BRIEF 3

Grants and Loans in Livelihood Restoration following a Natural Disaster

Despite concerns from some segments of the microfinance community, grants are often provided to microentrepreneurs following a natural disaster. The challenge for relief agencies and microfinance providers is to design these interventions in such a way that they contribute positively to restoration of livelihoods, without creating dependency or undermining efforts to provide market-based financial services on a sustainable basis over the long term.

Large-scale natural disasters affect microfinance clients by:

- causing severe damage to productive assets,
- disrupting local markets for their products and services.

In the absence of adequate savings or insurance, people affected by a natural disaster may use emergency loans for immediate consumption needs rather than to restart livelihood activities. Many disaster-affected people may also have outstanding debts. Supplying new loans in these situations may further destabilise their economic condition. Therefore, grants are often necessary to help people re-acquire assets required for income generation. Many relief agencies provide both in-kind and cash grants to help replace lost assets and to help with restoration of livelihoods. Grants to microentrepreneurs are indeed recommended as a core strategy in immediate post-disaster situations compared to microcredit (de Klerk, 2004; Parker and Pearse, 2001).

It is not uncommon for microfinance institutions (MFIs) to be asked to provide cash grants to their disaster-affected clients, to help them restore their livelihoods. However, many MFIs fear that the provision of grants will undermine their image as a reputable financial service provider and that it may negatively impact loan repayment discipline.

This brief focuses on grants made to microentrepreneurs, since they are the main client group of MFIs. It provides guidelines for micrograms and examines some of the effects of combined grant-and-loan products on MFIs and their clients. The overarching recommendation is that there must be deliberate and close ***coordination between relief agencies and MFIs*** to ensure effective interaction between grant and loan products.

Example:

NO COORDINATION BETWEEN RELIEF AGENCIES AND MFIs

In the wake of the Asian Tsunami, numerous relief agencies provided relatively large grants in the form of fishing boats, nets and cash. Recent evaluations of such grant programs showed that they were not very effective in creating sustainable livelihoods since they were poorly targeted,

long-running and not coordinated with microfinance organisations (Cosgrave, 2005). Cash grants and loans were available concurrently. This sent mixed signals to clients and resulted in low repayment rates, low client satisfaction and eventually loss of credit lines for many people.

For example, in Tsunami-affected Andaman and Nicobar Islands of India, SEEDS India and Cap Solidarités (France) found that communities where grants were ongoing showed less interest in credit programs compared to those areas where grants were phased out. Indeed, when an NGO started distributing grants almost one year after the Tsunami, microcredit clients openly questioned why they should repay loans when free money was available for many.

The MFI clients subsequently began delaying repayments and this severely affected the viability of the MFI. It became necessary to re-educate clients on repayment policies of the MFI (AIDMI, 2005).

Had the relief agency collaborated with the microfinance provider, it may have been possible to apply the grants to good effect without undermining the long-term provision of micro-loans.

Example:

GOOD COORDINATION BETWEEN RELIEF AGENCIES AND MFIs

On the other hand, when relief agencies and MFIs work in close coordination, sequencing loans to follow grants can be an effective strategy.

In tsunami-affected areas of Sri Lanka, a parent NGO relief organisation, Womens' Development Federation (WDF), worked with its MFI partner Janasakthi Bank to provide MFI clients with small cash grants, which were followed up with a loan. In Hambantota, Tangalle and Siribopura WDF provided funds to Janasakthi banking units to reconstruct damaged units and extend micro-credit for income-generating activities. In May 2005 clients received loans averaging $150 (LKR 15,000) from Janasakthi and a one-time cash grant of $50 (LKR 5000) from WDF to re-start their businesses. By October 2005 observers noted that many clients were running their businesses well and were starting to expand and demand new loans (World Bank, Sri Lanka, December 2005).

Similarly, on the southwestern coast of Sri Lanka a USAID funded project provided small in-kind grants through its relief partners for purchase of items such as cooking pots and other essential materials. Subsequently MFI partners arranged loans averaging US$150 for clients to buy inputs to run their microenterprises (USAID, 2005).

