FocusNote

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MICROFINANCE, GRANTS, AND NON-FINANCIAL RESPONSES TO POVERTY REDUCTION: WHERE DOES MICROCREDIT FIT?

This note was written for audiences from development specialties outside the financial sector to provide guidance on where microfinance is most appropriate, and where complementary and alternative interventions are more effective. It looks at microcredit as one element among many on a menu of possible interventions to generate income and employment, and alleviate poverty, including temporary poverty in post-crisis situations and longer-term hardcore poverty. This perspective should make it easier to see how microcredit relates to other financial and non-financial interventions, and to select a package of tools that are likely to work best in each specific situation. The discussion addresses five questions:

- **When is microcredit an appropriate response?**
- **What is needed for successful microcredit?**
- **When would savings and other financial services be more beneficial?**
- **When should grants and other financial entitlements be considered?**
- **What other interventions can strengthen the economic position of the poor?**

Introduction

"Microfinance" refers to provision of financial services—loans, savings, insurance, or transfer services—to low-income households. In the last two decades, practitioners have developed new techniques to deliver such services sustainably. Microfinance now looks particularly attractive as a tool to help the poor, since it is widely seen as improving livelihoods, reducing vulnerability, and fostering social as well as economic empowerment.

Most donor interventions have concentrated on one of those services, microcredit. While credit does not create economic potential, it can unleash it, enabling the poor to use their human and productive capital more profitably and to build up their asset base. In addition to credit, savings and insurance services are used by the poor to plan for future lump-sum needs and to reduce their exposure to income changes or sudden expenses.

Where the objective is to provide a financial safety net to poor households, then micro-grants (for instance, termination payments to employees who lose their jobs in the case of government downsizing) are another option worth considering. Other alternatives include employment programs, training, marketing, infrastructure development, and legal/regulatory reform. All these tools can expand the economic options available to the poor.

Precisely because microcredit is such a popular intervention today, we need to place it within this broader menu of options before deciding when and how to use it.

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Examining the Options

When is microcredit an appropriate response?

For microcredit to be appropriate, a pre-existing level of ongoing economic activity is needed. If not, then clients may not be able to benefit from credit and risk being pushed into debt problems. These client-related pre-conditions may not hold:

- In an immediate post-emergency environment
- For the chronically destitute, credit is unlikely to succeed without pre-existing efforts to reduce vulnerability and to build skills, confidence, and a minimal financial base
- In severely disadvantaged rural areas lacking infrastructure, services, and/or access to markets
- Where illness keeps people from productive activities. HIV/AIDS provides an extreme example of a situation where the poor may become *less able* to benefit from credit over time (see Box 1)

Even when there is a sufficient level of economic activity, market opportunities, and entrepreneurial capacity, limiting conditions to standard microcredit methodologies and delivery mechanisms can still cause microfinance efforts to be unsuccessful. These limiting conditions include:

- A population so dispersed that it is too costly to reach clients on a regular basis
- Dependence on a single economic activity—such as a single agricultural crop—which creates "covariance" risk for the microcredit institution
- Reliance on barter rather than cash transactions
- A population with a high degree of mobility or instability—for example, populations temporarily displaced due to civil conflict
- Likelihood of future crises such as civil violence, natural disasters, or hyperinflation
- Absence of law and order

Box 1: URWEGO's HIV/AIDS Experiment

The URWEGO microfinance program operates successfully in the challenging conditions of post-conflict Rwanda. World Relief provides technical assistance through an in-house advisor and an international team. Recently, URWEGO was asked by a local church to lend to poor women whose spouses had died of HIV/AIDS. Most of the women were HIV-positive themselves, and many reached the symptomatic stage within a few months of joining the program. As a few borrowers fell sick, they stopped attending meetings and eventually failed to repay. This caused the other members of the group to stop repayment, and the entire scheme quickly collapsed.

In evaluating this experiment, URWEGO staff pointed out the short planning horizon of the clients, and their progressively decreasing ability to carry out productive activities. They also concluded that targeting a single type of higher-risk client produced unacceptable risks for the program. URWEGO will no longer target microcredit to people living with HIV/AIDS, but remains committed to lending in communities where some clients will inevitably be infected.

