markets. These institutions can include “commercial and development banks, credit unions, mutual or community banks, non-governmental organizations (NGOs), finance companies, cooperatives, savings and credit associations, and other specialized intermediaries”.[86] Fundamental principles of finance must be observed by all institutions if they are to succeed. In addition to that, donors should aim their support mechanisms to match best international practices and long-run development of a sound financial system.

Strengths of intermediaries seeking support should include an institutional culture, structures, capacities and operating systems. These can help sustain service delivery to a wide range of low income clients. Requirements include a “sound structure, independence from political interference, good fit to local context, competent staff, a strong expansionary and

[83] Ibid
[84] Nagarajan 1997, Op cit,
[85] Ibid
[86] "Small and Microenterprise Finance: Principles for Selecting and Supporting Intermediaries." 1994. *http://www.gdrc.org/icm/sme-finance.html*.

sustainable business plan, and mission and vision to direct the institution's purpose, ownership and accountability".[87] Also a point of strength is accurate management information systems that are actively used to make decisions, motivate and provide accountability for funds. These systems are vital for effective and efficient management. Operations which efficiently manage small transaction with high productivity are also important in an intermediary. These are measured by variable like loans per staff and the operating costs as a percentage of average annual portfolios. In addition to that, meaningful and transparent financial reporting which conforms to international standards and allows donors to adequately evaluate performance should be practiced. Intermediaries should focus mainly on the poor, and should engage in client-appropriate lending thus tailoring to the needs of the specific market they are serving. Savings mobilization facilitates small deposits and provides ready-to-access funds when they are legally permissible[88]. Grants should be used in institutional development which is applicable at all stages of an institution's life, capitalization to enable institutions to mix costs of grant funds with commercial sources during the period it takes to build efficient operations and scale, managing operational losses although donors should avoid covering operating losses except during a clear, time-limited start-up or expansion phase., and purchase of fixed assets which may be seen as contributions to the equity base of the institution.

Donor support through loans is appropriate for lending-based institutions that meet performance standards. However, loan capital from local and commercial sources should be sought as early as possible, even at start-up. Care should be taken to avoid burdening young institutions with foreign exchange risk in loans denominated in foreign currency, unless adequate precautions are taken. Donors are also advised to be careful not to undermine savings mobilization efforts of savings-based institutions, such as savings and credit associations, by making loans available to them below the cost of mobilizing funds locally.

The transition to fully commercial sources of funding requires special forms of support that help introduce institutions to the financial system. Donors can act as catalysts to effect this transition through means such as investor equity, from both official and private sources. Donor support can help leverage private investment. Also through second-tier operations, which raise funds from commercial sources and on-lend to microenterprise finance institutions, and partial guarantees of loans made by commercial banks to NGOs.

Institutions following sound principles for sustainability must not be undermined by others providing competing services below cost or in ways that cannot be sustained. When providing subsidies (grant or loan) to small and microenterprise institutions, donors should ensure that they coordinate that support with other funders, such that institutions are given clear incentives to become financially viable. In particular, donors need to consult each other regarding appropriate interest rates and other terms on which assistance to any given institution is supplied[89]. Donors should also coordinate institutional support with sectoral policies such that financial institutions, including informal and semi-formal sectors, find enabling conditions for institutional development and growth. Donors should require regular reporting on institutional performance and should base funding decisions on achievement of performance targets. The following tables cover the minimum raw data that should be reported, but do not include analytic indicators, such as financial ratios or adjustments for subsidy or inflation. The intent is to ensure the quality and comparability of data so that financial analysis can be conducted in a way that

[87] Ibid
[88] Ibid
[89] Ibid

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both donors and programs can interpret. Meaningful analysis requires a firm base of data. These indicators are intended to furnish such a base[90].

Donor funding should complement, not replace, private capital. If possible, coordination of donor agency activities in microfinance has the potential to enhance economies of scale and promotes learning. At a minimum, donor cooperation and clear communication with microfinance providers can identify appropriate interventions, avoid duplication of funding and conflicting interventions, and clarify variances in areas and methodologies that different donors choose to support. Particular goals and target groups include poverty reduction through targeting poor households; economic development through targeting sustainable local businesses; job creation to promote stability and defeat the insurgency through a focus on unemployed young men in conflict areas; reduction of poverty and gender disparity through a focus on women; and poverty reduction or improved economic activity through a focus on rural areas and agriculture. Additionally, according to the priority of the donor, microfinance operations have had a focus either on rapid delivery of services in targeted communities, or on building sustainable operations for long-term success[91] .

