Recapitalising Liberia: principles for providing grants and loans for microenterprise development

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In previous post-conflict contexts, donors and practitioners have successfully provided grants and loans to affected populations to spur economic growth and reconstruction, promote the sustainable return of refugees and rehabilitate ex-combatants. However, recent experience demonstrates that if the provision of grants and loans is not well-managed, well-intentioned donors and practitioners can undermine the development of a healthy credit culture, delay the transition from relief to development and harm communities in the long run.

This note is offered as a practical tool for donors and practitioners working in post-conflict situations to maximise the positive impact from both grant and loan programmes for microenterprise development. These principles, based on emerging best practices from development and post-conflict environments, are designed to promote rapid reconstruction while laying the foundation for economic growth. This note was developed by donors and practitioners for use in Liberia, as a test case to see if cooperation among stakeholders will lead to the proper use of grant and credit interventions.

Appropriate criteria for grant or credit programmes

In relief situations, both grant and credit programmes can be appropriate tools to help economically active poor people begin or expand businesses. However, the two interventions are not interchangeable and should not be mixed.[1] Grant programmes quickly infuse capital to the entrepreneur without a repayment burden and require only moderate institutional capacity among implementing organisations. However, they serve a limited number of people and can negatively impact the credit culture if relied upon too extensively. Credit programmes have the potential to sustainably provide large numbers of entrepreneurs with capital but require strong institutional capacity to implement effectively. When deciding which type of intervention to fund/implement, donors and practitioners should consider the programme goal, operating environment, institutional capacity of the implementing organisation and the programme/funding horizon.

Grant programmes are appropriate when:

- the main goal of the programme is enterprise development for special populations – such as vulnerable women, ex-combatants and youth – who cannot manage microcredit loans effectively and/or to further such non-economic goals as ethnic reconciliation and house reconstruction
- the operating environment is unstable (some population mobility, high inflation) and the target population does not operate businesses, cannot access markets and/or is located in remote areas
- the implementing partners have community and microenterprise development experience but do not have the desire or capacity to conduct longer-term, more sophisticated microfinance programmes
- the programmes and funding horizon are short term (one year or less)

Credit programmes are appropriate when: [2]

- the main goal is general enterprise development for entrepreneurs who lack access to capital and can manage microcredit loans effectively
- the operating environment is stable (good security, little population mobility, low inflation) and the target population operates businesses, can access markets and has the capacity to repay
- the implementing institution has moderate to strong capacity and a focus on financial services or microenterprise development programmes
- the programmes and funding horizons are long term (minimum of three years)

In the immediate aftermath of conflict grant programmes may in many cases be more appropriate. However, as the situation stabilises and the general economic status of the population improves, the emphasis should change from grants to loans.

Development of the Sierra Leone Microfinance Sector

In 2001, Sierra Leone emerged from a devastating ten-year civil war. With peace, many credit programmes were begun to help entrepreneurs recover from the war. Though some performed well, most suffered from poor targeting, unqualified staff, unsuitable products and insufficient systems to recover loans. In 2003, a UN Capital Development Fund (UNCDF) assessment mission found that prior 'credit' programmes with weak repayment had created widespread client and practitioner confusion about credit. This was slowing the development of the microfinance sector and thus the pace of reconstruction.

Principles for implementing grant programmes

- Use grants as one-offs to avoid dependency and encourage investment: a series of grants can encourage dependency (as

beneficiaries come to expect handouts) and may serve as a disincentive for investment – since consuming, rather than investing the grant, will be rewarded with an additional grant.

- Separate grants from loans to avoid confusing clients: if unavoidable, the two activities should be separated by using different staff, targeting different populations and using clearly defined messages to present the products either as grant or loans.
- Accompany grants with advice: to increase the chances of effective investment, grants should be complemented by training and/or mentoring by knowledgeable staff.
- Require contributions or demonstrated commitment: to ensure that the beneficiary is serious about the business, grants should be contingent upon meeting certain requirements or making a contribution.
- Distribute contingent grants in two stages: the beneficiary must demonstrate proper use of a small initial grant, have attended training and/or developed a business plan before receiving the full grant amount.
- Require recipients of contribution grants to provide cash or in-kind inputs of at least 10% of the value of the project.
- Coordinate with credit programmes to facilitate long-term financing for clients: a direct process of graduation to a credit programme or by recommendation can encourage good grant clients to aspire to be recognised entrepreneurs eligible to gain sustainable financing for their businesses.