- A legal/regulatory, or monitoring and enforcement environment that constitutes a significant barrier to microenterprise or microfinance activities

- A lack of social capital or societal cohesion, which undermines the use of non-collateral credit methodologies

Such conditions challenge even capable and experienced microcredit institutions, forcing them to experiment with modifications that increase their risk and costs—sometimes significantly.

What is needed for successful microcredit?

If the conditions for microcredit are in place, who then should do it? Ideally, a strong local microcredit institution, a bank that is committed to poor clients, or an international microcredit organization are the best choices. Suitable institutions should have a commitment to the four basic tenets of high-quality microcredit:

1. Providing long-term financial services, or *permanence*

2. Reaching large numbers of clients, or *scale*

3. Reaching the poor, or *depth of outreach*

4. Reaching full *financial sustainability*

Unfortunately, a search may reveal that existing organizations are weak or pursuing other priorities. Banks often lack the motivation and flexibility to make the changes that microfinance requires. High-performance international practitioners—of which there are few—cannot expand everywhere. They may avoid environments where they see high risks or low potential for success.

In such situations, donors may choose to encourage non-microfinance institutions to move into microcredit. This approach requires substantial technical assistance and institutional development, with a sustainable microfinance institution as the end goal. Financial and capacity-building support should be linked to clearly defined performance indicators that can be easily monitored. Donors should place priority on developing national expertise and leadership. Where institutions are providing a mix of non-financial and financial services, these need to be clearly separated at every operational level (client, systems, accounting, and management).

Microcredit is more likely to be successful when it is implemented as a professional banking activity, with significant resources and a long-term commitment. Seasoned observers guess that for every 20 non-financial service organizations that consider microcredit as a new service, only one may actually be able or willing to pay the high price of implementing the operating principles required for sustainability. The Bangladesh Rural Advancement Committee (BRAC) added microfinance to its relief activities in 1974. Looking back on the process, BRAC founder Fazle Abed commented:

"The working of [a] microcredit system itself brings new elements . . . . A soft-hearted patronage approach of welfare organizations must give way to [a] hard-headed professional approach if the microfinance approach is to be sustainable and effective. This transition . . . can generate tension in an organization. The organization, therefore, needs to accept and internalize the change required of it. . . . Leaders of the organization must clearly understand what it entails and prepare their staff accordingly." [1]

Successful microcredit rests on two basic principles: client discipline and institutional discipline.

Client discipline means that poor people take responsibility for their decisions, agreeing to and making on-time payment of their principal and an amount of interest that will cover the full cost of the service.

[1] Interview with Fazle Abed conducted by Countdown 2005, reported on the Microcredit Summit web site, www.microcreditsummit.org/newsletter/action3.htm.

By living up to the credit contract, poor people discover their own capacity to direct their future. As Grameen Bank founder Mohammad Yunus said in 1998:

"Credit without strict discipline is nothing but charity. Charity does not help overcome poverty. Poverty is a disease that has a paralyzing effect on mind and body. A meaningful poverty alleviation program is one that helps people gather will and strength to make cracks in the walls around them."[2]

Client discipline serves not only the individual client, but also other clients, future clients, and the microcredit institution. Clients prosper when they do not bear the burden of repaying others' debts. Future clients prosper when capital recycles over and over to reach more poor households. The microcredit institution prospers by recovering its costs and building a sound financial footing independent from ongoing public subsidies.

Institutional discipline refers to a set of practices that lead to sustainability of the program, quality of service, and efficiency of operations, including:[3]

1. Charging interest rates that cover *all* costs, even when adjustments are made for donations and subsidies to reflect a market-rate cost of funds

2. Requiring full, on-time repayment from clients, and tracking repayments in a regular and frequent manner

3. Creating products and delivery techniques that are appropriate for clients

4. Investing in management information systems that provide timely and appropriate guidance to staff and management

[2] "Toward Creating a Poverty-Free World," speech of Mohammad Yunus, Grameen Bank, presented at the Club de Debate at Complutense University, Madrid, April 25, 1998.

[3] One recent volume that provides clear operational guidance for microfinance implementation is Joanna Ledgerwood's *Microfinance Handbook: An Institutional and Financial Perspective* (Washington, D.C.: Sustainable Banking with the Poor, The World Bank, 1999).

