

# Iraq National Microfinance Summit

Erbil, 13-16 November 2006

Global Experiences – and their Relevance for Iraq

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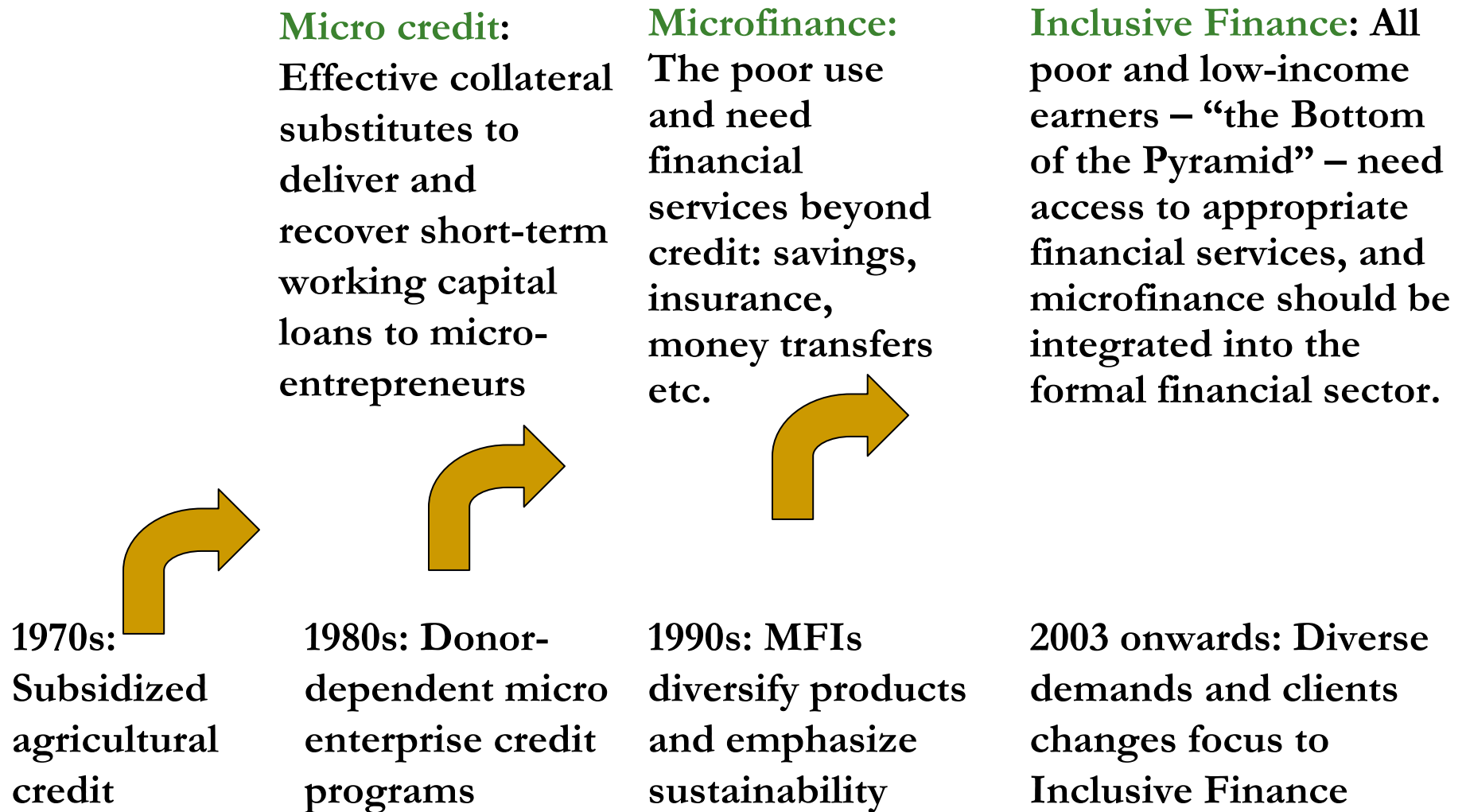
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# What is Microfinance?

**Microfinance is the provision of quality financial services to poor and low-income people who do not have access to traditional formal financial institutions.**



# Evolution of Microfinance



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# Microfinance Myths Proved Wrong

## ■ Myth

- “Poor people don’t repay loans”
- “The poor can’t pay the full cost of microfinance”
- “MFIs must depend on donor (external) funding”
- MFIs cannot be profitable and reach the poorest

