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## MFC Spotlight Note

# 6

# Role of Microfinance in the Household Reconstruction Process in Bosnia and Herzegovina

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### Introduction

This note presents a summary of findings from the study conducted within *Imp-Act* programme<sup>2</sup> on the role of micro-enterprise lending in the household reconstruction process during 1996-2002 in Bosnia and Herzegovina (BiH)<sup>3</sup>. This research is one of the first of its kind to examine the impact of minimalist micro-enterprise credit on reconstruction. Additionally, because microfinance is still a young and fast-learning industry, this study is intended to help engage in a debate about impact of microfinance on reconstruction. It can also contribute to putting forward some propositions to be tested in other post-conflict settings in order to widen the pool of microfinance recipients, and consequently the impact of microfinance on household reconstruction.

Many organisations have introduced microfinance as part of their larger portfolio of programming activities aimed at reconstruction and revitalisation of war-torn communities in BiH. The level of international support providing political stability and basic economic security has been high compared to the African post-war experience<sup>4</sup>. This in turn has aided the climate for sound microfinance programming and has provided a stable back-drop for their development and growth<sup>5</sup>. Given that microfinance in the specific environment of BiH during the reconstruction period (1996-2002) was limited to the provision of micro-enterprise credit, the goal of this research is to understand the role played by micro-enterprise credit in household reconstruction. An analysis of multiplier effects and impacts of microfinance at the macro-level goes much beyond the scope of this research. Therefore, the research does not attempt to find a definitive answer to the extent to which microfinance creates stability and economic revitalisation. Rather, the focus of the research is to explore the factors that influence whether an enterprise programme is aiding the household reconstruction process and where there is a gap between demand and supply of microfinance services.

There is a growing literature on microfinance in post-conflict situations (Doyle 1998, Nagarajan 1999, Wilson 2002, ILO 2003). Issues discussed include design considerations (goals, products and services of microfinance programmes in post-conflict settings), systems and procedures (best practices, monitoring, evaluation and impact measurement, role of key actors), timing of intervention, type of implementing agency, funding requirements, target group, funding and implementation of microfinance in post-conflict settings, in particular the extent to which they differ from “peaceful” countries, etc. However, rarely are the questions of impact raised. Paradoxically, greater understanding of the impact of microfinance services on the reconstruction process is a key to building successful post-conflict microfinance institutions in the future.

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<sup>2</sup> ImpAct Programme – [www.imp-act.org](http://www.imp-act.org) – is a collaboration which brings together 29 MFOs in 20 countries, a team of academics from three UK universities, international NGOs, policy-makers and donors. MFC acts as regional coordinator and TA provider to seven regional MFIs participating in the Programme.

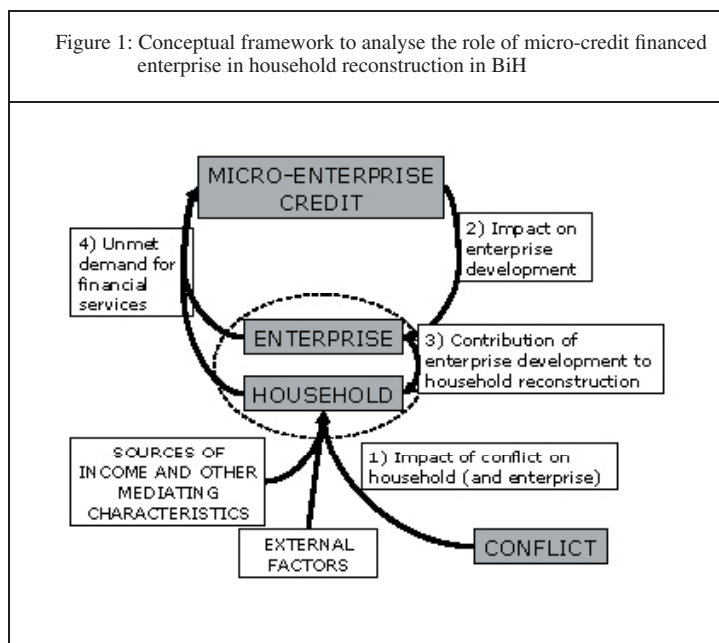
<sup>3</sup> Detailed methodology and findings can be found in the working paper at [www.mfc.org.pl](http://www.mfc.org.pl). Many organisations and individuals contributed to this paper. MFC would like to acknowledge the very important contribution for this research of two partner MFIs: Partner and BosVita. This project would not have existed without their support, knowledge, openness, patience and good spirit. In addition, MFC would like to acknowledge the contribution of the MFI Prizma in making two of its staff available to conduct the research. For data collection special thanks go to Selma Jahic (Partner), Biljana Smajic (BosVita), Beba Vejzovic and Lejla Viteskic (Prizma) who worked long hours in the field conducting the qualitative research. Particular recognition goes to Partner, and especially Danijela Ristic, for all the logistical support. The authors are grateful to the contributions brought by the Foundation for Sustainable Development, and especially Tamara Glusac, for their support in making available LIP II dataset, and by Elizabeth Dunn and Kasia Pawlak for their valuable comments to the draft research framework. This research would not have been conducted without the constant support of Paul Mosley who provided inspiring ideas and comments on the final paper. Finally, the authors wish to thank all the respondents for their time and patience during the fieldwork.

<sup>4</sup> It has been estimated that more than five billion USD have been poured into the country in foreign aid (Bisogno and Chong 2002).

<sup>5</sup> An unofficial estimate puts the number of MFIs in BiH at 42 registered organisations for a country of 3.8 millions inhabitants. Seventeen leading MFIs supported by the World Bank’s LIP disbursed over 50 000 loans from 1997-2000, and have been steadily expanding their operations (Dunn and Trtkovic 2003).

## Research Methodological Framework

It is assumed that significant conflict effects occur at the household level, thus the household is an important area of reconstruction. Household reconstruction is understood in broad terms as the enhancement of household security through building assets and satisfying basic needs in a durable manner. Therefore, vulnerability is a key component of the framework. Vulnerability is defined as the inability of a household to deal with risks leading to failure in satisfying these basic needs. Vulnerability captures the process of change as people move in and out of poverty<sup>6</sup>.



The crucial element of the framework is a relationship between enterprise development and household reconstruction. The micro-enterprise is placed in the framework as one of the household coping mechanisms – a way to ensure and stabilise income for the household, enabling it to sustainably build its assets and satisfy its basic needs. Micro-enterprise is assumed to contribute to vulnerability reduction for conflict-affected households. Is it really a significant input? How effective is it compared with other coping mechanisms? Under which circumstances and for which households is it an added value? In order to answer these questions, it is necessary to compare micro-enterprise to other available coping strategies for different groups in the post-conflict environment.

Building on previous impact studies done in BiH (Muench 1999, Tsilikounas 1999) this study aims to explore in more depth the ways and circumstances under which microfinance stimulates development of micro-enterprises owned by households affected by the conflict<sup>7</sup>.

The last part of the framework consists of trying to understand what other microfinance services were needed to increase the role of microfinance in the household reconstruction process. A hypothesis is put forward that Bosnian MFIs only partly fulfilled demand for financial services due to the exclusive provision of micro-enterprise credit. Having information about impact and unmet demand can be a basis to speculate about what would happen if the services were better adjusted.

Resource constraints did not allow for national-based research. One post conflict region within the country was selected to gauge demand for and impact of various microfinance services. The areas selected for this study are heavily destructed communities/villages close to Tuzla where partner MFIs intervene<sup>8</sup>. Two MFIs expressed willingness to participate in the study: Partner and BosVita. Both were created in 1997 and provide exclusively micro-enterprise credit.

Both quantitative and qualitative methods were used to respond to the research objectives. This approach enabled the researchers to collect information representative of the entire studied population through quantitative analysis further enriched by in-depth understanding of studied topics through qualitative inquiry. This mixed approach offered several benefits because the quantitative background information was used not only for triangulation of results, but also to develop a rigid sampling plan for the qualitative study.