Box 2: An Anonymous Case of Discouraging Client Discipline

One African social program was attracted to microcredit, but considered the requirement for client discipline too difficult for their poor clientele. Rather than openly pursue a grant program, they labeled their effort "microcredit," then provided loans to clients who were not expected to repay. Internally, this was termed "unreimbursable" credit. The results were as could be expected:

- Clients did not repay—either initially or over the longer term.
- The program rapidly decapitalized, and only continued based upon additional donor funds.
- Other local microcredit programs that demanded client discipline lost credibility and clients, as their clients exited to join the program providing "unreimbursable credit."
- After the program closed down, new microcredit programs found it even more difficult to implement a program based on full, on-time repayment in the affected communities.

5. Providing field staff with performance incentives

6. Introducing sufficient decentralization to permit agility and eventual scale-up

7. Planning from the start for capacity, growth, and sustainability

These concepts of client and institutional discipline provide a “litmus test.” If client or institutional discipline is seen as too confining or impossible to implement in a given setting, an institution’s attempt at microcredit is likely to fail.

When would savings and other financial services be more beneficial?

Credit is only one kind of financial service. The poor also want savings and insurance. Financial cooperatives and state banks are the only formal sources generally available to the poor, although a range of informal mechanisms exists. A brief overview of the role of savings and insurance for the poor follows.

Savings

No matter how poor, families almost always can and want to save, whether in cash or in-kind. (Cattle and jewelry are common non-cash saving mechanisms.) Poor households save to manage risk and plan cash flow for future investments.[4] They reduce their vulnerability by saving to cushion against shocks such as natural disasters, crop failures, job loss, illness and death. They “smooth consumption” by saving enough to support themselves during seasons when their income is lower, and save up lump sums large enough for family and business investments.

Savings facilities will help household risk management the most when they are safe and accessible to the depositors, and when the poor can deposit small amounts on a frequent basis. To allow full access to deposits, the financial institution must be well managed and have sufficient reserves to respond to periods of unusually high demand caused by natural or economic crises. Regulated financial institutions may be the only ones allowed to offer voluntary savings, raising an issue for policy-makers. Technical assistance and investment may be needed to increase the availability of savings products suited to the needs of the poor. The information systems, governance, and physical infrastructure of regulated financial institutions may need to be strengthened, and non-regulated institutions (for example, many savings and credit associations) can be assisted in their transition to a regulated legal form (such as a registered credit union).

The provision of voluntary savings services may be an effective response to some of the situations identified earlier in this note as unsuitable for microcredit, or where limiting factors constrain microcredit’s potential (although a lack of law and order would also be a limiting factor for savings). Unfortunately, most poor communities still lack access to safe, accessible, liquid savings mechanisms. Most NGOs and microcredit institutions cannot meet regulation requirements, though some provide support in developing informal savings arrangements. As another alternative, these microcredit institutions can play a critical role by brokering savings arrangements between poor clients and well-performing regulated financial institutions (including credit unions).

Micro-Insurance

While savings allow the poor to cushion for future events or emergencies, micro-insurance offers a way to manage specific risks by sharing the cost of unlikely events among many poor households. Microfinance institutions are now paying more attention to micro-insurance, but credit cooperatives have offered forms of life and health insurance for years, and informal

[4] Refer to Stuart Rutherford’s *The Poor and Their Money* (India: Oxford University Press, 2000) for a further explanation of the savings strategies employed by the poor.

burial societies have operated in most developing countries for generations.[5]

Like savings, direct provision of insurance services requires significant skills and systems, as well as institutional permanence. For this reason, NGOs may again best serve poor households by helping them gain access to the services of strong and established insurance companies. FINCA, an NGO operating in Uganda, acts as an agent for a formal healthcare plan in order to bring health insurance to FINCA's clients.[6]

Discussing micro-insurance calls for a caveat: this product may be most useful in those situations where it is also most difficult to implement, such as areas at high risk of natural disasters or, more recently, in populations suffering from HIV and AIDS. Unfortunately, insurance is a weak instrument for addressing community-wide risks or predicted outcomes, which is disappointing for those seeking to help the poor with the financial burden of these crises.

When should grants and other financial entitlements be considered?

Two types of grant instruments are considered here: termination payment arrangements and micro-grants.

