Microfinance for Refugees
Emerging Principles for Effective Implementation

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The success of microfinance to increase entrepreneurs' income in developing countries has encouraged practitioners and donors to extend services to more marginal areas, including in countries or to people affected by conflict. Refugees are among the most vulnerable of these new target populations. Programs have tried to provide loans to refugees in camps, in local resettlement situations and upon return to their home country or community. The results so far have been mixed. Some programs have demonstrated significant impact on income and assets at the client level and helped support the creation of sustainable microfinance institutions or financing mechanisms. Others have had a marginal impact with clients and collapsed under the weight of repayment problems or inefficient structures. Evidence from these programs suggests that microfinance *can* be an appropriate intervention for refugees to reduce vulnerability, increase self-sufficiency and improve the likelihood of successful repatriation and reintegration. However, the intervention must be designed according to principles which account for the specific characteristics and situation of refugees An examination of two successful American Refugee Committee (ARC) programs demonstrates some of these principles.

Microfinance and Refugees

Microfinance has succeeded in the provision of sustainable financial services to low-income entrepreneurs through innovations in methodology and mindset. Group and individual lending methodologies relied on community knowledge and relationships to conduct client assessments or replace physical collateral. Practitioners also took a step lending approach, where untested clients could develop credit histories as they repaid progressively larger loans. These methodological innovations were matched with a sustainability mindset that focused on charging cost recovery interest rates, improving efficiency and reducing risk by serving existing businesses.

Unfortunately, the unique dynamics of refugee situations preclude using many of the approaches that are successful with stable populations. Individuals who are refugees defy simple classifications in terms of their backgrounds, educational levels and employment histories. However, as refugees they share common characteristics: they are transient and tend to have few, if any, assets, a deficiency of connections with the community around them, meager entrepreneurial experience, and an uncertain future. These characteristics place refugees in risk categories that are unsuitable for traditional microfinance lending and/or make the implementation of group guarantees, client assessment and step lending principles difficult. At the same time, the uncertain future of refugees in camps or in the country of return makes a refugee-based sustainability strategy difficult to achieve. Finally, refugees are situated in a relief environment where implementing organizations' staff members are often hesitant to fully require repayment, are unwilling to charge interest, and/or do not have the technical capacity to implement finance programs. In this

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situation, microfinance cannot be simply replicated from development contexts, nor implemented by many organizations that operate in relief contexts.

Two Case Studies

Despite these difficulties, there are a number of cases of successful microfinance programs that serve refugees effectively. For example, in two complementary programs, linked by its *Refuge to Return* concept, ARC has successfully served Sierra Leoneans, first as refugees in Guinea and later as returnees in Sierra Leone.

In Guinea ARC has been able to successfully serve camp-based Sierra Leonean refugees with microfinance and microenterprise development services. Recognizing that many refugees could not manage loans without additional assistance, the microfinance component was integrated with other services, including business training and small grants for the most vulnerable entrepreneurs. These complementary services enabled clients to effectively invest their loans and allowed the program to help over 4,000 entrepreneurs in 2001-2002 to begin businesses and increase income, all while maintaining an average arrears rate of less than 3%.

In Sierra Leone, ARC began a microfinance program to serve returning refugees, internally displaced people, and other community entrepreneurs. Although it was oriented towards returnees, the program also served the larger community, allowing it to reduce friction between the different communities and conduct proper client selection. Learning from successful post-conflict institutions in the Balkans, ARC also hired technical staff, developed a long-term plan for the program, and followed sound microfinance principles. After two years of operations, the program serves 5,000 clients (over 35% former refugees) with an arrears rate of less than 1% and covers the costs of three of its five branches.

A key link between the two programs was created through ARC's *Refuge to Return* certificate system. In this system, refugees who paid back their loans received a certificate that entitled them to preferential access to credit from ARC's Microfinance program in Sierra Leone. By providing a means for refugees to transfer their credit history, refugees had a greater incentive to repay their loans and the Sierra Leonean MF institution was provided with a group of pre-tested clients. Between 2001-2002, over 25% of ARC microfinance clients in Sierra Leone had been former ARC refugee clients.

These programs were successful because they were adapted to a refugee context, conducted by appropriate staff, and complemented with business development services and/or other assistance. Based on their success and that of other strong refugee programs, principles for effectively providing microfinance to refugees are beginning to emerge.