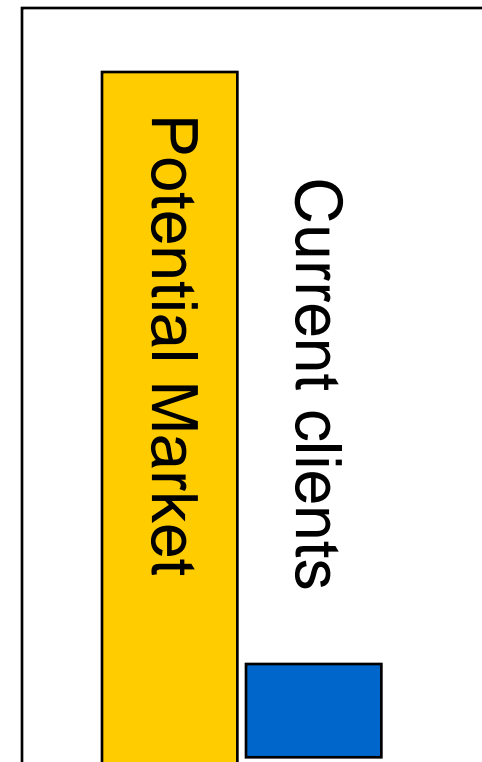
## ■ Fact

- ✓ Early 80’s – the poor have better repayment than the rest of us
  - ✓ Early 90s – Access to finance is more important than price
  - ✓ Mid 90s – MFIs began to attract commercial funding
  - ✓ Today – MFIs striving to reach twin objectives
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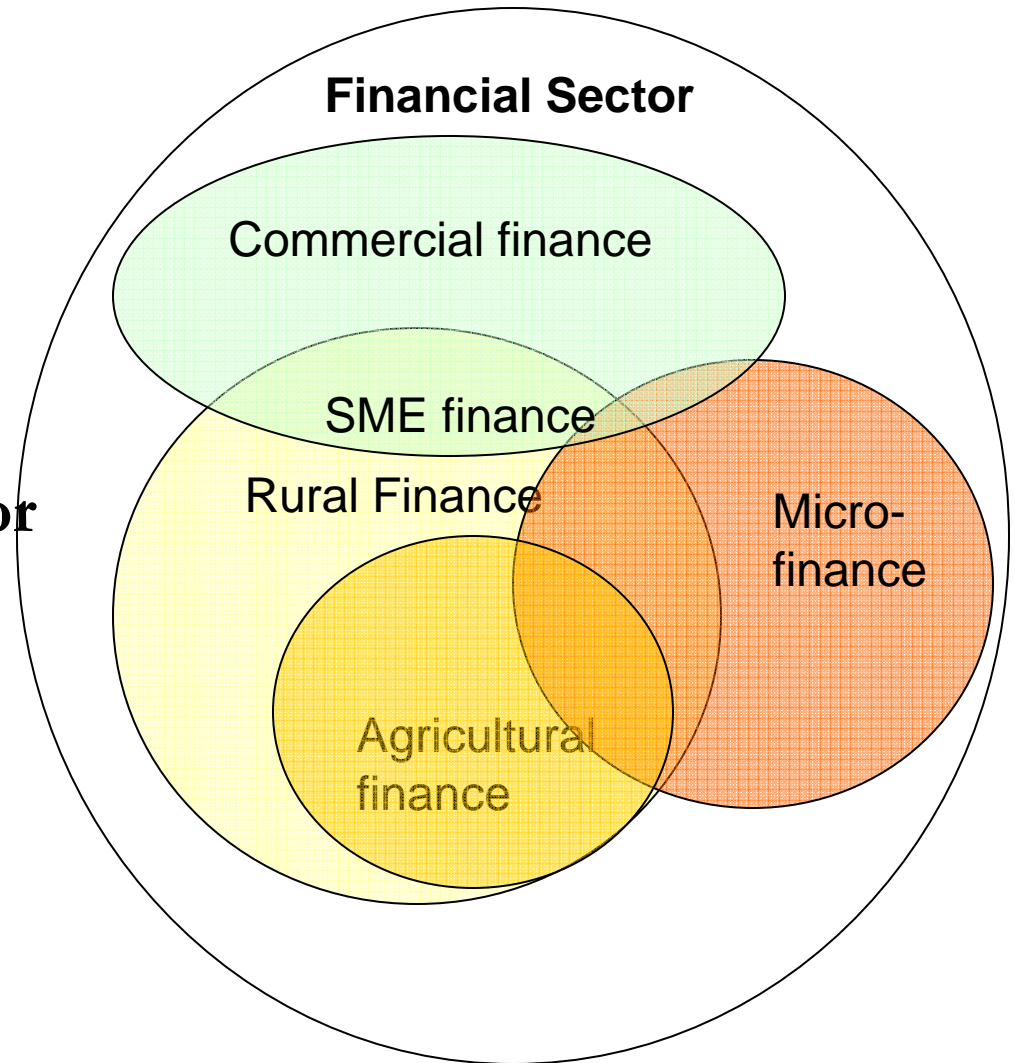
# Evolving lessons for Donors

- High unmet demand for financial services
- Small % of potential market covered
- Annual growth in outreach over the past years through improved practices
- Few financially sustainable providers
- Donors spent up to US \$ 800m – 1bn per annum on microfinance
- Donors often ineffective
- Smart subsidies can help development of sustainable institutions and financial systems



# Vision: Inclusive Financial Sectors

- Diverse institutions providing competitive and permanent access
- to a wide variety of financial services
- for a broad range of poor and low-income households and their enterprises, thus
- opening markets to increasingly poor and geographically remote customers.



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# Why Support Inclusive Finance?