Termination Payments

Termination payments are one alternative to microcredit for helping those laid off from formal sector or government employment to get into self-employment. Ex-employees vary widely in their entrepreneurial abilities and technical skills, so microcredit may be risky both for the ex-employees and for the microcredit providers. Microcredit programs that attempt to "create entrepreneurs," particularly among high-risk, low-experience groups, are likely to face losses and to burden people with debt. An example of this is provided in Box 5 (see page 12).

Termination payments, on the other hand, are non-debt mechanisms and, if carefully designed, can still promote sound investments. For example, payment mechanisms can be designed to allow recipients' contributions to leverage further funds, thus encouraging saving and planning for the future. Termination payments can be disbursed into special savings accounts, thus reducing security risks and encouraging careful use of the funds. Recipients may also be trained to use or upgrade their current skills for self-employment or application to other sectors. These examples demonstrate how multiple tools can assist ex-employees to enter self-employment, without pushing them into credit—and therefore debt—before their skills and ideas are developed.

Termination payments are a more sophisticated form of grant, and can be linked effectively to non-financial services (see later section for more details of non-financial intervention options). An alternative—and more complex—form of termination payment, a pension fund, can give the displaced worked a longer-term cushion. However, pension funds require immensely sophisticated planning and require years to implement.

Micro-Grants

Micro-grants provide a safety net, and can be the first step in a strategy to graduate the poor from vulnerability toward economic self-sufficiency. Those hit by crisis may need a temporary safety net. Displaced persons during or immediately following a conflict, or those affected by natural disasters such as earthquakes and floods, may be suitable candidates for one-off, targeted "safety net" grants that enable them to re-

[5] For more information, see Warren Brown and Craig Churchill, "Providing Insurance to Low-Income Households: Part I–A Primer on Insurance Principles and Products," November 1999; and "Insurance Provision for Low Income Communities: Part II–Initial Lessons from Micro-Insurance Experiments for the Poor" (USAID Microenterprise Best Practices Project, May 2000), available at www.mip.org/pubs/mbp-def.htm.

[6] Readers interested in an analysis of varied approaches taken by microcredit organizations to facilitate access to micro-insurance products can consult Michael McCord's "Health Care Microinsurance: A Synthesis of Case Studies from Four Health Care Financing Programs in Uganda, Tanzania, India, and Cambodia" (MicroSave-Africa, 2000).

build their livelihoods and replace lost assets. Coordination with any existing microfinance institution is necessary, though, as there may be microfinance institutions that are strong and flexible enough to provide a similar service to their clients on a commercial basis. The Bangladeshi microfinance institution, ASA, responded to the 1998 flood by offering its clients the opportunity either to withdraw their savings or to take out a consumption loan.[7]

Micro-grants for the hardcore poor or for people affected by HIV/AIDS may constitute a longer-term safety net. These people are unlikely to be in a position to use a loan productively: loans might be used to meet basic consumption or health needs rather than to invest in income-earning activities. Indeed, use of debt-based instruments such as microcredit may further erode their economic position. Grant-based schemes may provide a starting point to bring people to the level where they can make plans and consider investments. Grants can be the first step in reducing vulnerability, and allowing the hardcore poor to invest time and resources in learning skills and building an asset base.

BRAC's Income Generation for Vulnerable Groups Development (IGVGD) program provides a model for this graduation process. Targeted towards destitute rural Bangladeshi women, the program assists participants to move from absolute poverty to economic independence. Over 10 years, nearly a million participants have made that transition.

BRAC's IGVGD case is unique, given the sheer size of BRAC's operations in relief, microfinance, advocacy, and other areas. Most graduation efforts would be implemented through inter-institutional or inter-program partnerships, with each partner focusing on areas of comparative advantage. The IGVGD example makes it clear that successful graduation takes time.

[7] For more information, readers can refer to Warren Brown and Geetha Nagarajan, "Bangladeshi Experience in Adapting Financial Services to Cope with Floods: Implications for the Microfinance Industry" (USAID Microenterprise Best Practices Project, August 2000).