<sup>6</sup> This dynamic dimension of vulnerability is very important in a post conflict environment where high magnitude and variety of risks occur during the transition from survival to subsistence to livelihood. As suggested in Sebstad and Cohen (2000) vulnerability is considered in terms of the assets and range of coping mechanisms available to a household to deal with shocks, economic stress events, and other downward pressures. Households with fewer assets and available coping mechanisms are more vulnerable and those with more assets and coping mechanisms are less vulnerable.

<sup>7</sup> It is important to note that a possibility of direct impact of micro-enterprise credit at the household level is controlled and verified in the framework by in-depth analysis of the loan use.

<sup>8</sup> It included the following municipalities: Tuzla, Lukavac, Derventa and Bratunac.

## Conflict And Household Vulnerability

The quantitative data research benefited from the existing dataset collected for the purpose of a national microfinance impact study coordinated by the World Bank and the Foundation for Sustainable Development under Local Initiatives Project II<sup>9</sup>. For the purpose of the reconstruction study, only the datasets of Partner and BosVita were used. The total sample size was 576 respondents consisting of 312 repeat clients, 56 new clients and 208 respective non-clients of the same characteristics<sup>10</sup>.

Building on results from the quantitative analysis, qualitative research was conducted. Two main research techniques were used: focus group discussions (FGD) driven by participatory rapid appraisal (PRA) tools<sup>11</sup> and semi-structured individual in-depth interviews<sup>12</sup>. Twenty-seven FGDs and 16 individual interviews were held in total from February 25 to 28 and from March 19 to 22, 2003. There was a deliberate attempt to create very homogeneous and structured samples so that focus groups could be compared two by two<sup>13</sup>. Samples were stratified based on whether participants were clients or non-clients, from relatively less or more vulnerable households, from households with relatively high or low importance of business income, and living in rural or urban areas. Individual in-depth interviews were conducted with experienced clients who had excellent repayment histories and with those who had experienced repayment problems.

The war in BiH started in mid-1992 and lasted until the signing of the Dayton Peace Agreement in late 1995. The conflict left the country impoverished, homes devastated and the infrastructure ruined, and brought the economy to a halt<sup>14</sup>. The catastrophic war in BiH ended in 1995 setting the stage for reconstruction activities. At the same time BiH, like most of countries in the region, experienced a switch from centrally-planned to market economy. The combination of post-conflict effects and market reforms impoverished a large proportion of the Bosnian population. In the post war reality 19.5 per cent of the BiH population is classified as poor (World Bank 2002). Similarly to other transitional countries, it is important to note that the phenomenon of “new poor” in BiH differs significantly from the understanding of poverty in traditionally poor settings in Africa and Asia. One of predominant characteristics of the “new poor” is relatively high education level and good household physical asset base (World Bank 2000).

The quantitative results strongly confirm that conflict has intensified household vulnerability. Thirty-one percent of sampled respondents come from households that were affected by the conflict<sup>15</sup>. There are no particular differences in terms of conflict destruction across different groups of population because conflict by definition affected equally all groups of society. Of those that were affected, 36.9 per cent returned to their residences or municipalities of origin while the rest of the population is still displaced. Even after seven years of reconstruction, more vulnerable people are to be found amongst those who were affected by the conflict.

The crucial element of the qualitative research was to identify the risks that were associated with the biggest financial pressure during the reconstruction period<sup>16</sup>. This helped to understand which risks were the most difficult to be satisfied, therefore putting households in crisis.

<sup>9</sup> The World Bank and LIP longitudinal study aims at assessing the impact of microfinance at the enterprise level. The first round of data collection took place from April to August 2002. The survey methodology is documented in a baseline findings report (Dunn and Tvrtkovic 2003). This quasi-experimental design uses a treatment group composed of clients from 11 leading Bosnian MFIs. The control group is composed of new clients and respective non clients of the same characteristics. Non clients, that have never taken a micro-enterprise credit, are recommended by current microfinance clients to an interview.

<sup>10</sup> Given that this data was collected to assess the impact of microfinance at the enterprise level, the team encountered some limitations in terms of its use to cover all research areas mentioned above. Notably, the sections on household and use of financial services are very limited in the survey, which limits the analysis of the relationships between enterprise and household as well as needs for financial services. Moreover, given its longitudinal design, there is no retrospective data that could allow, for example, historical comparisons between clients and non-clients. In addition, there are no good proxies for hidden characteristics such as entrepreneurship, self-confidence, business relations, etc. that are usually essential factors in microfinance client selection. These limitations entail an inability to explore all relationships, such as the main factors of joining a microcredit programme during a reconstruction phase.

<sup>11</sup> FGD bring together six to 10 individuals into a homogeneous group so as to explore a few issues in depth, with the help of a trained moderator/facilitator. The PRA tools used during FGD stimulate discussions, enabling participants to visualise issues and, adding more structure to the discussion to help moderators keep participants focused on the specific topics, and facilitate future analysis and comparisons across different groups. The main source of inspiration for the development of PRA tools was a MicroSave-Africa toolkit for microfinance market research.

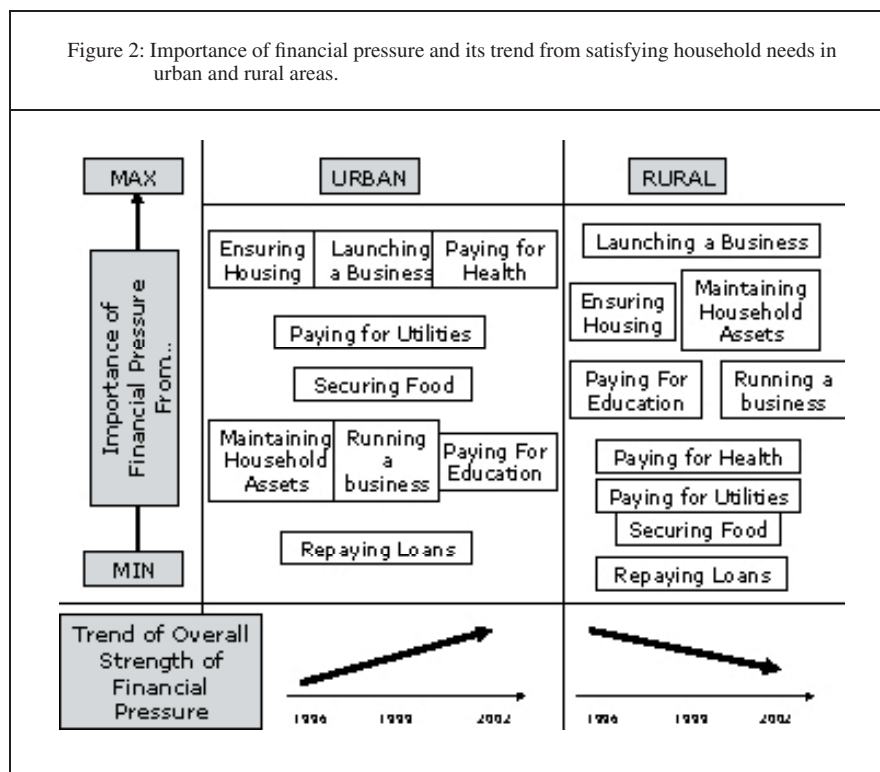
<sup>12</sup> The team conducted a series of individual interviews based on the AIMS loan use tool adjusted to address the specific research objectives. It was decided to conduct individual interviews on more sensitive issues instead of discussing them in-depth in focus groups.

<sup>13</sup> Two indexes developed in the quantitative survey were used for sampling: household vulnerability and enterprise importance. Household Vulnerability = Household income + number of household income sources + enterprise importance index. Enterprise Importance = business income/total household income. Further considerations in how well the enterprise is doing included the following: high or first loan size (for clients), size of enterprise, sector, and growth of average loan size.

<sup>14</sup> Two hundred thousand people were killed, a million and a half sought refugee in other countries. According to the UNHCR data, 26% of the population was displaced in 1997 (Goronja 1999). In BiH the magnitude of the GDP loss was far above the loss of any other transition country, even of those who suffered similar wars during their transition processes. World Bank estimates cite the loss of GDP ranging from US\$8.7 billion in 1991 to US\$1.5 billion in 1994. Economic activity was nearly paralysed, while industrial production recorded a fall of more than 90 per cent in real terms. Physical destruction was heavily concentrated in factories and industrial premises affecting employment opportunities, contributing to boost unemployment to levels estimated in late 1996 at between 33 per cent and 45 per cent (Bisogno and Chong 2002).