**Development of the financial sector induces:**

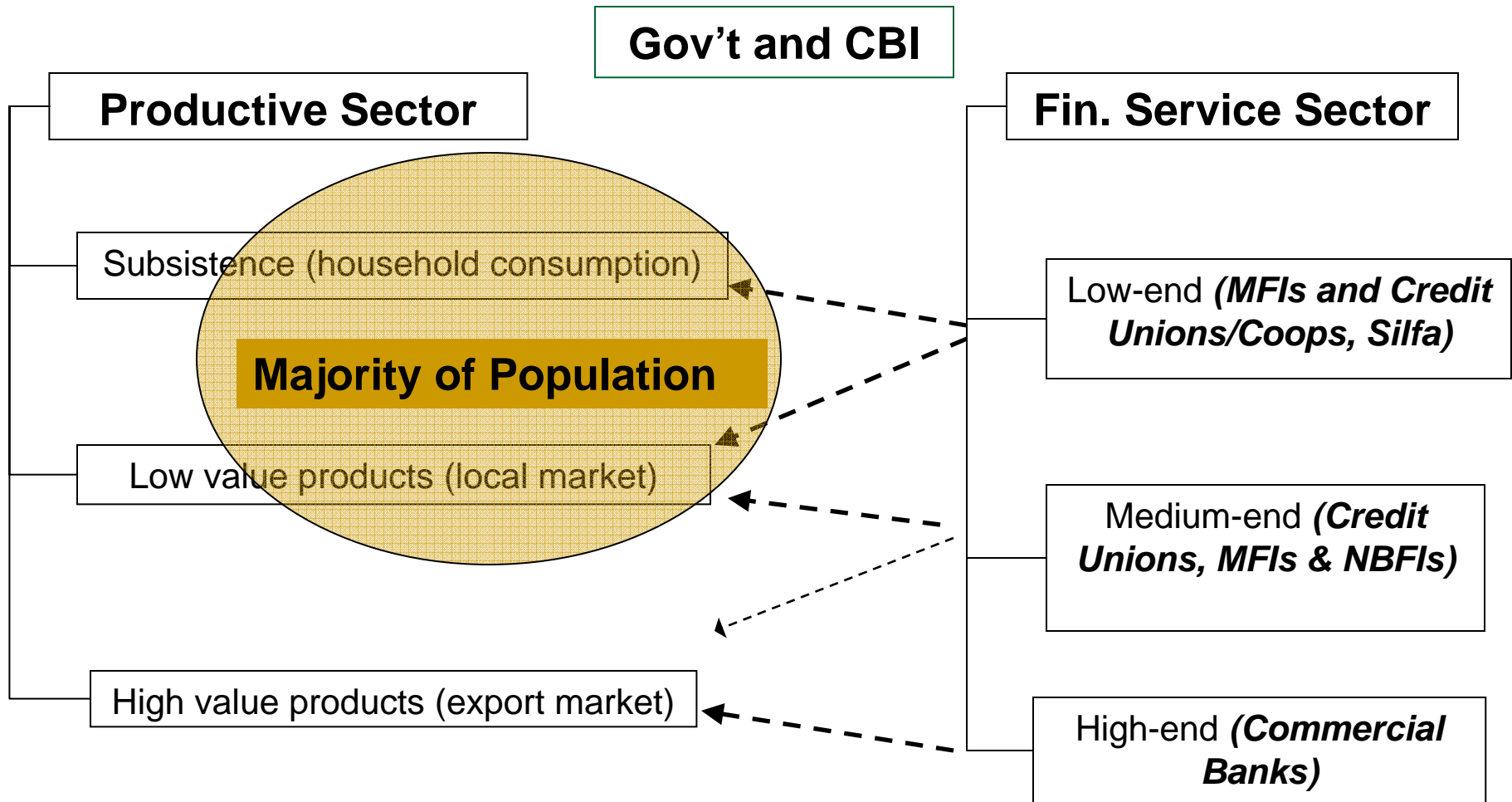
- **Incomes of the poor to grow faster than GDP per capita;**
- **Income inequality to fall more rapidly;**
- **Poverty rates to decrease at a faster rate**

Source: World Bank “Finance, Inequality, and Poverty: Cross Country Evidence”,  
Beck, Demirguc-Kunt, & Levine