[8] From Syed Hashemi, *Linking Microfinance and Safety Net Programs to Include the Poorest: The Case of IGVGD in Bangladesh,* CGAP Focus Note No. 21 (Washington, D.C.: CGAP, May 2001). See also M. Gilgin, "Safety net linkages with microfinance: BRAC's Income Generation for Vulnerable Groups (IGVGD)," (BRAC, 2000).

Box 3: A Graduation Example—BRAC's IGVGD

IGVGD begins with an 18-month commitment of free food (with the support of the World Food Program and the government) to people at greatest immediate risk. The program engages participants in skills-training programs in income-generating activities, such as poultry rearing and silk. The IGVGD program also provides the hardcore poor participants with access to BRAC's Essential Health Care services, which addresses the link between productivity and health. During this period, BRAC helps participants learn to save, to build up an economic "nest egg" for future investment and protection. Most participants then progress to individual income-earning activities within the same sectors. Within two years of starting the process, roughly 80 percent had made the transition—with their small income-earning activities and accumulated savings—into BRAC's mainstream microfinance program as borrowers. This progression of support services—from grants to training to savings to self-employment—appears to be sufficient to break down the barriers of extreme poverty, social isolation, lack of productive skills, and poor self-confidence that previously kept this population from self-employment.[8]

Box 4: Micro-grant Guidelines

Micro-grants should:

- **Be very carefully targeted to those that microcredit cannot serve in a particular context (for example, the destitute poor and temporarily displaced persons);**
- **Be one-off, and include a "graduation" process to market-based mechanisms, such as microcredit;**
- **Be carefully structured and monitored to ensure that they are spent as intended;**
- **Be accompanied by training or mentoring when grants are intended for productive purposes;**
- **Require a cash contribution of at least 5 to 10 percent of the grant value from the grant recipient; and**
- **Avoid financing investments that result in income streams that could be used to repay a loan from a microfinance institution.**

This may limit the potential for shorter-term projects to be partners in graduation initiatives.

Grant support can create long-term dependence and distort the market for microcredit. Box 4 provides guidelines for micro-grants to ensure that grants complement, rather than crowd out, commercial financial services and productive investments.[9]

Requiring a cash contribution from the grant recipient helps ensure that the entrepreneur is committed to the proposed economic activity, and has not simply dreamt it up in response to grant availability. This cash contribution can be an initial contribution to the working capital needed for the proposed activity. Investments that will result in an income stream in the short term are better funded through a loan from a microfinance institution. Funding such investments with a micro-grant not only risks "crowding out" long-term providers of loan finance, but also encourages an inappropriate cost structure for the economic activity, putting at risk its future success.

Microfinance providers and microfinance experts working in the region should first be consulted to ensure that any micro-grant program does not (at worst) compete with or undermine local microfinance institutions, and (at best) is carefully coordinated with microfinance to provide an eventual way out of grant dependence. Informal microfinance providers, such as village banks and savings and loans clubs, should be included in the consultation process, as these have an importance for the poor that is disproportionate to their profile and size.

What other interventions can strengthen the economic position of the poor?

Financial options—whether credit, savings, insurance, or grants—are still only part of the menu of choices for poverty alleviation. Some other interventions that may be required to enable the poor to benefit from financial services are outlined here.

[9] These guidelines are informed by an internal background paper written by William F. Steel, "Rural and Micro Finance Implementation in Africa under Vision to Action" (Washington, D.C.: World Bank, Rural and Micro Finance/Small Enterprise Thematic Group, 2001).

Improving Infrastructure

Deficient infrastructure and public services can act as a brake on economic activity, and community-level investments in these areas (roads, communications, education, etc.) can provide a platform for self-employment activities. Investments may also be needed in disaster prevention or preparedness systems, or in disaster recovery to rebuild productive and communications infrastructure.

Community-level investments in *commercial* or *productive* infrastructure, such as market centers; commodity assembly; processing, or grading points; grain mills; and small-scale irrigation infrastructure are also important in facilitating enterprise activity. Mechanisms for promoting such investments include the community grant mechanisms of social funds and rural investment funds, private-public sector partnerships, and NGO projects. While many investments in infrastructure and public services have "public good" characteristics, investments in *commercial* infrastructure have "private good" characteristics, and are less suited to grants. They are likely to be managed by a single entity or owner (be it an individual, group, community association, or company), and a loan can therefore be made on the basis of the economic benefits that will accrue to that entity. A grant mechanism risks competing with, or crowding out, the private financial sector.