<sup>15</sup> Two variables were used to identify those households heavily affected by the conflict: the fact of moving from its living place during the conflict and the status of still being displaced. It was agreed that while this definition is not perfect, overall it is still a robust measure of the effect of conflict on households in BiH.

<sup>16</sup> In the post-conflict setting it is particularly difficult to research risks as most of them are new to people and are very often associated with psychological trauma. Therefore, to avoid touching on sensitive issues during the qualitative research, it was decided that the three types of risks – structural, life-cycle and crisis – would be transformed into difficulties in satisfying household basic needs such as: securing food, paying for utilities, paying for health expenses, ensuring education, ensuring housing, maintaining household assets, launching a business, running a business, and repaying loans. Financial pressure associated with these risks were analysed in terms of difficulty in satisfying a particular household need over a one-year period. It was agreed that financial pressure depends on frequency and amount needed to satisfy a need, and availability of coping mechanisms to address it.



Overall, regardless of the location, two needs came through as the most difficult ones to satisfy: ensuring housing and launching a business.

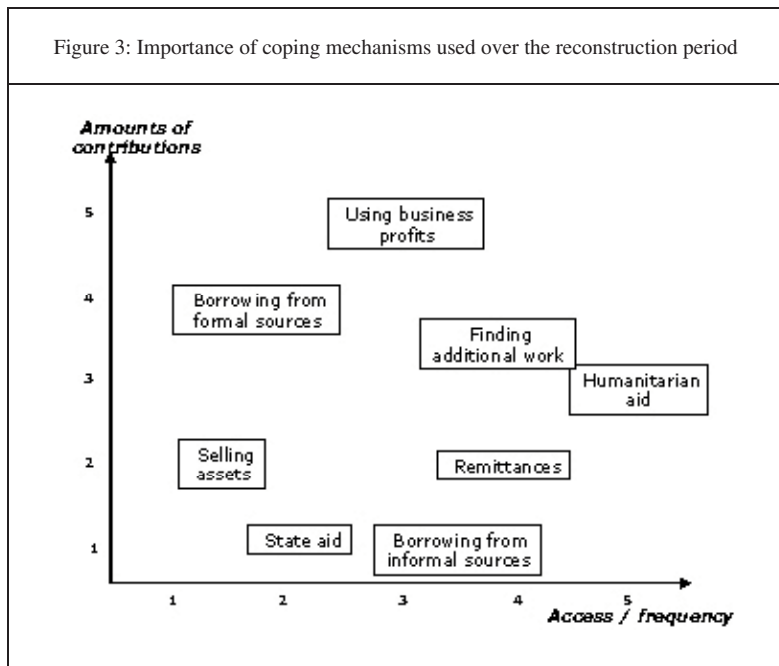
Ensuring housing has had more structural roots as it has been linked to the problem of displacement and return. However, the situation has not changed much for people in rural areas while in urban areas, pressure is perceived as increasingly difficult over the reconstruction period due to an increase in rents, high costs of construction, and the fact that people who had been occupying others' homes have been asked to leave. Ensuring housing constitutes the biggest financial pressure in urban areas at the moment.

In view of the collapse of stable state jobs, financial pressure from launching a business was very high over the reconstruction period both in rural and urban areas. However, there were significant differences in terms of timing of this pressure. In rural areas, the highest financial pressure came from trying to launch a business just after the conflict ended because this was to be crucial for survival and there were no support mechanisms available at the time. On the other hand, urban dwellers were not so inclined to start businesses just after the war given that they were receiving aid and/or were still employed. Therefore, in general the pressure was not so relevant in urban areas. As time went by, fewer jobs were available and therefore it was increasingly important to start a business.

The analysis of differences between households of different vulnerability levels provides an interesting insight into their perceptions of pressures. In urban areas more vulnerable households are more concerned with ensuring housing, launching a business, and securing food than less vulnerable entities. The risks associated with satisfying these needs are the most important factors contributing to an increase in vulnerability. Furthermore, a hypothesis can be put forward that micro-enterprise is a risky affair particularly for more vulnerable households, that do not have good available coping mechanisms in case of seasonal business fluctuations. In addition, while the conflict situation forced these households to run their own economic activities, their household human and social assets are not sufficient to sustain the activities. Other risks surface among the less vulnerable households in both urban and rural areas. Even when they possess greater qualifications and experience to launch a business and are able to satisfy nutritional and shelter needs, households still face significant risks linked to paying health and utility bills. This is predominantly due to a lack of developed and accessible coping mechanisms to cope with health problems and utility payments as well as more regulation in these sectors, leading to increase of costs for users.

Faced with pressure coming from many different risks, households in post-conflict BiH have used a variety of coping mechanisms to manage or protect against different risks<sup>17</sup>. Coping mechanisms are

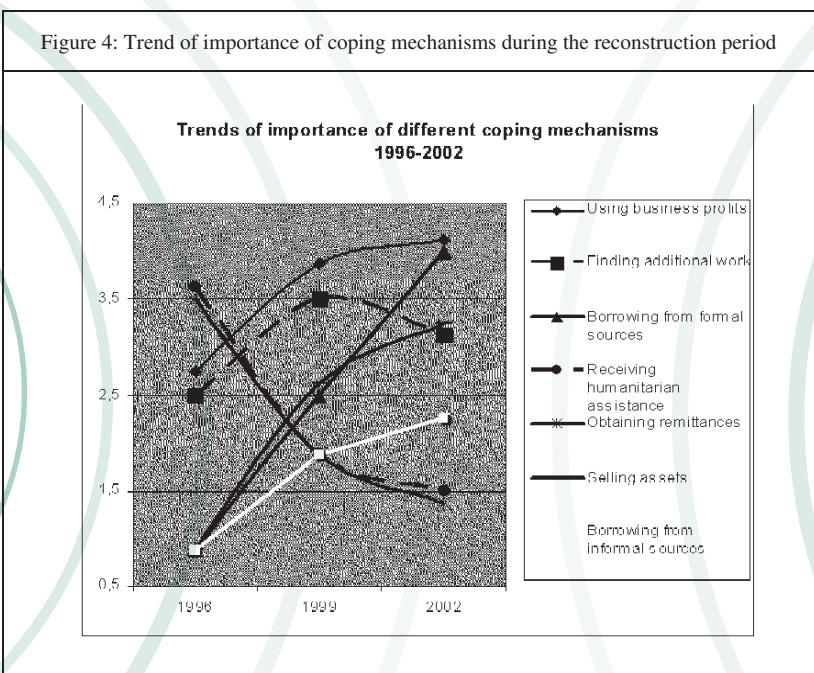
<sup>17</sup> When discussing coping mechanisms, focus groups participants were referring to three different aspects: a) accessibility of the coping mechanism; b) amounts of contribution and c) trend overtime. A significant coping mechanism was defined as one that is relatively accessible (frequently used) and generates substantial amounts of money so as to deal with a given shock.



quite similar across areas and types of groups. If household reconstruction is viewed as a dynamic concept over a relatively long period of time, then few coping mechanisms have really contributed to household reconstruction in that they have either generated relatively small amounts of money (family borrowing), or have been very transient (aid). Regardless of the location, respondents reported using business profits and finding additional work as the most important mechanisms to deal with the greater risks discussed in the previous section. As shown in figure #3, the amounts of contributions from business profits compensated for the relative low access to this coping mechanism, especially at the beginning of the reconstruction period. The significance of business profits, in terms of access and amounts of contributions, was growing steadily over the reconstruction period.

Finding additional work was an important strategy to deal with risks, especially in the middle period of reconstruction. Its significance as a coping mechanism is decreasing now as more visa restrictions introduced during the reconstruction period have recently made this coping mechanism less available to the local population.

Humanitarian aid was dominant and widely accessible to all groups of the population just after the war and has been gradually decreasing.