World Bank Policy Research Working Paper 3338, June 2004

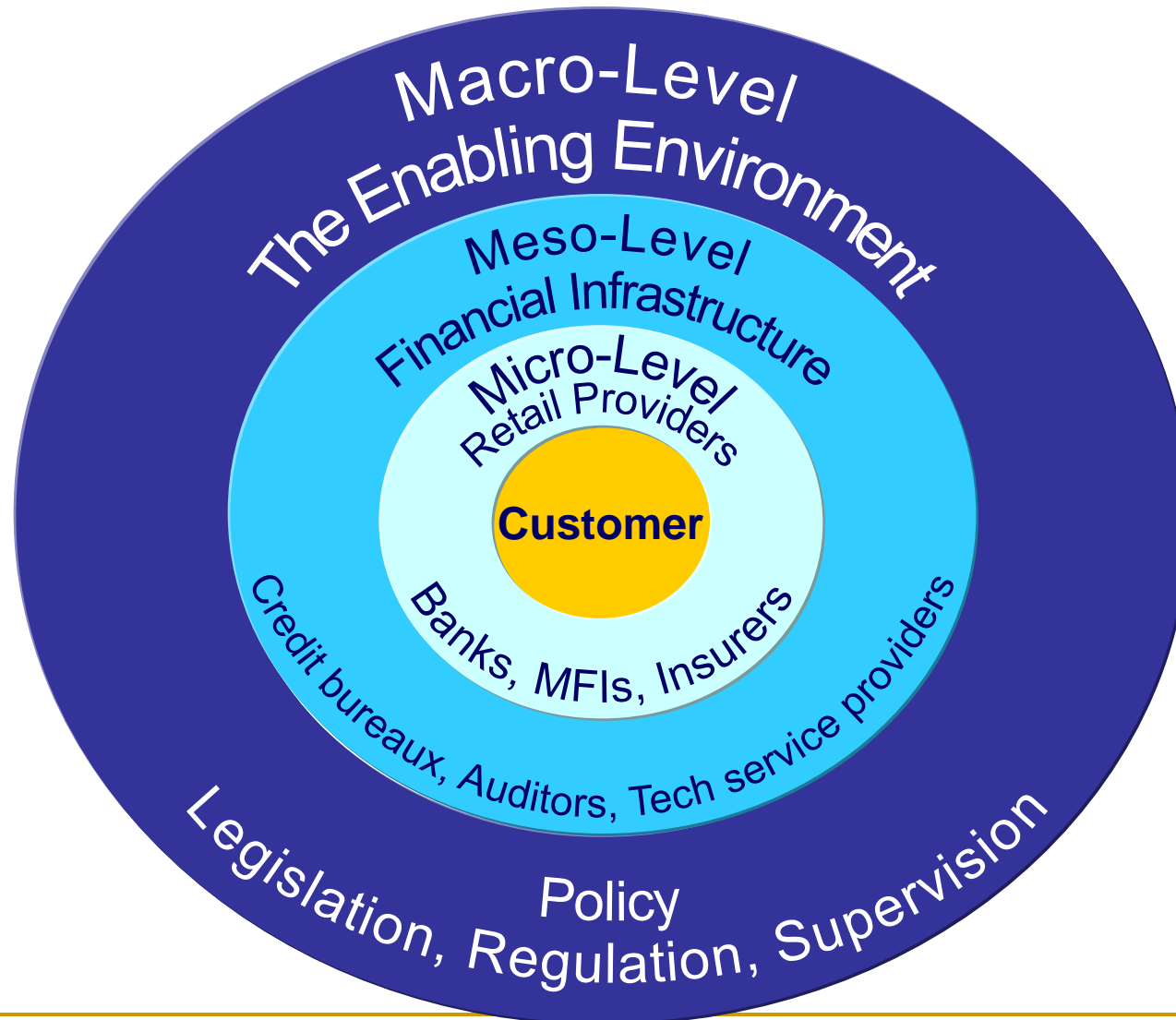
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# Structure of Economy – Microfinance View