The international organizations have largely tended to resist providing directed services in areas that are not stable, evidencing a preference for focusing on building sustainable operations. Often the same donor will express an interest in both aspects of microfinance development. Donors may also wish to explore other alternatives besides microfinance (for example, cash-for-work) that may be a better fit with this and other specific objectives[92].

Funding based on large, ongoing subsidies with a charity rationale has failed. Such programs have drained resources without becoming sustainable, and have contributed to the mistaken notion that the poor are un-bankable. Funders should provide financial and other support in such a way to ensure the quality of services provided and the widest outreach, as well as to foster the movement to scale, financial self-sufficiency, and independence from donor support, taking into account the particular characteristics of different types of institutions. Donors should ensure that institutions, in their effort to become sustainable, maintain a focus on offering appropriate services to the poor.

In the box below, the experience of East Timor provides valuable lessons, although it is not a country directly from the region. East Timor’s experience shows that prefabricated solutions especially by international agencies should not be taken and implemented without a thorough understanding of the situation in the country, the status of the clients and their needs.

**Box 2: East Timor- A Story of a Failure**

In 1999, after East Timor’s independence from Indonesia, the World Bank, the IMF, and the Asian Development Bank (ADB) launched the restructuring of the country’s economy. They initiated the rural economy and decentralized the government through Community Empowerment Project (CEP) which grants loans to small community projects such as repairing roads, water sanitation projects and microcredit-funded kiosks. Instead of reshaping Timor's economy, this resulted in community conflicts, indifference and poor project sustainability.

By moving into reconstruction, the World Bank aimed at delivering speedy material

[90] Ibid
[91] USAID. "Iraq Private Sector Growth and Employment Generation: The Iraq Microfinance Strategy." 2007.
[92] Ibid

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assistance and to build robust institutions of local governance that would "empower" communities to engage in their own development. The communities under the CEP had to abide by the World Bank's guidelines, supervision, missions and key Performance Indicators, giving them too little autonomy. Deadlines for quick disbursement of project funds and detailed bureaucratic rules plunged the communities in confusion and conflicting situations. In addition to that, giving credit to micro entrepreneurs placed most of them in a precarious position, as many spent the money on urgent needs or saw only one business option: run a kiosk. In fact, 54% of CEP microcredit loans went to kiosks, leading to few customers and too much competition. Not only were most of the loan recipients illiterate and ignorant of their businesses' health and sustainability, 70% of microcredit cases were deemed to be incapable of breaking even and thus paying back the original loan.

The World Bank tried to build a nation on the quick by imposing free-market economics on the grassroots, but there are clear limits to what credit and some accounting skills can remedy. Also, lacking a political legitimacy and perceived as essentially a funds distributor, the Bank failed at bringing democracy to the country-side. Instead of taking advantage of the local legitimacy and technical knowledge, the Bank bypassed these sources and struggled to establish its "civilising" mission.

*Source: The World Bank's Land of Kiosks: community driven development in Timor-Leste- Ben Moxham.*

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## Part 4. Conclusions and Recommendations

### 4.1. Conclusion

International evidence shows that there is a need for a clear strategy set by the government through which goals and objectives have to be set depending on the country's needs and market characteristics. Donor and government coordination is an essential component in sound microfinance practices. This does not mean that over-regulation is a positive thing. The governmental role should be limited to guiding the process by regulating deposits of the MFIs, and providing technical, financial and outreach support. This role also includes formulating supportive policy and regulatory environment, avoiding the distortion of the market by direct service delivery with subsidized fees, and avoiding policies that negatively impact on both the effectiveness and efficiency of microfinance institutions Thus governments should enable financial services not provide them directly.[93]

Attracting successful international MFIs is also an effective strategy as these institutions acquire experience and reputation and have access to support from parent bodies. Microfinance investments should have a long term scope as the development of microfinance capacity is a slow and costly process. In addition to that, facilitating cooperation and partnerships between public and private players is essential to enhance access to such key factors as financing, skills and basic services. Access to broader financial options should be facilitated and thus continuing development of domestic financial markets coupled with skill-building for regulators and private financial institutions is necessary.