## Impact Of Micro-Enterprise Credit On Enterprise Development

Borrowing from formal sources was an important strategy in urban areas over the entire reconstruction period. It included mostly MFIs given that the banking sector was being entirely re-shaped and re-built (Adison et al. 2000). Conversely, it was virtually not accessible to rural households until 2001. Its importance is growing now in both urban and rural locations because of relatively important amounts contributed. In 1996, only people in urban areas who had formal employment could have access to bank loans, therefore borrowing from formal sources was not a significant coping mechanism. MFI loans did not start until 1997 in urban areas and in 2000-2001 in rural areas.

According to focus group participants, remittances were the most important coping mechanism just after the war, which is also confirmed by other quantitative analysis (Bisogno and Chong 2002). Remittances have been less prevalent as a coping mechanism overtime because war has become a more distant episode, creating a sense of “fatigue” from people abroad about sending money to their family.

Summing it up, if one reviews financial pressure overtime, paradoxically the situation was not necessarily the worst immediately after the war. It is when the state safety nets collapsed in 1999 that people had to find alternative coping mechanisms. With the state going bankrupt, citizens have been increasingly asked to contribute higher amounts to utilities and health, while amounts of state aid drastically plummeted. Therefore, it is the collapse of the economy and the necessary transition to a market economy combined with the conflict that led to enhanced household vulnerability, rather than the conflict per se. In addition, while households in rural areas appeared more vulnerable after the war, they gradually built effective coping strategies and re-built their livelihoods. On the other hand, households in urban areas after the war did not feel high pressure because they benefited from a combination of large amounts of humanitarian aid, remittances from their family abroad, state-subsidised health expenses, utilities and education. However, all along, they were not building coping mechanisms to deal with the future and therefore their vulnerability increased overtime. In rural areas people had to rely at an earlier stage on themselves. Over time each need has become relatively easier to satisfy because people have built some coping mechanisms. In contrast to urban areas donations were not given directly to buy food, but were made for livestock or fuel for tractors and enabled households to build up assets and start production.

**Hypothesis #1:** In the studied area, business credit provided by the MFIs has a positive impact on development of enterprise owned by conflict-affected household.

### Who joins and stays in micro-enterprise credit programmes?<sup>18</sup>

It is important to note that many people from households affected by the conflict have been included in microcredit programmes. Of existing clients, 38.8 per cent of them were affected by the conflict (comparing to only 20.7 per cent of non clients). Additionally, significantly more clients than non-clients are still displaced.

On the other hand those who are vulnerable<sup>19</sup> tend to be excluded from micro-enterprise services<sup>20</sup>. This points to a self-selection bias to microcredit programmes by less vulnerable households. New clients have more sources of household income, and are therefore less dependent on enterprise income. However, in terms of income level, those who join and those who do not join are similar. It is in terms of dynamic dimensions of their income level that they differ.

Last but not least, enterprise characteristics are not a reason to exclude somebody from programme participation. New clients run businesses that are more often recently established and not registered. It is the only difference at the enterprise level. New clients operate similar enterprises to non-clients in terms of type and size. There is no difference between new clients and non-clients in terms of number of businesses operated by the household. Overall, 69 per cent of households operate only one business.

The results of the exit analysis confirm the findings presented above about those who join. Once again there is evidence that those affected by the conflict have participated longer and obtained significantly larger loan amounts than those not affected. Micro-credit client drop-out rates are significant in BiH: 40-50 per cent of clients leave after three loan cycles (Pawlak 2003, Matul and Vejzovic 2003). In the dataset used for this research, only 15 per cent of clients have taken four or more loans<sup>21</sup>. Given low client retention rates, an analysis of the extent and period of client participation in the micro-credit programmes is of utmost importance to impact analysis<sup>22</sup>. In the various in-depth qualitative research initiatives that Partner has undertaken under *Imp-Act*, it is evident that most of the reasons

<sup>18</sup> Two fundamental questions to be considered in any impact assessment are: 1) who joins the micro-enterprise credit programmes and 2) to what extent and for what period do the clients participate? Answering these two questions allows controlling for client self-selection and desertion. If these issues are not taken into account, any impact assessment results may be over-estimated.

<sup>19</sup> Given limited availability of household variables in the quantitative analyses vulnerable households were defined as those with low level of income, limited number of income sources per household adult, and with big dependency on self-employment income (perceived more risky than salaried work). A composite index was created.

<sup>20</sup> It is true under assumption that marketing and policies to attract and approve are the same now and they have been over the reconstruction period. The dataset does not allow doing a retrospective analysis.

<sup>21</sup> 85% clients have taken 1 to 3 loans. 25% has taken in total less than 2 000 KM; 25 % has taken more than 7 000 KM.

<sup>22</sup> One can argue that if those people who stay are significantly different (more entrepreneurial, better contractual relations, etc.) than those who leave the real development impact of microcredit is much lower (microcredit helps only those who are already better than others and excludes those who need help. Only variables: first loan size and average growth in loan size can depict some of these hidden characteristics. They are used for further impact analyses as control variables.

for desertion are linked to product design aspects such as short loan term and high interest rate, and problems related to the difficult market situation.

### Loan use

During focus groups and in-depth loan use interviews, MFI clients stated that MFI loans have been almost always strictly used for business purposes. Of the 16 loan use interviews conducted in an in-depth and objective way, 13 interviewees used their first loan strictly for business and three used a small part for household purposes (usually food and utilities). On their last loan, 12 out of 16 people used the loan strictly for business and four used it to save for education, to buy an apartment and to renovate the house<sup>23</sup>.

### Impact and its beneficiaries

There are no significant differences between clients and non-clients with regard to financial pressure from launching a business in both urban and rural areas. However, a positive trend can be observed in rural areas where between 1999 and 2002, clients have experienced a lessening of financial pressure from launching a business. At the same time the financial pressure has been increasing for non-clients in rural areas. This is a realistic proposition as MFIs have entered rural areas during this period with a slightly modified methodology, including credit for start-ups. One explanation for the lack of significant impact on facilitating launching a business is that micro-enterprise loans were not available just after the war until 1997/8. In addition, the gradual introduction of regulations for self-employment activities contributed to an increase in the costs of launching a business. Regulatory costs of launching and running a business in BiH are perceived as very high (Smith and Wise 2002).

The findings related to impact of micro-enterprise credit on running an enterprise, including mitigating business and liquidity crises, are similar in direction and even sharper in magnitude as in the case of launching a business. In urban areas, micro-credit clients rank running a business as the need associated with the biggest financial pressure comparing to other household needs. Conversely, non-clients rank it as a need representing relatively the lowest financial pressure. On the contrary, in rural areas the financial pressure from running a business is comparable for client and non-client households over the reconstruction period. The difference is that for MFI clients this pressure is decreasing steadily while for non-clients this pressure is increasing steadily. One can conclude that MFIs, at least in the Tuzla area, played an important role at a time when the environment was conducive to businesses and microcredit provided an additional boost. On the other hand, on more mature, saturated and regulated markets, the added value of micro-credit seems to be diminishing.

Additionally, running a business is perceived as more difficult for clients from more vulnerable households. Groups comprising vulnerable participants who had very low-level survival activities rarely thought of contracting business loans while more economically vibrant groups felt strongly that a business loan would be the best way to bring money to their households by starting a business.

## Box 1

Nesija runs a grocery store. With her first loan she used part of the earnings for the business and part for household expenses (food, clothes, and utilities). She started experiencing problems with her last loan when: 1) SFOR workers, who represented her major customers, eventually left the country, bringing her sales sharply down; 2) health problems in her family led to increased expenses. Nesija is now experiencing problems repaying her loans because she reports not having enough of a financial cushion to cope with the crisis.

In general in quantitative terms there is no indication that participation in the microcredit programme leads to an increase in income, number of workers, amounts invested in location improvement and equipment purchase. There are no statistically significant differences between existing clients and non-clients in these areas<sup>24</sup>. However there are some indications that the more one participates, in terms of number of loans obtained and total amount of loans, the more likely it is that enterprise development will be linked to the micro-credit programme, even if controlled for the self-selection bias. This is especially valid for people affected by the conflict for whom participation in the microcredit programme leads to more frequent and larger investments in business location as well as higher business income<sup>25</sup>.