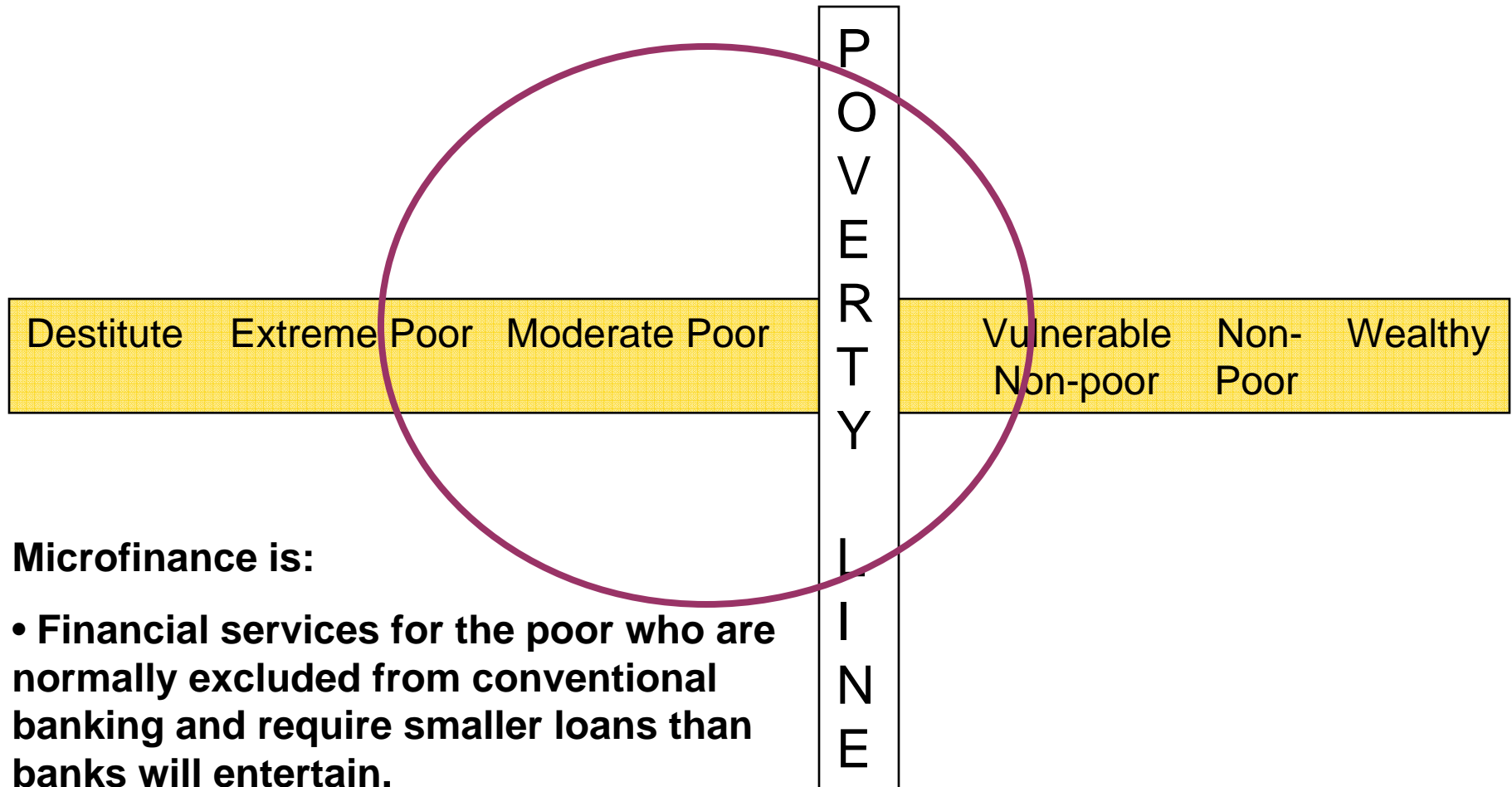


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# What is “the Financial Sector?”



# Rationale: Reaching the Poor



## Microfinance is:

- Financial services for the poor who are normally excluded from conventional banking and require smaller loans than banks will entertain.
  - Striving to integrate into the overall financial system while maintaining the social mission of poverty reduction.
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# Why Support Inclusive Finance?

[www.cgap.org/docs/FocusNote\\_24.pdf](http://www.cgap.org/docs/FocusNote_24.pdf)

**Access to financial services increases economic security and contributes to the achievement of the MDGs by allowing people to ...**

- Respond to economic opportunity
- Invest in the future
- Build assets and diversify income streams
- Cope with hardship and manage risks
- Smooth consumption

**Stronger positive impacts are associated with length of time participating.**

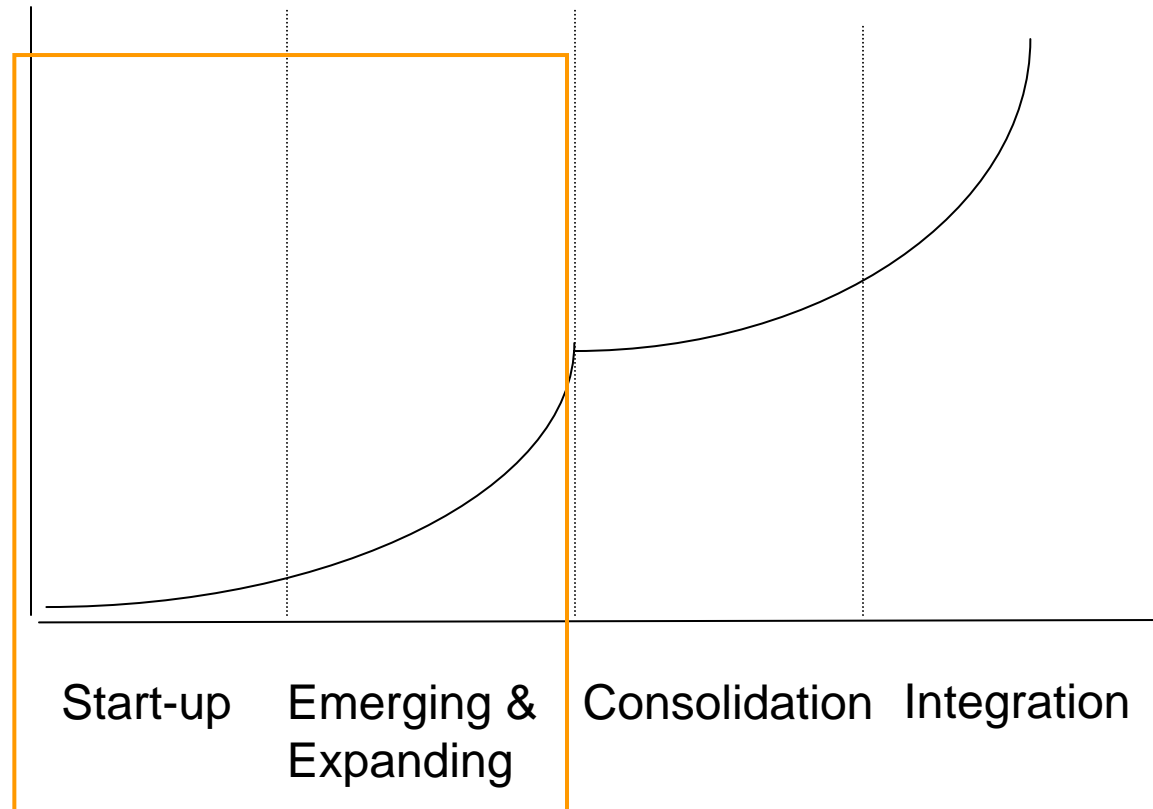
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# Building Inclusive Financial Sectors