[93] Staschen 1999, op cit

According to the Microfinance Best Practices, microcredit institutions should adapt their services to meet the local client population especially in times of conflict (offering short-term loans or small loan amounts, "stepped lending" or opening offices in accessible locations.[94] Like any other business, they should work on keeping their costs down. This reduction will eventually trickle down to the client through lower interest rates or operational and processing fees. The dependence on timely repayment means that MFIs should incentivize programs that motivate clients, and must work toward recovering long-term costs, although operations typically assume losses in the initial start-up period. In addition to that, scaling-up outreach by steadily increasing access to larger numbers of people is critical to organizational viability. The nature of the post-conflict situation will remain correlated with the nature of the conflict and its intensity. Each microfinance institution should work on maximizing knowledge of other case studies on countries with similar issues, but the way to deal with conflict should be adapted depending on the specific characteristics of the country, and its economy and business culture.

Specifically in conflict-affected areas in the region (Iraq, Palestine and Lebanon profiled in section 2), there is a need to revise the regulatory framework for microfinance, and consequently develop local MFIs into professional and financially stable organizations. Second, creating partnerships between MFIs, the private sector, the commercial banking sector and international microfinance support organizations will help in making this sector more developed and more resilient to shocks. This can be facilitated by establishing specialized microfinance units that will provide support, guidance and monitoring as well as a link between the governmental visions and the public,private and non-governmental organizations engaging in microfinance activities. Third, establishing an advisory framework of microfinance policies can also be used by MFIs to introduce international best practice, and introducing annual ratings of MFIs will facilitate competitiveness analysis and benchmarking of the sector. Ensuring sustainability and growth of the organizations requires appropriate governance and access to commercial funds. To reach capacity, institution building and legal transformation are a key requirement. Small enterprises could be fostered through ensuring better access to markets, finance, and business linkages, this in addition to particular efforts to focus on youth and women, as well as enterprises that have the capacity to employ many people like family farms for example. Broad alliances for microfinance could also trigger better lending and develop financially sustainable models. Innovative schemes are also needed to transform financial flows from the many emigrant diasporas into long-term productive investments in their home countries especially in areas of conflict where people flee the countries to seek less troubled environments.

To promote the microfinance culture in the region, there is a pressing need to educate governments, NGO's and the general public. Most MFIs still rely on subsidized funding which makes them less financially self-sufficient. Thus, regulatory environments should be set in a way to create a competitive edge, and provide a solid ground for developing activities targeted at new funding sources. Facilitating licensing, entry and exit procedures, setting capital requirements to give MFIs a status that will allow them to raise funds from private investors in loans and/or equity are all important aspects of improving the sector and making it more resilient to shocks and conflicts. Allowing MFIs to raise equity will give it a cushion in times of uncertainty and help it survive and benefit more people. Legislative measures should also be taken to prevent the risk of corruption in the industry especially for MFIs benefiting from external financing (MIX 2009). A further step is to encourage Commercial Banks' participation in micro-lending. In

[94] *MBP Microfinance Following Conflict, Brief No. 3.* Microfinance Best Practices. *http://www.gdrc.org/icm/disasters/Developing2.pdf*

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addition to that, the need to empower women and increase their productivity is also something that would help in increasing the outreach of microfinance and empowering women and making them more productive in their communities.

While unregulated MFIs are reaching poorer clients, they have higher costs and smaller operations volume; these institutions will need to scale up, transform, or merge with other institutions to achieve levels of efficiency that can guarantee their continued operation. Cooperatives compare favorably for savings mobilization, even though, on average, they do not lend as much as other MFI types. Given their lower operating costs, cooperatives are well poised to improve financial performance and remain competitive. Commercial banks are entering the market, and competition is increasing in many countries. MFIs will need to innovate and provide high-quality services to retain clients and remain competitive in their local financial services markets. In addition to regulation of the institutions, judiciary reforms are important for contractual reinforcement[95]. There needs to be more awareness regarding the financial products and the differences between them. MFIs should work to minimize their costs and, when applicable, offer group lending methodologies which imply economies of scale through group transactions and thus reduced costs.

Although donor funding is highly necessary, it should complement, not replace, private capital. MFIs should be regulated to attract capital which will help these institutions become more sustainable and resilient to shocks. Voluntary savings and deposits are the largest and most liquid financing sources for microfinance institutions. On a different level, these savings meet the demand for local savings services which is underserved in most cases. Donors should avoid NGO dependency and should specify exit options from the start.