<sup>23</sup> These results seem to support the previous assumption about low fungibility of micro-enterprise credit in BiH. However, they must be treated with care due to low sample size and other research yielding opposite findings (Tsilikounas 1999).

<sup>24</sup> In the dataset there are four main impact variables that can be used at the enterprise level (total business income, number of workers, location improvement (including amount invested), equipment purchase (including amount invested)). Two types of analyses were run: identifying statistically significant differences between existing clients and non clients (Chi2 cross tabs and non parametrical tests) and finding statistically significant correlations between impact variables and number of loans taken and total amount of credit obtained (partial correlations). Main control variables in the analyses were first loan size, average growth of loan size and vulnerability index. In order to spot differences between those conflict affected and others the analyses were run twice on the total sample and on the sample consisted only of those affected by the conflict.

<sup>25</sup> Among those affected who are clients, 39.3 per cent invested in their business location in the last 12 months (comparing with only 25.6% for those affected who are not clients). Furthermore the larger the amount of credit (and number of loans) the larger the investment.

## Contribution Of Enterprise Development To Household Reconstruction

These findings seem to be confirmed by qualitative in-depth loan use interviews. Of sixteen individuals interviewed, 12 mentioned that the loan had enabled them to diversify their business, expand and purchase more assets, including diversifying livestock, purchasing more business space, diversifying in sewing a new type of clothing, etc. This points to the fact that the loan has supported enterprise development.

In addition, one of the findings of the focus groups and individual interviews is that in many cases, the loan provided a possibility to shift into another type of business. Given that the economic situation in Bosnia was changing very fast, people needed to adjust to changes, especially if they were dependent on one business. This ability to bounce back, or resilience, can be observed amongst most clients.

In general, it appears that the impact of microfinance programmes on enterprise development has been greater when people were relatively less vulnerable and had a stronger enterprise to start with. The less vulnerable clients mentioned that they had savings from before the war that could be used for the businesses. As they had a relatively strong asset base, they were able to reinvest all or almost all of their business profits back into the business, regardless of how difficult their household situation was. When faced with crises, their various sources of income helped them to deal with shocks. In most cases non clients either did not know about microfinance programmes and/or were afraid not to be able to repay given their lack of entrepreneurial spirit, skills or ability to plan. This strengthens the hypothesis of a self-selection by less vulnerable clients.

**Hypothesis #2:** In the studied area reconstruction of a conflict-affected household is stimulated by development of a micro-credit financed enterprise.

The quantitative analysis proved that enterprise type and size determine very strongly a household's vulnerability level. Household income is strongly correlated with enterprise characteristics such as employment, income, maturity, type (services) and registration. These results provide evidence that micro-enterprise performance is strongly linked with household well-being and security.

*"The additional work we used to do on the side became our main activity".*

As shown in figure 3, it is clear that income generated from micro-enterprises was relatively the most efficient of the available coping mechanisms, mitigating various risks during the reconstruction period and contributing this way to reducing household vulnerability. Its importance has been steadily increasing over the reconstruction period and this fact was confirmed by both rural and urban households, regardless of their post-conflict status and their households' vulnerability level. Business income was mentioned as the most efficient coping mechanism by both MFI clients and non-clients. The qualitative nature of the data does not allow comparing the effectiveness of the contribution between these two groups.

Assuming that micro-enterprise lending had a positive impact on enterprise development of selected households (as shown in previous section), the fact that income from these enterprises replaced more negative or short-term coping mechanisms is a sufficient fact to justify the value and importance of micro-enterprise credit. Previous sections also point out that the contribution of micro-credit financed enterprise to household reconstruction was much larger for certain groups than for others and not accessible to everyone. Rural or urban location and household vulnerability level mediate the extent to which enterprises financed by microcredit have contributed to household reconstruction.

On the basis of the previous analysis, in general the entire population of MFI clients can be divided into two categories: 1) those from more vulnerable households who run businesses for survival; 2) those from less vulnerable households who managed to expand and diversify their businesses. For both groups, the income generated from their enterprises was an effective coping mechanism. The only difference is that survival enterprises seem to provide a short-term solution, especially in urban areas, while expanding businesses promise to be a stable source of income for the future.

Regarding survival entrepreneurs, although clients mention that it is their preference to invest business earnings back into the business rather than to use it for household purposes, they mostly use them for the latter. This is why they say that loans are very important for business growth because the current level of earnings rarely allows for that. When people are able to reinvest some money into the business, it is usually to cover running costs, not expansion. In their case business profits go entirely towards satisfying household needs such as food, school, health and utilities. In fact, these groups tend to view their very small businesses as combined with their household, and both types of expenses are often mixed. They say that the business plays a crucial role in their household security. In urban areas, where for the past five years MFIs have contributed to boosting the micro-enterprise sector, the market is becoming very competitive. At the same time, taxes and other expenses associated with other new regulations are being enforced. All these aspects are viewed by respondents as threatening the existence of their survival enterprises. To conclude, the role of micro-enterprise credit in supporting survival enterprises was essential to household reconstruction, however, it is phasing out as the business environment is getting more mature.



## Unmet Demand For Microfinance Services

In the case of expanding entrepreneurs, respondents reported that a marginal number of households in their area are able to use some of the business profits for business expansion. Participants with larger and more mature businesses report that they are able to reinvest about half of the proceeds into their business and use the other half for household expenses. There is evidence confirming the hypothesis that enterprise development leads to household reconstruction. The investment in enterprises – a sign of enterprise development – has a positive impact on reducing household vulnerability and increasing household income<sup>26</sup>. It is unanimous regardless of household post-conflict status and the importance of enterprise income in the household budget. This relationship is stronger in urban areas where entrepreneurs were exposed to micro-credit for a longer period of time. In addition, there is a trend observed among conflict-affected households who own fast growing businesses that these enterprises become virtually the only, even if substantial, source of income. The analysis shows that even if there is more risk in focusing on one high profit business, the profits generated from these activities compensate for a potential increase in vulnerability due to the reliance on one unstable income source. For conflict-affected households depending heavily on business income, an increase in business income reduces household vulnerability. Income effect is bigger than risk effect<sup>27</sup>.

Last but not least, it must be remembered that households who are more vulnerable are either excluded from microcredit services or are among the survival group. It is important to get to know what other microfinance services could be delivered to stimulate the reconstruction of their households.

**Hypothesis #3:** In the studied area where only micro-enterprise credit is provided there is unmet demand for other financial services, which significantly lowers the potential impact of microfinance on reconstruction process.

Considering microfinance as a wide spectrum of financial and supporting non-financial services adapted to the needs of the poor and vulnerable, this section explores unmet needs for microfinance services among the conflict affected households in BiH in the period just after the war ended (1995-98). As described in previous sections of this paper, the more vulnerable households have not benefited fully from the micro-enterprise programmes, were excluded from these programmes or were not attracted by them. On the basis of the combined analysis of financial pressure from various household needs (section 3.1) and detailed retrospective research on the type of services people wanted just after the war<sup>28</sup>, this paper argues that the needs presented in the figure 5 were not met<sup>29</sup>.

### Credit Services

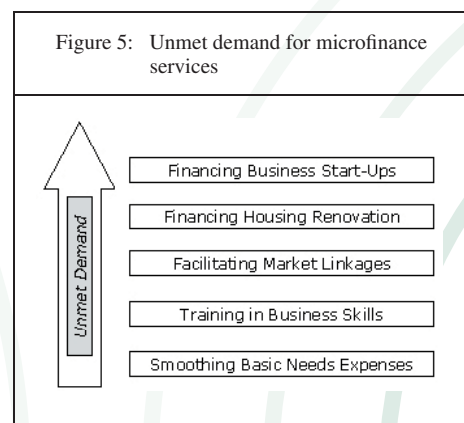
#### Financing Business Start-Ups

In both rural and urban areas, financial pressure associated with launching a business was one of the most significant pressures identified. Respondents reported that they would have liked the microfinance institutions to start giving out loans earlier than they did<sup>30</sup>.