Principles for implementing credit programmes

Global microfinance best practice lessons apply and work in reasonably stable post-conflict situations after the immediate post-conflict stage[3]. Accordingly, the guiding principles set out below focus on the selection criteria that donors and practitioners should use, rather than the implementation principles themselves.[4] Nevertheless, considering the difficulty and expertise required to implement effective and sustainable microfinance in developing countries, and the institutional weakness normally found in post-conflict countries, donors and practitioners should pay particular attention to meeting the selection criteria before funding or proposing microfinance interventions.

Any institution or international technical support agency receiving support for credit/savings activities should be able to demonstrate competency or strong promise of potential in the following areas:[5]

- Institutional strength: sound institutional culture with a mission and vision able to expand microfinance services to low-income clients; management and information systems that provide accurate and transparent financial reports according to internationally recognised standards and efficient operating systems.
- Quality service and outreach: focus on serving low-income clients and on expanding client reach and market penetration; financial services that meet the needs of the clients; capacity to adapt services to meet the distinct needs of entrepreneurs in post-conflict situations (less trust, greater mobility, decapitalised businesses, more conservative coping strategies).
- Sound financial performance: interest rates on loans sufficient to cover the full costs of efficient lending on a sustainable basis, low portfolio in arrears and low default rates, and a plan for a diversified funding base for microfinance operations to minimise dependency on donor subsidies.
- Reporting: all recipient institutions must have a system for reporting regularly on the quality of their services, outreach and financial performance, including annually audited financial statements.

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Next steps

Post-conflict countries such as Liberia offer the opportunity to meet the immediate needs of conflict-affected populations while building the foundation for a vibrant entrepreneurial sector that will help fuel long-term growth and stability. However, the threat also exists that a large influx of relief money, improperly directed into grant or loan programmes, will not be absorbed properly and will create dependency or a poor credit culture. The principles in this paper offer a starting point for donors and practitioners to begin coordinating their activities and thus to help ensure that funds both further short-term reconstruction and gain long-term returns.

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Beyond the suggestions made in this paper relating to grant and credit programmes, donors and practitioners should also consider complementary interventions to improve the climate for enterprise development. Many entrepreneurs have difficulty not due to a lack of capital but due to a lack of skills or access to markets, information and technology. Business development skills programmes help entrepreneurs overcome these gaps and increase profits. Post-conflict situations provide the opportunity to reform what were often poorly functioning sectors in the first place. Legal reforms and regulatory strengthening can significantly improve the environment for providing financial services by commercial banks and other entities.

1. *Microcredit Menu*, CGAP Focus Note #20. www.cgap.org/docs/FocusNote_20.html

2. Doyle, Karen '*Microfinance in the Wake of Conflict'*, The SEEP Network, 1998 www.mip.org/pdfs/mbp/conflict.PDF; Larson, Dave '*MBP Microfinance following Conflict, Technical Briefs'*, DAI 2000 www.microfinancegateway.org/content/article/detail/14553

3. ILO/UNHCR Technical Workshop: '*Microfinance in Post-Conflict Situations: Towards Guiding Principles for Action'*, by Geetha Nagarajan, 1999. www.microfinancegateway.org/content/article/detail/2934

4. The CGAP (www.cgap.org) website is a good resource for implementation principles.

5. '*Small and Micro Enterprise Finance Guiding principles for Selecting and Supporting Intermediaries'*, Committee of Donor Agencies for Small Enterprise Development, and as adopted in the UNDP Programme Manual, Chapters 4.3.5 and 6.4.6, and the related annexes www.ilo.org/public/english/employment/ent/papers/financgd.htm