Microfinance should not be mixed with relief work or charity because it functions very differently from other developmental tools. It is a method to supply access to finance which otherwise would not be available. So, some initiatives may target a certain kind of poor (entrepreneurial for example), while others target the upper poor group or the low middle classes. Other initiatives, if they have the capacity, can even invest in high risk groups like the extremely poor and make them suitable to become entrepreneurial through instruments like savings and insurance, termination payments or even micro grants. Therefore, other instruments such as food-for-work, public work programs, capacity building efforts, and business development services to prepare the poor and the marginal groups to take advantage of economic opportunity should be examined in the quest for making the underprivileged benefit from financial services. MFIs have also succeeded in training and capacity building to the underserved poor people in many countries across the world. Especially in a post-conflict environment, humanitarian concerns and microfinance work should not overshadow each other. The two should be integrated in public policies, in order to capitalize on microfinance practices to maximize humanitarian aid.

In conflict environments, microfinance could work on a two-way-causal relation where it could decrease the intensity of the conflict as it is providing people with access to improve their living conditions, and could be improved by decreased conflict. It is important to understand at which stage of conflict the country is in before engaging in any form of microfinance activities, and it is important to study the nature of the conflict before implementing anything. Some MFIs engaged in conflict resolution between different parts of the community after the conflicts have seized. It is clear that MFIs can offer a lot to the communities they operate with, and the diversification of their services is important for them to grow and decrease their portfolio risk.

[95] Lafourcade 2005, Op Cit

Initially, the most important point is to mobilize efforts towards avoiding the recurrence of conflict in order to boost investor confidence. The next step is to achieve a quick transition from conflict which avoids donor dependence. Though, this should not be undertaken through very rapid uncoordinated reforms. This should be followed by committed efforts by donors and governments to restore trust in the country's institutions. Coordination among the stakeholders in the microfinance sector should be increased starting from the initial steps of the programs, and financial products which ensure economies of scale and scope should be sought. Institutions should clearly identify their outreach and sustainability plans. Most importantly, before the replication of any previous experience, best and worst practices especially from countries with similar conflict environments should be examined to try to learn from the mistakes of others and perhaps get inspired from their creative successful solutions. For instance, funding based on large, ongoing subsidies with a charity rationale has failed.

Based on international best practices, and field experiences, this paper concludes that the main focus of microfinance should be directed towards poverty alleviation. The outreach of microfinance services should be increased to meet the high demands of a large population base which lacks access to financing and thus is crippled from doing any form of revenue-generating activities. Increasing outreach should be done in a way that takes into consideration the specific needs of the population under study and not simply implement strategies that worked elsewhere. Although conflict has harmful effects on the MFIs, it has been evident that many institutions proved resilient even in highly dangerous environments. Although they lost a considerable amount of resources, they were able to maintain their place and resume their services in the market.

This report has shown that the unique case studies of the ESCWA region, which is characterized by uncertainty due to recurring conflicts, that MFIs are able to survive adverse political and security conditions if they have the flexibility, sustainability and resources to adjust their products and procedures to overcome the obstacles brought about by conflict and political turmoil. Using data on the microfinance sector and household's livelihood like consumption and GDP per capita, this report proved the significance of the impact of microfinance activities on people's livelihood and employment generation.

While the above recommendations and conclusions apply to most of the conflict affected countries in the ESCWA region, below are some specific recommendations for the three conflict countries tackled in this report, namely Iraq, Palestine and Lebanon.

## 4.2. Recommendations

### 4.2.1 Iraq

Several recommendations can be made to actors involved in the microfinance business in Iraq. In the first place the government of Iraq should create the necessary conditions conducive to the creation of a positive environment for the development of microfinance in the country. This would entail reviewing and reinforcing its regulatory framework. The dispositions regulating the industry should be strong. At the same time they should not cause unnecessary impediments to the industry. In a wider context the Iraqi government should set policies that

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stimulate financial services for businesses and borrowers while also protecting depositors. The government should clamp down on corruption and improve the business environment, including access to markets and infrastructure. It should also put in place programs to support the needs of small and medium enterprises.