Non clients have not joined microfinance programmes for two reasons: either they were afraid not to be able to repay the loans or they found the loan conditions to be unsuitable and/or too restrictive for their potential or existing business. Both reasons point to the potential inappropriateness of the available micro-enterprise loans at the time for them. More insights regarding analysis of the credit product attributes are included in box 2.

Last but not least, more vulnerable participants in rural areas mention that loans for agriculture with suitable conditions were not available then, are not available now and that such loans would need to be tailored to each type of agricultural businesses with grace periods and flexible repayment terms

Figure 5: Unmet demand for microfinance services



<sup>26</sup> These are significant results of non parametric tests. Location improvement has a positive impact on both household income and vulnerability, whereas equipment purchase only on household income.

<sup>27</sup> Significant results from correlations run on those conflict affected households that are dependent heavily on business income – it is not significant neither for the whole sample nor for other groups.

<sup>28</sup> We assume that due to low financial education of vulnerable households their wants for financial services are not always matched ideally with their development needs and institutional capacities of providers. That is why, this analysis combines wants with previous analysis of needs. All this is done having institutional lens on. Only those services and their scope that are within an intervention of MFIs (directly or through partnerships) are considered.

<sup>29</sup> It must be noted that microfinance clients and non-clients only discussed credit and business development services. Respondents did not talk at all about savings and insurance products. This may be due to a lack of awareness of their development potential. Additionally, the recent collapse of financial systems resulted in a lack of trust in financial providers, which is especially crucial to savings and insurance. Last but not least, at the beginning of the reconstruction period, households were faced with many current crises which prevented them from seeking risk protection (Lindh de Montoya and Mc Neil 2003).

<sup>30</sup> In urban areas, people said that they would have taken loans as early as 1996. In rural areas, people mention their regret at the fact that between 1995 and 1998, no such business loans were available and that loans were only offered in the Serb Republic in 2000.

for start-up businesses.

#### Financing Housing Renovation

Ensuring reasonable housing conditions was as important to households during the reconstruction period as the need to launch a business. The high financial pressure was caused by lack of efficient coping mechanisms. Housing credit services were not available but were perceived to be of paramount importance after the war. Conflict-affected households had to resort to all possible means to solve this issue, often putting themselves at risk, as exemplified through the anecdotes in box 3. As an illustration of the demand for housing services, among all delinquent clients interviewed during this research, the most important reason for repayment problems was due to clients diverting a part of their enterprise loan to cover housing expenses. This was especially prevalent among those vulnerable households who depended heavily on micro-enterprise income. For them any konvertible mark (KM) diverted from its original use could have potential fatal consequences on business profitability and subsequent ability to repay the loan.

One can imagine that providing housing credit services would help the less vulnerable households in effectively managing their household money with relation to their most pressing needs. On the other hand, it is difficult to imagine a full-cost housing product benefiting more vulnerable households to be delivered by young MFIs just after the conflict. Results prove that more vulnerable households would not be able to manage an additional loan under acceptable conditions for an MFI. However, the fact that many vulnerable households were in dire need of housing and that some of them diverted parts of the loan for this use, thereby undermining their enterprise development efforts, implies that this demand can no longer be ignored today in post-conflict settings, especially in moderate climate zones.

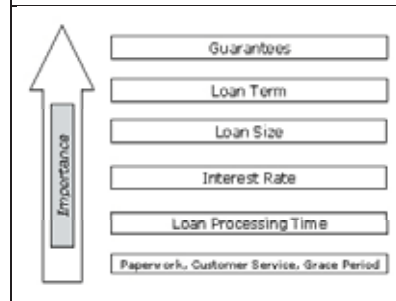
One potential solution to the problem was housing grants and self-help support from international organisations. The “housing issue” was at the heart of the post Dayton Agreement, and the entire international agenda revolved around displacement and population movements. Cities were awarded aid based on whether or not their local officials were being supportive to returnees, refugees or displaced

### Box 2: Preferences for Credit Product Design

Participants were asked to rank the relative importance of the various loan parameters after the conflict and to determine whether or not this ranking would be different today. The ranking was the same for business and housing loans. Moreover, results were similar regardless of area, level of development of the enterprise, household vulnerability and time since the conflict ended.

- Guarantees** - All participants report that it was difficult at the time to find guarantors because people were losing their jobs, the environment was insecure and people did not trust each other. In these days, microfinance organisations were helpful because their guarantee requirements were more flexible than that of banks, and some programmes offered solidarity group loans. Additionally, guarantors were not yet fully aware of the implications of their position and therefore were more willing to accept this responsibility. The situation with guarantees is harder now than it has ever been. Most participants would give in on any other attribute of a loan to enjoy more flexible guarantee requirements and simpler access.
- Loan term** - Most groups say that it is long loan term is important to facilitate repayment in adequate small installments and have enough time to turnover their business several times to repay the loan.
- Loan Size** - Respondents said that if they do not earn enough from their business because the investment is too small, then they do not have enough to repay the loan and their business stagnates. In all areas of the research, participants complained about the loan sizes offered by microfinance programmes. Especially among the less vulnerable groups loans are viewed as too small for business expansion, therefore business earnings are only good enough to cover some household needs and barely business running costs. Some people have had to borrow from informal lenders at 20% monthly interest because MFIs would not provide them with the amounts needed. Conversely, if the loan was too large, they were faced with repayment problems.
- Interest rate** - All groups reported that if loan size and term were appropriate with flexible guarantees, paying more interest would not be an issue. Most groups were aware that they did not fit the conditions to be eligible for low interest loans, what they wanted was first and foremost access.

Figure 6: Importance of Credit Product Attributes



individuals. Certainly one of the biggest tragedies of this war has been the consequences of the displacement. However, because of its complexity linked to housing titles and local politics, relatively little was done ultimately in terms of housing reconstruction if one compares it to expectations. This has obviously been a huge blow to the population there who still suffers from it. One can imagine MFIs facilitating provision of housing grants in partnerships with local NGOs. If good targeting policies were in place it would benefit the most vulnerable households.

The other solution is for MFIs to provide housing credit services to less vulnerable households. This should help them manage their household budget, limiting the risks of undermining their micro-enterprise performance. It seems reasonable to claim that they would be able to repay the loan and benefit from a full-cost product. These households would have liked these loans to be tailored to their needs, including buying land, renovating a house, improving the home, etc. – with relevant loan sizes ranging from 4,000-12,000 KM for a three to five year period and monthly instalments of 200 KM<sup>31</sup>.

It is important to note that in all areas visited during the qualitative research, respondents mentioned that seven years after the war, ensuring housing is still one of the most important needs and that for the most part there is no accessible housing credit. Therefore, there is clearly an untapped market for this type of product today.

#### Smoothing Basic Needs Expenses

Difficulties linked to health payments and utility bills were associated in urban areas with increased financial pressure. There was a need for consumer lending since in case of health crisis or other emergencies, people often resorted to moneylenders paying them high interest rates. Respondents report how useful these consumer loans could have been and still could be at certain times of the year and for specific purchases such as buying wood for heating in the winter time<sup>32</sup>.

#### Box 3:

Vhidin has had five loans with an MFI. He has always paid on time. Now he is experiencing problems with loan repayment due to increased competition from other fast food restaurants in Lukavac. While he reports that he used 50 per cent of his business earnings to renovate his house and another 30 per cent for basic household expenses, the MFI's loan officer reports that he used a part of the last loan directly for renovation of the house. Vhidin says that he would like to get a housing loan over five years for 20,000 KM. He does report however that when he started with the MFI, he would not have needed any other type of loan and that his business was the priority.

Suada is displaced in Lukavac, her house in the village Dubošnica was burned down. She experienced difficulties with her MFI loans and is no longer the MFI client. Suada's problems stem from the fact that her sales of rugs and textiles have been decreasing due to the bad local economy but also because she invested a significant amount of her business earnings into renovating her house rather than in her business. Suada admits that she overestimated her sales and kept investing more and more of her sales into the house and less and less into the business. Her husband has a steady employment and he often helped her meet her payments. She says that if she had invested her profit more wisely she would have been fine with her business and with the loan repayment.