## Outreach

Active Portfolio of MFIs

## Sustainability



- Identify opportunities and constraints for development
- Invest in development of the microfinance sector

## Number of MFIs



# Which support for Inclusive Finance?

- **MICRO-level: Promote Strong Retail-Level Institutions**
  - Lack of strong, competent retail capacity remains the **KEY** bottleneck
  - Financial sustainability essential to reach significant scale
  - Grants and subsidized loans can crowd out commercial capital markets
  - Institution-building requires a long-term commitment by donors
- **MESO-level: Support Industry Infrastructure**
  - Investments in industry infrastructure benefit financial institutions
  - Weak institutional and human capacity is the key constraint
  - Advances in technology are crucial to reduce costs (ITC, cell)
  - Some subsidies may be required (= public goods)
- **MACRO-level: Foster a Conducive Policy Environment**
  - Government's most critical contribution → maintain macroeconomic stability
  - Interest rate ceilings restrict access to financial services
  - Government-run credit programs generally distort markets
  - Policy level work requires specialized technical capacity and experience

# The Global Industry at a Glance:

Global industry, 446 MFIs (2005) report to [www.themix.org](http://www.themix.org):

<b>Outreach Indicators:</b>	<b>MFIs Global (446)</b>	<b>MENA (23)</b>	<b>IQ Peer group (5)</b>
Total Borrowers	21.8 million	890,000	
Ave.borrowers/MFI	73,923	38,695	7,872
Gross portfolio \$	6.5 billion	246 million	
Per MFI	29 million	10.7 million	1,13 million
Ave. outst. Loan balance	\$ 887	\$ 246	\$ 115
As % GNI per capita (depth)	83%	15%	12%
Total No. savers	41.5 million	-	-
Ave. no. savers/MFI	43,564		
Savings deposits \$	6 billion	-	-
Ave. per MFI	20.5 million		

# Microfinance is not a Magic Bullet

Financial services for the poor are ....

- A wide range of flexible, appropriate products and services tailored to the preferences and needs of the poor
- One of many poverty alleviation interventions
- Successfully provided by a variety of institutions
- Able to contribute to ongoing social returns only when provided in a sustainable manner
- **NOT** just microcredit – the poor require a broad variety of financial services
- **NOT** a silver bullet in the war against poverty
- **NOT** an easy way to deliver social transfers – its difficult to do it right
- **NOT** a short-term or one-time exercise to solve a multi-dimensional problem
- **NOT** a substitute for investment in education, health or infrastructure

# Finance Sector in Iraq

Main providers:

High income segment (15%)  
Large enterprises

-2 SOCBs  
(Full range of services)

- Trade Bank  
-19 private banks  
(full range)

- 4 spec. SOCBs (ag.,  
housing, soc., industry)

Mid level (65%)  
SMEs

-Remittance agents

- Money lenders, trade finance (credit)

-Al-Thiqa, ACSI, RI  
-Cooperatives

- Al Aman, Al Bashair, Al Inma'a

Total current  
MF supply:  
20,000 loans?

Micro-enterprises &  
The Poor and Low-  
Income segment  
(20%, 5.6 million)

- Silfa, informal credit Poverty line

WB: Estimated MF demand: 800,000 savings accounts; 320,000 loans at \$ 500 – \$1,500

**Crisis Type**  
(Determines types of impacts at each level)

		Levels			
		Micro Level	Meso Level	Macro Level	
Crisis Type	Slow onset disasters	<ul style="list-style-type: none"> <li>Loss of assets</li> <li>Loss of skills due to migration</li> <li>Declines in productivity</li> </ul>	<ul style="list-style-type: none"> <li>Migration weak marketing networks</li> <li>Damage to or loss of natural resources</li> </ul>	<ul style="list-style-type: none"> <li>Localized reduction in capacity to enforce laws and provide basic services</li> </ul>	Least Developed Countries/ regions  Medium Developed Countries/ regions  Highly developed countries/ regions
	Rapid onset disasters	<ul style="list-style-type: none"> <li>Loss of assets</li> <li>Disrupted markets</li> <li>Trauma</li> </ul>	<ul style="list-style-type: none"> <li>Infrastructure damaged/ devastated</li> </ul>		
	Conflict	<ul style="list-style-type: none"> <li>Loss of assets</li> <li>Loss of skills due to migration/ ineffective education</li> <li>Instability/loss of networks &amp; increased operating costs limiting market scope</li> <li>Trauma</li> </ul>	<ul style="list-style-type: none"> <li>Infrastructure damaged/ devastated</li> <li>Licit networks disrupted; illicit networks strengthened</li> </ul>	<ul style="list-style-type: none"> <li>Reduced national capacity to enforce laws and provide basic services</li> </ul>	