With respect to the international community a diversification of funds should envisaged. This would entail the increasing participation of more NGOs and even international institutions like UN agencies. ESCWA could contribute decisively in the tasks of capacity building. This could be done by organizing trainings and seminars to create the capacity of Iraqi officials on the several technical aspects of microfinance.

Izdihar also offers some recommendations for donors. Their main tasks would be to clearly define the concept of microfinance in Iraq, assist in raising awareness of the topic, assist in resolving regulatory and legal issues, provide support or training, set and adhere to clear reporting guidelines, support networking among the Iraqi microfinance community and support bank linkages and expanding services related to microfinance as the industry continues to evolve under very challenging and unstable circumstances.

Many important problems remain in terms of challenges for the microfinance industry in Iraq. First the lack of political stability after the change of regime has made the operations of microfinance institutions very difficult. The lack of security and banking infrastructure has impeded the development and expansion of this industry in Iraq. Even if the situation is beginning to improve Iraq still constitutes a post-conflict society with all which this categorization entails. The underdeveloped banking infrastructure has also hampered the operations of MFIs. MFIs in many cases have not been able to transfer funds between branches and have had difficulties processing loan payments and producing correct records. Additional investment in microfinance development and expansion remains critical.

Nevertheless reasons for optimism also exist. Demand for microfinance services in Iraq is high. A financing gap exists as there is a need to re-energize business activity through microcredit loans to micro and small business entrepreneurs. Many microfinance activities have yielded positive results and have benefited wide sectors of the population.

### 4.2.2 Lebanon

While Lebanon constitutes a typical post-conflict country, as opposed to the ongoing conflict situations in Palestine and Iraq, progress still needs to be made to improve the microfinance sector in this country. Indeed, rather than create new MFIs, it would be more appropriate to upgrade and improve existing ones.

There is an urgent need for human resource development in the microfinance sector. Advisory services and training, with a focus on best practices in credit methodology and marketing, are crucial. There is also a need for additional funding to help providers expand their product portfolios and reach in the region, thus increasing access to finance.

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The Government should play a critical role by implementing effective policies to ensure the soundness of financial service providers and minimize market distortions, as well as submitting microfinance institutions to the central bank supervision and regulatory requirements. More specifically, the Government should develop an appropriate legal environment through:

- Appropriate and enforceable credit laws: Appropriate laws that will facilitate collection and increase accountability of client and must allow for cost effective enforcement through the courts and on the ground;
- Appropriate institutional regulation: the government should operate within the “institutional development” matrix, i.e. to assist providers to move along the development continuum

Another important role for the Government is information sharing through the development of an adequate “Central des Risques” to allow for the sharing of information on “delinquent” clients between various organizations as well as provide basic statistics on micro enterprises in Lebanon, such as number, location and typical profile. Furthermore, the Government should provide operational tools such as basic maps. Best practices should also be promoted within this context of information sharing. International examples have shown that some of these best practices can include:

- No subsidies (interest rates)
- Policies that encourage small loans with short maturities
- Delivery of services in a market-oriented manner
- The grounding of actions in a well articulated long-term plan.
- Promotion of partnerships between donors and the private sector

### 4.2.3 Palestine

While Palestinian MFIs are suffer from the ongoing occupation and ensuing economic devastation of both Gaza and West Bank, including the recent conflict in Gaza, recommendations can be suggested with regards to internal and institutional constraints of MFIs in the occupied territories.

The first challenge for the microfinance players in Palestine is to resolve the apparent paradox of financial sustainability vs social profitability. In order to fulfil their mission of social profitability, the financial sustainability of MFIs has to be achieved.

Palestinian MFIs must take into account that product design and delivery should allow for general instability and potential economic interruptions, in other words, they must be flexible.

External donor aid is the most important source of capital for most MFIs in Palestine and therefore it is important that the donor community must approach microfinance activities from a development perspective rather than as a relief activity. Practitioners should work together with donors to design funding mechanisms that permit continued institutional development of the microfinance programme after the emergency funding has expired.

There needs to be improved collaboration between the Palestinian Monetary Authority and MFIs which would help to move on the challenge of the institutional framework, promoting a deeper understanding of the differences and complementarities between banks and MFIs. There

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needs to be an expansion of the banking law in order to open banking facilities to MFIs. In addition, there is a need to change the rules that govern MFIs in order to facilitate their governance, through mechanisms used in the Not for Profit Company Law (combining advantages of the non-profit law with company law.

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