If the private sector is reticent in providing financing, or is simply not present, then guarantee mechanisms or matching grants may be needed to attract private investment. However, the *additionality* of such incentives first needs to be clear, in order to ensure that public or donor money is not being used to make already attractive investments more profitable.

Where the absence of financial intermediaries means that loan financing of *commercial* infrastructure is not an option, such investments may be funded through a community-level income-generating project. The resulting revenue could be used to build a community savings and credit association, with technical assistance and capacity building provided. The association would manage the income flow from the project through an account with a formal financial institution (such as a bank), and use the income to capitalize itself and to engage in lending activities with its members.[10] Where a savings and credit association is not a legal option, then a credit union structure may be sufficiently flexible to accommodate a savings and credit association-type structure.

Infrastructure and community development projects may provide jobs and employment experience for those otherwise unemployed, as is illustrated in Box 5 on page 12. This leads to the next option, employment programs.

Employment Programs

The skills required for self-employment—the ability to identify opportunities, bear financial risk, make difficult decisions, etc.—are not a "standard" set of characteristics. For those people without these skills, employment programs can provide a means of becoming more employable. This approach engages poor individuals in low-skill activities for which they are compensated in cash or in kind, and in so doing gives them employment experience and skills. Food-for-work programs and public works efforts fit this model. In many cases, these programs may be out of reach of cash-strapped local governments, but within the power of donors. For example, the Global Food for Education Initiative, implemented by the United Nations' World Food Program (WFP) and 14 private voluntary agencies, has launched a "food for school" program where children take home a food ration for doing their "job"—that of attending school.[11] Like traditional food-for-work programs, this effort aims at creating a long-term productive labor force, but focuses on a younger cohort.

[10] This concept of linking community-level microfinance mechanisms to income-generating projects has been further developed by William F. Steel of the World Bank.

[11] See the Global Food for Education Initiative (GFEI), implemented by the World Food Program and partners, www.wfp.org.

Non-Financial Services

Non-financial services range from "social intermediation" to build social capital and basic skills within the community, to "business development services" for entrepreneurs. Social intermediation can help poor and marginal groups take advantage of economic opportunities, through training in literacy or basic financial skills, group capacity-building efforts, and providing information on available financial services. Business Development Services, or "BDS," focus on entrepreneurs and on potential entrepreneurs. They address constraints to business creation and growth, and include:

- Training, mentoring, and advisory services
- Providing market information through market agents, databases, publications, visits, and other mechanisms
- Linking entrepreneurs with potential buyers and markets
- Building business networks and linkages to promote inter-firm cooperation
- Creating lower-cost or higher value-added technologies

BDS providers are now expected to operate on an increasingly commercial basis.[12] Charging fees for services has the added benefit of raising the quality and fit of the services, because entrepreneurs will not purchase services that they do not value. Moreover, this promotes cost recovery and sustainability. This contrasts with social intermediation activities, which have

[12] See "The Blue Book," a publication of the Committee of Donor Agencies for Small Enterprise Development, for an introduction to the revised thinking and approach for BDS that is now increasingly accepted by donors and practitioners: "Business Development Services for Small Enterprises: Guiding Principles for Donor Intervention" (February 2001). It is available at www.ilo.org/public/english/employment/ent/papers/guide.htm

Fig 1: The Non-Financial Services Continuum

SOCIAL INTERMEDIATION →				BDS
Subsidized				*Fully Commercial*
Health education	Literacy training Group capacity building		Business networks and linkages Entrepreneur training and mentoring Advisory services	Provisions of market information Market linkage schemes

The gray area represents the blurred distinction between those non-financial services requiring at least a degree of subsidization and those that can be provided on a commercial basis.

some characteristics of "public goods" and, accordingly, lower expectations of and possibilities for cost recovery. Figure 1 presents a suggested continuum from social intermediation to BDS, based on the attainable level of cost recovery.