Zuhdija has a bookkeeping agency. He ran into difficulties when he used a part of his business surplus for his house. At the time he would have taken a housing loan if it had been available. Zuhdija got into financial difficulty when he incurred more debt from a friend who installed windows and doors for him and he could not repay everything. However, now looking back Zuhdija says that he realises that it was more important to take a business loan since he would have had no way of repaying a housing loan.

<sup>31</sup> In the entire country, only Prizma offers housing loans in addition to its micro-enterprise product. Other MFIs argue that offering non-business loans is against the recent MFI law. The question of whether or not it is institutionally feasible to start providing housing credit services from the very beginning rests unanswered.

<sup>32</sup> Prizma has been the only MFI to be offering such loans since 2001. However, Prizma's loan parameters in no way compare to the conditions requested by study participants in that its consumer loans are usually very short-term (maximum six months) and for very small amounts (500 KM). Other Bosnian MFIs started to provide consumer loans in 2003.

In accordance with the rural-urban difference noted in terms of the nature of risks presented earlier in this paper, rural households did not put as much emphasis on consumer loans during the reconstruction phase as in urban areas. Their perception was to pay for these costs from business earnings rather than to accumulate debt.

### **Business Development Services**

All respondents in Tuzla, Derventa, Bratunac and Lukavac agreed throughout the course of this research that support in business development services (BDS) would have been very important after the conflict. Support in creating market linkages, starting innovative businesses and gaining the appropriate skills to prevent crises was viewed as essential after the war. When MFIs started operating in the Federation, then in the Serb Republic, none of them focused on BDS, but rather followed the minimalist credit-only approach. A few programmes were offering free business training, but mostly as collateral and a condition for getting a loan. There was no real study of the market or support by business people in helping identify market needs.

Regardless of the area, client status and vulnerability or enterprise level, clients recognised the importance of BDS services but there was no unanimous willingness to pay for them. In fact, participants either reported that they would not be willing to pay for this, or that they would be able to pay a maximum of 50 KM and that it could be paid out of the business loan. They all said that the amount that would be paid for should be tailored to the type of business, hence making pricing complex, diverse and prone to claims of lack of fairness. Among the individuals who thought that they would not have paid for these services, most of them argued that at the time, the priority was to pay for food and education, therefore they would have welcomed advice but only for free.

### **Facilitating Market Linkages**

Regardless of the location, respondents reported that between 1995 and 1998, this support would have been of utmost importance. Markets were flooded with goods after the war; many people were producing bread or raising cows or chickens but did not know where to sell their goods given the large level of available supply and market saturation. Many refugees were selling imported clothes and had to sell them for very small margins due to high competition. Focus groups participants said that in addition to problems related to the conflict, with any kind of business start-up, it takes over one year to understand the market dynamics related to any sector. Helping create market connections and understanding these dynamics can significantly increase chances of success and accelerate this initiation period.

### **Training in Business Skills**

*“what’s the point of starting a business if chances are that it is going to fail?”*

Respondents widely recognised the fact that gaining skills in a specific business after the war was important. In particular, they would have welcomed support not only with starting a specific business, but also with determining what type of business to start. Prior to the war, some companies offered seminars, and the organisation Amika was offering courses for free, which was much appreciated.

## Conclusion

Especially in rural areas many people were forced to start new businesses for which they had no experience prior to the war, or were faced with high competition and were selling their products at very low margins to the food processing factories. Very importantly, rural households mentioned that in agriculture it is especially important to follow technology and to obtain technical assistance so as to be able to develop a business plan, minimise risks and put aside profit from the business.

Micro-enterprise credit has stimulated household reconstruction in BiH because it has provided a relatively efficient and lasting coping mechanism given a limited range of available household risk protection and management strategies existing in BiH. For most clients, micro-enterprise credit has helped sustain household self-employment. Income generated from micro-enterprise was perceived as the most efficient coping mechanism among conflict-affected households so as to fulfil some of the most important household needs over the reconstruction period. It is unquestionable that the financial success of building sustainable microfinance institutions has been due to the implementation of a structured and standardised minimalist approach. MFI practitioners and policy designers did excellent work in BiH in applying microfinance best practices as of the mid-1990s. MFIs in BiH for the most part were completely new to microfinance and had to learn all practices from scratch, which was made possible only by streamlining service delivery and offerings at the beginning. It is very important to note that they managed to incorporate some of the reconstruction principles in their actions, such as ethnic impartiality or working with displaced populations. Additionally, the main principles of micro-enterprise lending seemed to be valid in post-conflict areas as well. Evidence is provided by the analysis of preferences for credit product design. Microfinance clients value access to high quality services and are ready to pay full price for them.

However, on the basis of the results presented in this paper, it appears that microfinance and related services could play a more substantial role in household reconstruction in post-conflict areas. A thorough analysis of household needs indicates that in BiH there is a significant need for other credit and business development services. Therefore, this paper claims that there is a need for a more integrated approach in post-conflict settings. It puts at stake reaching high profits in the short-term but seems to provide reasonable social returns over the entire reconstruction period and does not preclude the development of a strong sustainable microfinance sector in the longer term. This is only possible with a microfinance development policy framework that balances financial and social returns over a longer period of time. Given that each conflict and subsequent reconstruction is very specific, the elements of this package will slightly differ across settings depending on the critical, priority needs to be satisfied.

## Reflections For Further Discussion

Given that microfinance is still a young and fast learning industry and this research is one of the first to explore the impact of minimalist micro-enterprise credit on household reconstruction, it inspires to put forward the following propositions to be tested in other post-conflict settings in order to widen the pool of microfinance recipients and consequently the impact of microfinance on household reconstruction.

### **Implementation as soon as pre-conditions are met in both urban and rural areas**

The case of BiH shows that conflict-affected households needed credit services immediately after the war. This paper argues that as soon as necessary pre-conditions for microfinance services delivery are in place (Nagarajan 1997, Doyle 1998, Adison 2000) there is a need for immediate implementation preceded by a thorough research to design the right package. This is a crucial consideration for other post-conflict countries where some essential conditions already exist, as observed in certain parts of Afghanistan, for example. As more and more rural microfinance best practices are available<sup>33</sup> it is reasonable to claim that microfinance activities should be implemented in rural areas because the need for them exists immediately after the conflict, as the example of BiH shows.

### **Integrated approach to microfinance provision**

The BiH case shows that there is a need for a more integrated approach to the provision of microfinance services in post-conflict countries. Micro-enterprise lending played a very important role in the reconstruction process in BiH. However, there is evidence that if a wider range of services had been offered, the added value of microfinance to the reconstruction process would have been more significant. This could ensure including more vulnerable households in the microfinance programmes, retaining more prospective clients and increasing the number of clients who benefit from the services in a durable and significant way. As an example, given that ensuring housing was associated with a very high financial pressure, housing needs often jeopardised the smooth development of micro-enterprises. Housing grants or credit services would have helped households affected by conflict solve the problem and better manage their squeezed resources, therefore providing a better basis to the benefits of micro-enterprise development. Similarly, as the markets were becoming more sophisticated and regulated after the initial period of disorder, it was increasingly difficult for micro-entrepreneurs to sustain their activities. More focus on business development services, such as facilitating market linkages and training in business skills, would contribute to the strengthening of micro-enterprises for more vulnerable households, getting them back on a durable development track. In addition, it would be possible for MFIs to reduce their client desertion rates, which would also improve their sustainability figures. Global experience shows that not all additional services must be delivered by an MFI. MFIs can look for partnerships with housing finance companies, organisations disbursing housing and productive grants, BDS providers, private marketing companies, etc. Last but not least, it

<sup>33</sup> See for example <http://www.basis.wisc.edu/rfc/>.

is important to balance well institutional development and satisfaction of vulnerable households needs. There is no straightforward answer about whether MFIs should start as integrated service provider or conversely start as a minimalist programme, and build first their capacity to provide more integrated services. One obvious observation though is that the integrated approach in post-conflict settings is highly needed and should be introduced as soon as institutional capacities permit.