The success of these 'Trickle Up' programs, that provide very small grants to those that the MFIs identify as potential clients then later give grantees access to regular microfinance products through MFIs, has now been demonstrated. Trickle Up grants are appropriate for the extreme poor, women, refugees, immigrants, people living with HIV/AIDS, people living with disabilities and those affected by disasters. Many Trickle Up programs provide partner MFIs with grants that they can use to reach people that do not initially qualify for their

own programs. With help from such grants entrepreneurs can 'graduate' and qualify for the partner-agency savings and loans program, provided they have managed their business properly and contributed to their personal savings. Trickle Up has implemented some of these programs in Sri Lanka in tsunami-affected areas (Palanisamy, 2005).

Another example of coordinated distribution of cash grants using MFIs is a case from CARE Mozambique (Nagarajan, 2001). After the floods of February 2000, CARE provided one-off cash grants of average US$100 each to around 2000 families, including clients of two MFIs—Fundo de Crédito Comunitário (FCC) and Caixa Comunitária de Crédito e Poupanca (CCCP).

The MFIs approached their clients and informed them of the grants from CARE. The grants were disbursed by CARE staff. To those grant recipients that also had active loans, the MFIs offered the option of applying the grant to repay their outstanding loan balance, so they could maintain their credit line and immediately qualify for a new loan. The MFIs then provided new loans to those that had repaid their old debts. Alternatively, clients could receive the entire cash grant and reschedule the repayment of their loans over a period of time decided by the MFIs. New loans, however, were not made available until the restructured loans were repaid.

Repayment effected through the grants helped the MFIs to avoid cash-flow problems, immediately service their clients, and protect their credibility. Resumption of the loan cycle quickly helped to revive the MFI's business and, as a result, the incomes at the end of the year were not significantly different from the previous year (Nagarajan, 2001).

This approach was effective due to several factors:

Co-ordination among agencies.

CARE, FCC and CCCP worked well together, enabling an effective design and delivery of the product, and helping to avoid duplication of grants to the same recipients.

Small grant size.

There were many small grants rather than a few large grants, thus spreading their positive impact and minimising the potential for inequitable distribution.

Implicit link between grant and loans.

Although implicit, the cash grant was tied to the repayment of loans. Therefore, it was perceived less as a handout and more as a mechanism to help them continue as clients of the MFI.

Good timing.

The grants were made after the emergency stage, when markets began to emerge. Therefore, people could resume their economic activities using either the grants or new loans received after repaying previous loans.

Other assistance.

Other forms of assistance, such as building materials, food and clothing, were provided by other relief organisations. This meant that the cash grant was available to re-start economic activities. In the absence of this other assistance, the cash grants could have been diverted for consumption

purposes and the MFIs could have experienced repayment problems.

Good communication.

Frequent contact with clients and clear communication by the MFI staff before grants were disbursed was effective. The staff informed the returning clients of the possibility of a grant from an external agency that could be used to repay outstanding debt, making them immediately eligible for a larger loan to restart their business.

Immediate resumption of regular loan cycles.

The MFI avoided a liquidity squeeze because clients kept up loan repayments and helped FCC and CCCP to disburse regular loans. Client desertion was low.

Example:

BAD COORDINATION BETWEEN RELIEF AGENCIES AND MFIs

One relief agency initiated a loan-cum-grant package in partnership with a local bank, to restore livelihoods among the affected populations and to ease them from relief to recovery phase using market-based principles. The agency designed the package after conducting PRA exercises among potential recipients in June 2005.

The PRA analysis helped identify activities to support the introduction of the package and also to fix the terms of operation: total size of the package not to exceed $1000 per recipient, grant to loan ratio of 60:40; one-year loans to be repaid in monthly instalments with an annual interest of 18%. The package was provided through groups, with no collateral required except for group guarantees. Both men and women were eligible. The groups can comprise members of the same gender or can be mixed.

The relief agency provided the grants but selected a local financial institution to provide the loan component. Prior to the tsunami the financial institution typically served a broad clientele and the non performing loans were about 30–40% of its portfolio.