Legal and Regulatory Reform

Excessively bureaucratic procedures for registering and operating a microenterprise have an important disincentive effect on the creation and growth of enterprises. Artificial caps on interest rates on loans may restrict microfinance activities by making sustainability difficult to achieve. Regulations governing the use of non-mortgage collateral, and the priority assigned to debtor versus creditor in default and debt collection proceedings, have direct impact on both the clients and the providers of microcredit services. Property rights, and the cost of registering property, affect the poor's access to loans outside the often limited range of microcredit available to them.

Assisting legal reform processes, or lobbying for regulatory reform, can have important implications for the poor's access to economic opportunities and flexible, safe financial services. While donors are in a position to play a more active role in promoting and assisting regulatory reform and policy change, NGOs can play an advocacy role. The Self-Employed Women's Association (SEWA) provides an example of how an institution can push for regulatory change on behalf of the poor. SEWA organized members and lobbied for public space for women street vendors in India, leading to dialogue and ultimately to an acceptable solution that met both the municipality's and the women's needs.[13]

An illustrative case

Box 5 illustrates key themes presented in this note, such as the preconditions needed for successful microcredit, and the importance of designing interventions that fit the needs and capacity of the target clientele and the wider operating context. In this case, microcredit was initially chosen, but proved to be an inappropriate tool for both the participants and the context. Other choices, including non-financial services, were available which better suited the environment, the client, and the ultimate project objectives. In the final analysis, microcredit had a smaller role, and was best provided by a specialized provider on a commercial basis, and not by a short-term program on an entitlement basis.

Taking the Dialogue Forward

This paper provides an overview of a range of financial and non-financial tools available for poverty alleviation. It places microcredit as only one choice among many legitimate options. Microcredit can and should be complemented with other interventions that create new potential, by drawing a larger set of individuals into the process of generating income.

Donors and policy-makers play a critical role in stepping away from advocacy of "one-size-fits-all" interventions, in championing a more nuanced dialogue about client needs, and in promoting situation-specific partnerships between service providers. Such a strategic approach that builds interaction and linkages between specialized institutions is needed for effective and coordinated poverty alleviation interventions.

[13] Martha Chen, ed., *Beyond Credit: A Subsector Approach to Promoting Women's Enterprises* (Ottawa: Aga Khan Foundation Canada, 1996).

Box 5: Navigating the Choices for Ex-Combatant Reintegration in Congo/Brazzaville

In 2000, the International Organization for Migration (IOM) and the United Nations Development Program (UNDP) launched a pilot effort to reintegrate ex-combatants into self-employment and simultaneously collect small arms in Congo/Brazzaville. The program intended to use microcredit to launch enterprises for the ex-combatants. Priority access to loans would be given to former soldiers who turned in their weapons and to group projects in order to lower administrative and supervisory overhead costs. Through a two-month pilot phase, this concept was carefully tested by the technical team. The majority of ex-combatants had little experience in business, and the business plans they developed lacked viability. The technical team recommended significant revisions to the program before proceeding.

The team therefore modified the strategy to focus on training (a non-financial service). The training would be followed with one of two options. Those with the experience or capability to run a business could still be supported through micro-loans to open a new venture. The team recommended that microcredit be provided through a strategic partnership with a local microcredit institution rather than by creating a new microcredit window. For the majority of ex-combatants, however, self-employment remained highly risky. The project therefore aimed to create jobs within existing businesses or as subcontractors of services to local governments, through a range of incentives to stimulate supply of jobs.

By becoming more realistic about clients' abilities, the team removed much of the pressure on microcredit institutions to give loans when they could not guarantee client or institutional discipline. Within the first 10 weeks of launching the revised approach, the project reached over 4,000 ex-combatants with re-integration support. Initial funding ran out, and based on strong early results, the program was able to raise significant follow-on funding.[14]

[14] This case was provided by Mr. Maximo Halty, Program Manager for the Programme National de Réinsertion des Ex-Combattants et de Ramassage d'Armes, Congo/Brazzaville, International Organization for Migration (IOM), e-mail correspondence, March 2001.

This note was written by Joan Parker of Development Alternatives, Inc., and CGAP, represented by Doug Pearce. This paper draws on research on microfinance in unstable environments conducted under USAID's Microenterprise Best Practices (MBP) Project between 1997 and 2001. William Steel of the World Bank provided substantial input to this paper. Rich Rosenberg, Ousa Sananikone, and Syed Hashemi, all of CGAP, provided valuable input and comments.

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