#### **Policy framework over a longer term that balances financial and social objectives**

There is an evident trade-off between reconstructing the financial sector and reconstructing it in a way that more effectively contributes to the household reconstruction process. The latter process requires more time. As mentioned earlier in this paper, MFIs have been very successful in financial terms, reaching their sustainability goals in three to four years, which sets very good foundations for financial sector reconstruction. However, the research provided qualitative evidence that impact of Bosnian MFIs would have been larger if a wider range of services had been integrated. This was not possible under the existing rigid policy framework for sustainability as a huge incentive was behind it: further funding and support ensuring long-term institutional sustainability. It was legitimate to see most MFIs apply strict micro-enterprise lending best practices and focus solely on enterprise lending to less vulnerable groups as it facilitated the attainment of sustainability criteria. This paper argues that if a microfinance development policy framework balancing equally financial and social goals were put in place, it would encourage MFI innovation and delivery of a wider range of necessary services, therefore increasing its added value to the household reconstruction process. The plan for financial sustainability is necessary but if the period for reaching it is extended, social returns will be higher. This kind of approach is more and more feasible, and probably was not realistic in the mid 90s, as only now is there growing documentation and interest in measuring the social performance of MFIs (Brody et al. 2003; Tulchin 2003) making it possible to include cost-effective social benchmarks.

#### **Household vulnerability as key to design customised microfinance services**

There is a need for a more thorough analysis of reconstruction needs for microfinance. Apart from a usual investigation of the market and physical and social capital destruction, household vulnerability must be taken into account. This paper argues that, especially in post-conflict settings, household vulnerability should be the main element in the design and implementation of well tailored products and services. This means gaining a thorough understanding of the various risks faced by households and the role that household assets and available coping mechanisms play in mitigating these risks. This would help design relevant microfinance services that will assist households in increasing their security in a durable manner and focusing on the priority household needs. As stated earlier, given that every conflict and reconstruction are different (Adison et al. 2000) a customised approach is needed in each case. For example, in BiH – a setting that combines transitional and post-conflict characteristics – there was an evident need for micro-enterprise lending due to rising unemployment and disintegrated social networks (Olejarova et al. 2003) resulting in limited access to informal borrowing to start a business. Conversely, Wilson (2002) summarizing the needs for microfinance in traditionally poor settings – Angola, Cambodia, Mozambique and Rwanda – concludes firmly that the biggest need was access to quick and small cash loans for non-restricted use. These differences support a claim that there is a need to conduct research at the household level analysing specificities of household vulnerability in each post-conflict setting and combining it with needs at other levels (as community, infrastructure, financial markets, etc.) in order to inform the design and composition of an optimal microfinance package.

#### **Leveraging microfinance activities on relief productive grants**

Evidently there must be a distinction between grants and loans as lack of clarity causes confusion and significant difficulties for microfinance providers (Wilson 2002). This was confirmed in BiH. MFIs should be wary of working in areas that have received significant amounts of donations. However, relatively successful transition from relief to development in rural areas in BiH shows that productive grants constitute a very important opportunity for MFIs to leverage their impact. MFIs should try to be involved at the policy level early on so as to shape future long-term programming, including design and structure of grants. Asset building grants to vulnerable households are an important pre-requisite to micro-enterprise lending as they ensure that the households are better positioned to mitigate various business fluctuations.

#### **More flexible and continued credit services for start-ups**

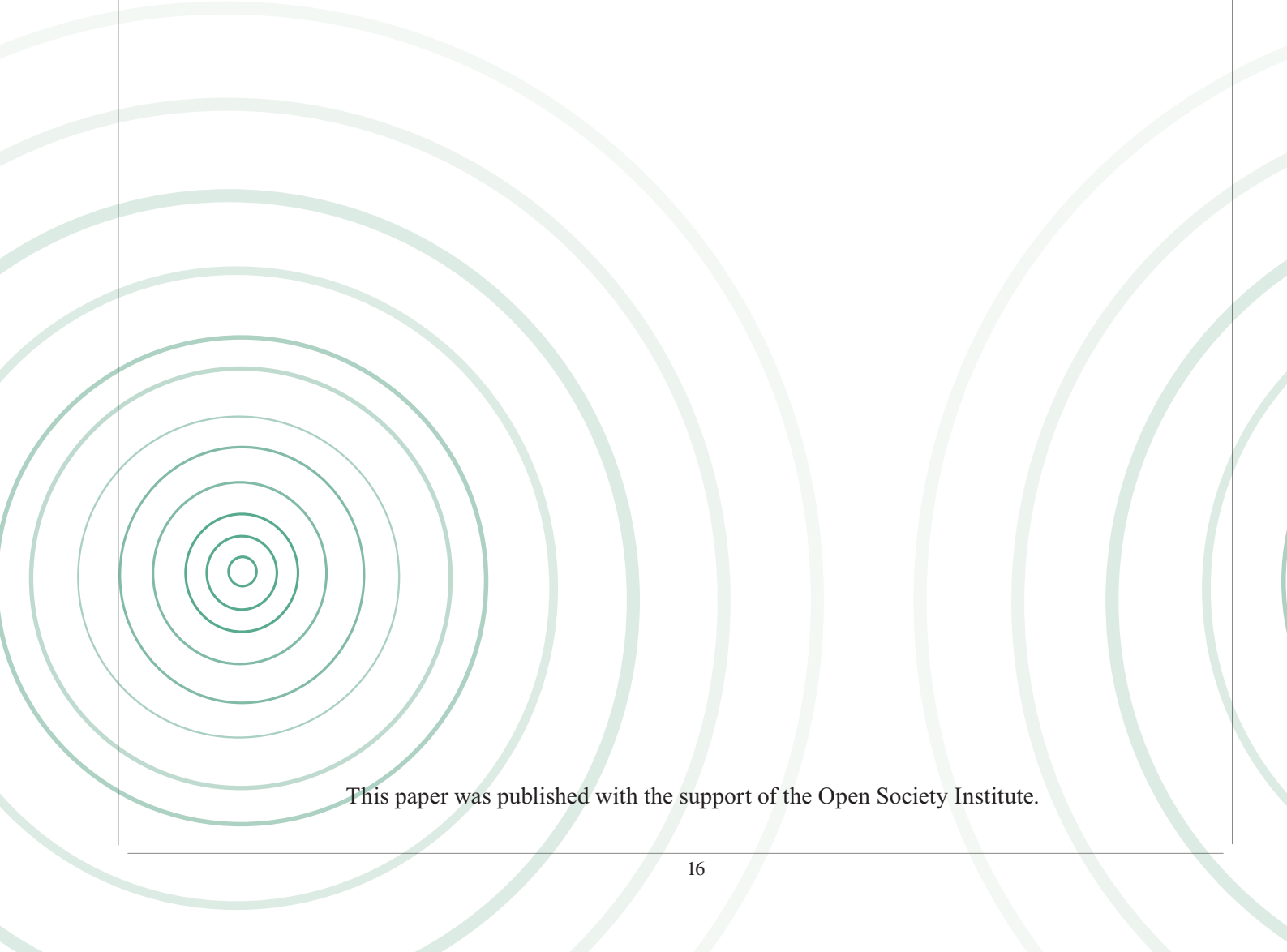
An analysis of preferences towards credit product attributes in post-conflict environment highlights that people appreciate access to flexible services. It was also confirmed by the research elsewhere in post-conflict settings (Wilson 2002). This is especially relevant for product and services to start-ups. This research has pointed out that more people would have joined the micro enterprise programmes if more tailored loans had been available. Moreover, it is often less costly and easier to launch a business just after the war in the context of a low enforcement of regulations and untapped market environment. As reconstruction starts, markets tend to become more saturated and regulations are put in place. That is why it is important to provide and improve credit and business development services for start-ups over the entire reconstruction period.

#### **Lessening guarantee requirements through solidarity group methodology and more flexible individual requirements**

In contrast to what was observed in other post-conflict settings regarding a preference for the individual lending methodology (Wilson 2002) this paper argues that the use of the solidarity group methodology is justified in BiH. Firstly, it worked well in early stages (Goronja 1999) and is still the most important business of some strong MFIs in BiH (e.g. Mi-Bospo, Mikra, Prizma). Secondly, a guarantee system was the most important attribute for MFI borrowers and non-clients regardless of location and vulnerability

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