The loan-cum-grant program went into operation in July 2005. Members of the relief agency frequently visited the villagers and made them aware that the agency had provided the package. During their visits they monitored use of the grant component, and were gratified to observe that the majority of package recipients purchased assets to restart their livelihoods and many were operating a micro-business. While men often purchased fishing nets, small motors, transport vehicles and boats, women obtained inventories to run petty trade and to repair sewing machines etc.

An evaluation of the loan component in March 2005 showed that repayment rates were around 60%. But analysts found very little evidence of deposits at the financial institutions where the loans originated. These institutions now refuse to make follow-up loans to the package beneficiaries.

The relief agency attempted to coordinate and partner with a financial institution to make the grants and loans, but problems remained. It was a large package, and grants were used for replacing high-value assets. The grant portion of the package exceeded the loan portion. The chosen partner bank was inexperienced in making

micro-loans and maintained a poor portfolio prior to the tsunami. Members of the relief agency visiting the targeted areas inadvertently implied that the package was a grant, even though part of it was a loan. Also, failure to secure the title of the boats as collateral led to the sale of assets suitable for generating incomes.

Example:

WHAT IF SEPARATE RELIEF AND MFI AGENCIES ARE NOT AVAILABLE FOR COORDINATION?

Often many multi-service organisations providing both relief and MFI services are found to operate in disaster-affected areas. In such cases the best practice to prevent mixed signals to clients has been to use separate operational units and specialised staff to provide required services. For example, The American Refugee Committee (ARC) that operates in many conflict and disaster-affected areas provides small initial grants to refugees and IDPs in camps then later inducts recipients into regular microfinance programs. ARC operates grants separate from the MFI by using staff dedicated solely to either relief or microfinance activities, separate office spaces and individual names for the programs. They also operate in a two-step manner where loans 'follow' grants. ARC monitors grantees to determine if they have asset growth at the end of the grant period, whether a viable on-going business has been created/re-started, and whether the business is able to tap into sustainable financial services such as savings and loans after the grant period ends.

ARC learned that sequencing grants and loans encourage investment in productive assets. The agency is now attempting to provide these services in drought-affected regions of Africa and in the parts of northern Sri Lanka affected by conflicts and the tsunami (ARC, 2005, Nourse, 2004; and Nourse in an Interview with FDC researcher, 2006).

GUIDELINES FOR MFIs INVOLVED WITH CASH GRANTS FOR LIVELIHOOD RESTORATION

Grants are not suitable for all disaster situations.

Grants are less appropriate in places with frequent disaster events, areas with serious delinquency problems and regions where markets cannot return to normal for a long time, thus restricting recommencement of economic activities.

Wherever possible, provide grants through a relief partner and loans through the MFI.

Do not provide grants and loans through the same organisation unless there is no alternative. However, if there are no relief partners for the MFI, the MFI should at least separate staff and offices providing grants from those providing loans. Transitioning staff from grant makers to loan providers and vice-versa will only harm the MFI in terms of poor repayments for the loan portfolio.

Be transparent with the criteria for selection of grant beneficiaries.

The criteria for distribution of grants should be made clear to avoid conflicts within the community.

For example, many MFIs only include those that microcredit cannot serve at that time. These may comprise active and non-active clients that are temporarily displaced and severely affected.

Some MFIs let local communities help identify the beneficiaries to receive the grants and this advice may lead them to widows, the very poor and those that lost the most assets.

The final choice of beneficiaries in most cases, however, is determined by the fund size and magnitude of the disaster.

Provide grants only for a very short time.

As a rule of thumb, grants should be phased out once markets begin to revive and ceased once the markets begin to function regularly.

Grants should be one-off, and there should be a 'graduation' process to market-based mechanisms such as microcredit.

Accompany grants with advice that this is a one-time intervention. This information should be provided prior to disbursement of grant. Do not simultaneously provide grants and loans to the same individual client.

Require beneficiary participation for asset replacements.

Some agencies in tsunami-affected areas insisted that the recipient make a cash contribution of at least 5–10 per cent of the grant value, to ensure that the entrepreneur remained committed to the proposed economic activity, and had not simply dreamt it up in response to grant availability. In highly affected areas, where funds are not available due to total loss of assets and incomes, some agencies require clients to contribute their labour to rebuild community assets.

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