(Determines coping ability and speed of recovery)

<u>Limited</u> Limited region affected and low level of impact	<u>Moderate</u> Limited region affected but high level of destruction or large region affected, but low level of impact	<u>Extreme</u> Large area affected with high level of destruction
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**Severity Level**  
(Determines depth of impact at each level)

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# MF in Conflict environments - Lessons Learned so Far

1. Microfinance is not a conflict resolution tool - Good Practices **DO** apply
  2. Check that Essential and Preferable Preconditions for microfinance are present
  3. Specialize: separate relief and development activities  
Manage preparatory relief activities *well*  
Plan for sequencing from the beginning  
*Agree* and be firm on timing  
Human resources and staff capacity is **THE KEY**
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# 1. Good Microfinance Practices

## For Practitioners

- **Decide on time line: MFIs are in it for the long haul!**
- **Attract experienced management and TA**
- **Research the market: Understand clients' needs and capacity to repay**
- **Credit is not enough**
- **Maintain high portfolio quality**
- **Apply market interest rates**
- **Plan for full cost recovery**

## For Donors

- **Select experienced partners**
- **Have sufficient, qualified in-house staff**
- **Avoid targeted programs**
- **Take a patient, long-term perspective**
- **Design flexible, longer-term funding mechanisms**
- **Avoid disbursement pressures**
- **Collaborate for coherence; locally and with donors**

## 2. Preconditions for MF in crises

<ul style="list-style-type: none"><li>■ <b>Essential preconditions</b><ul style="list-style-type: none"><li>❑ minimum political stability;</li><li>❑ a stable population; and,</li><li>❑ sufficient economic activity and a cash economy.</li></ul></li></ul>	<p><b>Iraq, late 2006:</b></p> <ul style="list-style-type: none"><li>☹ Limited political stability and associated low level of security in many areas of the country</li><li>☹ Population is stable... enough</li><li>☺ Sufficient economic activity and a cash economy in most areas of the country.</li></ul>
<ul style="list-style-type: none"><li>■ <b>Preferred conditions</b><ul style="list-style-type: none"><li>❑ functioning government;</li><li>❑ enabling legislation;</li><li>❑ functioning commercial banking sector;</li><li>❑ social capital or trust;</li><li>❑ skilled workforce</li></ul></li><hr/><li>❑ macroeconomic stability – absence of hyper inflation.</li></ul>	<ul style="list-style-type: none"><li>☺ Government reasonably functional</li><li>☺ NBFIs law to be redrafted</li><li>☹ Commercial banks are weak</li> <li>☹ Exists, but increasingly secular</li><li>☺ Work force is skilled but limited MF expertise</li><hr/><li>☹ Inflation a concern</li></ul>

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# Management of risks

- Violence hampers the ability to do quality microfinance; doing poor-quality finance should not be an option
    - Other interventions may be more appropriate
    - If MF, pilot slowly, with strong attention to risk management
    - Demand-driven security...involve the community!
  - Limited MF resources: few applicants, high turnover, multi-tasking staff, little expertise
    - Hire-in expertise: ST TA, INGO home office staff, link to regional hubs for trouble shooting, create 'rapid deployment team'
    - Safety and incentives
  - Limited sustainability: Negative real interest rates
    - Exposure and consultation on Islamic vs. secular banking principles
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## 3. Relief vs. Sustainable Development

- Short-term subsidized Relief vs. longer-term sustainable Development
  - Effective sequencing of interventions is difficult:
    - Implementing subsidized relief requires different skills from those needed for sustainable development
    - Coordination is difficult in emergency environment
    - When to stop relief and start development as households recover at different speeds
  - Transfer from relief to sustainable service provision requires planning...from Day 1
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# Road Map for Early and Broad Strategies

Phase	Transitional (1-2 years)	Early Stabilization (2-3 years)	Late Stabilization (3-5 years)	Consolidation (5 years +)
<b>Major Milestones</b>	Peace agreement and peacekeepers	Organization for and holding of national elections	National government organized	Organization for and holding of local elections
<b>Presence of Essential and Preferred MF Conditions*</b>	Most essential; Few preferred	All essential; Few preferred	All essential; Some preferred	All essential; Most preferred
<b>Approach Level, Actor and Illustrative Activities</b>	<p><b>Micro:</b> MF donors Invest in MFIs; promote best practices</p> <p><b>Meso:</b> MF donors and practitioners; Agree to MF best practices</p>	<p><b>Micro:</b> MF donors; Invest in MFIs; promote best practices</p> <p><b>Meso:</b> MF practitioners; Develop MF network</p> <p><b>Macro:</b> MF donors and govt.; Work together to develop MF policies</p>	<p><b>Micro:</b> MF donors; Invest in MFIs; promote best practices</p> <p><b>Meso:</b> MF donors; Support MF networks and auditors</p> <p><b>Macro:</b> MF donors and govt.; Work together to enforce policies</p>	<p><b>Micro:</b> MF donors and private entities; Invest in MF</p> <p><b>Meso:</b> MF donors; Support networks, auditors, and introduce raters</p> <p><b>Macro:</b> MF donors and govt.; Work together to enforce policies</p>