Implementation Principles - Microfinance for camp based refugees

Though refugee camp entrepreneurs can be very enterprising, the prevalence of free services and vulnerability of many potential clients makes the provision of microfinance very difficult and requires innovative adaptation of traditional models:

- Complement lending with other services. The high vulnerability of refugees means that many cannot manage a loan without additional business training and mentoring. For the most vulnerable, small contingent grants may be appropriate as a first step before they access credit. These services can be supplied by the provider of the microfinance services or other experienced agencies.

- Use intensive client screening and monitoring. Since the community ties that bind solidarity groups or provide information on credit worthiness are often not available in a refugee camp, the implementing agency should engage in intensive client screening and monitoring with their field staff. Beyond helping to assess clients, the monitoring encourages borrowers and provides an early warning system of delinquency.

- Brand loan programs differently. Camp based refugees quickly become accustomed to receiving free services from relief agencies and thus at first resist repaying loans or paying interest. To confront this attitude, programs must brand themselves differently from other relief programs, educating their potential clients about why the loans must be repaid and responding quickly to arrears issues. This branding should be conducted with donors and other relief agencies, to ensure that other organizations are not undermining the strong repayment ethos.

- Aim for sustainability over the long term. Considering the transient and isolated nature of refugees in many camp situations, it is generally inappropriate to invest in a sustainable structure in the camp. Instead, programs can consider sustainability in the context of return and thus focus on building a strong credit culture and linking refugees with microfinance programs in their home country.

- Consider alternative microfinance models. Providing loans from an outside institution is not the only successful microfinance model. Small credit unions, rotating savings and credit associations (ROSCAs) and "self-help" groups can also be effective ways for refugees to develop sources of capital to fuel their businesses. Outside agencies can take the facilitating role in these cases, helping to start self-managed groups of refugees.

- Hire appropriate staff. If considering lending, ensure that the managing staff are knowledgeable about microenterprise development programs and are prepared to collect. Otherwise, clients will not be supported effectively, repayment rates will plummet immediately following the first case of arrears, and program goals will not be fulfilled.

Implementing Principles - Microfinance for locally settled or returning refugees

Refugees who have temporarily settled in a third country, locally integrated into host community or are returning home have many more opportunities than camp-based refugees. Nevertheless, their lack of housing and assets, unsecured legal rights and/or often tense relationship with host communities demand adaptations to the traditional microfinance model. Lessons from successful microfinance programs in these situations include:

- Promote the program as credit, not grants. Similar to refugee camp situations, microfinance in relief and post-conflict situations must be presented (and implemented) as serious credit programs, where delinquency is not tolerated, interest is required, etc.

- Broad client focus. Microfinance programs that only serve returnees among a larger population generally fail. Their client selection is constrained to a small pool of entrepreneurs, increasing risk; they may have to spread operations over a wide area; and they will achieve limited outreach, reducing sustainability while potentially building resentments among the host community. Instead, programs with a returnee focus should serve a broad spectrum of entrepreneurs, though with a large minority of returnees.

- Follow microfinance best practices. The microfinance best practices that have been developed for other countries are applicable for returnees and in post-conflict situations as well. These include planning for sustainability from the outset, providing client focused services, establishing strong information management and reporting systems, etc.

- Complement microfinance with other services. Considering the greater vulnerability of most returnees when compared to other community members, they may need complementary services to successfully manage microfinance loans. These services can include business training and mentoring, or small start-up grants to raise them to the level where they can effectively use credit. Generally, these additional services should be provided by other agencies.

- Appropriate staff. Effectively providing microfinance requires different skill sets, systems and mentality than providing relief. Relief agencies that become involved in microfinance must hire technical staff, adjust their policies and become more business/efficiency minded to succeed.

Microfinance for Refugees – the Way Forward

Over the past ten years, microfinance has gained significant confidence among donors and practitioners for its ability to help low-income entrepreneurs to increase and diversify income. Microfinance offers the same possibility for refugees, but only when appropriately adapted and applied. Examining successful programs indicates that programs should tailor their approach, maintaining microfinance best practices, while taking into account the relief context and adding complementary services where needed. Through this means, microfinance services can be effectively provided and refugee livelihoods improved.