# Road Map contd.

Phase	Transitional (1-2 years)	Early Stabilization (2-3 years)	Late stabilization (3-5 years)	Consolidation (5+ years)
<b>Expected Outcomes</b>	<ul style="list-style-type: none"> <li>➤ Only limited # of relief-driven / poorly designed credit programs</li> <li>➤ Growing client base in easier to reach urban areas</li> <li>➤ Best practices followed by MFIs</li> <li>➤ Government involved in sector by developing MF supportive policies</li> </ul>		<ul style="list-style-type: none"> <li>➤ Growing client base beyond urban/easy to reach areas</li> <li>➤ Many retail institutions achieve steady increases in outreach, sustainability, efficiency, and capacity</li> <li>➤ Government enforces supportive policies, involved, but not intrusive</li> <li>➤ Commercial funding sources emerge</li> </ul>	

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# Operational Guidelines – Phase 1-2

**If Good Practices cannot be applied, microfinance is not the best response!!**

## **1. Micro-Level: Build strong, Good-Practice MFIs:**

### *For practitioners:*

- Demand-driven institution-building – vision, mission, strategy!
- Strong partners and managers, technical expertise, training and TA
- Listen to the market!! Design products, services, delivery mechanisms to suit needs as they emerge and change over time
- Sound pricing policies (cost-covering interest rates/fee structure)

### *For Donors:*

- Performance-based and competed funding based on informed risk
  - Market-led and flexible investments – consult and coordinate
  - Don't require targeting and avoid disbursement pressures for MF – social transfers and economic development grants disburse faster and safer.
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# Operational Guidelines – Phase 1-2

## 2. Build a Good Practice-based Industry:

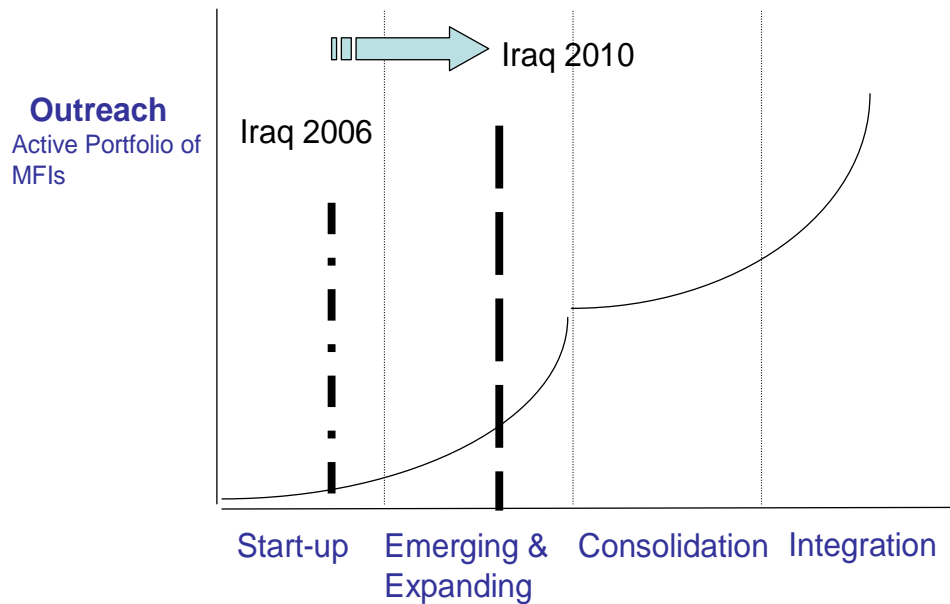
### *For Practitioners:*

- Exposure, training, consultation, study
- Agree on Code of Conduct for MF in IQ incl. banking principles
- Develop and update an Outreach Map
- Agree on Uniform Performance Reporting and Monitoring Tool for all MFIs and all donors
- Invite/involve banks, NBFIs, CBI, non-financial NGOs, and local community authorities – demonstrate demand and ensure transparency

### *For Donors:*

- Comply with the “Blue Book” (CGAPs Guidelines for MF Donors)
  - Develop, endorse and enforce “Principles for Donor Support to MF in Iraq”
  - Work with existing, specialist service providers to fill human resource gaps
  - Support market research and product development and other ‘public goods’
  - Help mainstream microfinance: consult and support MF at policy level
  - Demand transparency !
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# Strategic Goals



Development phases for financial services to the Base of the Pyramid

- Sustainable FSPs are serving increasing % of the population sustainably with high-quality and demand-driven products
- 25% growth in number of BOP households opening a voluntary savings account per year
- 15% growth in number of BOP HHs accessing credit as per demand
- 5 FSPs are sustainable with average PaR of max. 5%
- The industry is well coordinated, monitors own progress, and has created linkages with formal financial system.