

**MICROFINANCE SECTOR DEVELOPMENT  
IN SIERRA LEONE**

**- AN ASSESSMENT-**

**Peter Kooi  
John Tucker**

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## Table of Contents

	List of Abbreviations	
	Executive Summary	
A	Country Context	6
B	The development of the lower segments of the financial sector	6
C	Microfinance sector development in Sierra Leone	9
C.1	Supply of microfinance	9
C.1.1	Commercial banks	9
C.1.2	Development banks	11
C.2	Semi-formal sector and programmes	13
C.3	Informal sector	18
C.4	Wholesale finance to the sector	18
C.5	Demand for microfinance	19
C.6	Legal environment	20
C.7	Host country policy and strategy	21
C.8	Prior and ongoing assistance to the microfinance sector	22
D	Opportunities and constraints for development of microfinance sector	22
D.1	Opportunities	22
D.2	Constraints	23
E	Conclusions	24
F	Recommendations	25
Annex 1	List of Persons Interviewed	
Annex 2	List of documents & reports consulted	

## List of Abbreviations

AfDB	African Development Bank
ARC	American Refugee Committee
ARD	Association of Rural Development
BPRM	Bureau of Population, Refugees and Migration
HDI	Human Development Index
IDB	Islamic Development Bank
MDGs	Millennium Development Goals
MFI	Microfinance Institution
MIS	Management Information Systems
MODEP	Ministry of Development and Planning
NaCSA	National Commission for Social Action
NCDB	National Cooperative Development Bank
NDB	National Development Bank
NGO	Non Governmental Organization
PRIMED	Promoting Initiatives for Micro Enterprise Development
SAPA	Social Action and Poverty Alleviation Programme
SLANGO	Sierra Leone Association of NGO's
SLCB	Sierra Leone Commercial Bank
SME	Small and Medium Enterprises
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
UNHCR	United Nations High Commission for Refugees
USAID	United States Agency for International Development

## Executive Summary

Sierra Leone has a population of 5.6 million people in an area of 71,740 square kilometers. The GDP per capita is around 350 US\$ while the HDI is one of the lowest in the world. Peace returned to Sierra Leone in January 2002, after a decade of conflict. Economic growth is estimated at around 5.5 percent (2001) and inflation at around 2.2 percent (2001)

A national election was held in May 2002 and a democratic government was elected. A National Recovery Strategy was designed to address the immediate post war challenges to advance peaceful resettlement and re-integration<sup>1</sup>. Government, with technical and financial support from donors, focused on four priority areas: restoration of the state authority, rebuilding communities, peace building & human rights and the restoration of the economy. Overtime the inflation has been successfully kept low and the national currency (Leone) has been stable.

With respect to the priority area that focuses on the restoration of the economy, the Government put high emphasis on sustainable provision of financial services to poor and low income people. The Government recognized that “the country’s large informal sector has the potential to absorb huge numbers of the working population. A key policy tool to stimulate this informal sector is the sector of microfinance”<sup>2</sup>. The government recently adopted a policy that is conducive for the development of the microfinance sector.

At present, the financial sector in Sierra Leone is highly exclusive. The financial sector mostly serves the wealthy, high margin type enterprises and people with guaranteed salaries. Most commercial banks are primarily invested in treasury bills while only a limited percentage of their assets are invested in on lending to the business sector. The microfinance sector, on the other hand, is at a very nascent stage. This sector is composed of a mix of projects run by international NGOs with limited (but growing) expertise in microfinance, national NGOs that only recently focused on microfinance and other young experiments.

The volume of the present supply of financial services to micro and small businesses services is less than 10 percent of the potential customers and less than 2 percent of the potential volume of demand. It is estimated that development of the microfinance sector and downscaling of the commercial banks, which would result in developing an inclusive financial sector, would have a direct impact on at least 20 percent of the total population in terms of income and employment generation in a sustainable manner.

Experience from developing countries in developing an all-inclusive microfinance sector demonstrate that a vibrant, commercially oriented microfinance sector stimulates commercial banks to downscale their operations for strategic and longer term commercial motives. It has been demonstrated that a gradual integration of the microfinance sector into the commercial financial sector is key to building an all inclusive financial system.

Hence, it is important, at any stage of development of the microfinance sector, to identify the key constraints and opportunities in order to define joint interventions to optimally enhance the development of the microfinance sector.

In this respect the mission identified the following opportunities:

1. The potential demand is high in Sierra Leone. Most of this demand is unmet.

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<sup>1</sup> National Recovery Strategy, Sierra Leone, 2002-2003

<sup>2</sup> National Recovery Strategy, Sierra Leone, 2002-2003, page 57

2. The government is supportive of the development of a sustainable microfinance as an integral part of the financial system.
3. The present laws and regulations allow a microfinance sector to develop.
4. A diverse range of microfinance operators has emerged.
5. Many operators have a clear focus on sustainability and outreach.

The mission observed the following constraints:

1. The absence of leaders that demonstrate that microfinance is commercially viable.
2. Insufficient funding is available to build a sustainable microfinance sector.
3. The capacity of operators is limited.
4. A confusion between grants and loans at the client level.
5. Coordination among stakeholders is limited.
6. Absence of regulation to integrate microfinance in the financial system.
7. High expectations of stakeholders on rapid expansion of the microfinance industry.

The mission concludes that, at present the microfinance sector in Sierra Leone is at a nascent stage and only serves a fraction of the existing demand. Significant support is needed to build capacity, capital base and outreach of the microfinance operators. The present status of the microfinance industry and the favorable environment created by the Government provide a unique opportunity for donors to invest in microfinance sector development in Sierra Leone. Government and donors could combine their efforts based on a vision to build an inclusive financial sector where the microfinance sector develops as an integrated part of the financial system. In this scenario it is feasible that within a period of 5 to 7 year a large and self-financing microfinance industry will be built.

The mission therefore recommends that donors to make considerable funding available to potentially viable microfinance institutions and microfinance banking units for capacity building, capitalization and expansion. It is also recommended that Government and donors further the enabling environment through dissemination of best practices, improved coordination, policies and regulations that allow for rapid microfinance sector development and its integration into the financial system.

## **A. Country Context**

1. The population of Sierra Leone is estimated to be 5.6 million inhabitants, with an estimated 935,800 households. Estimates are that the informal sector accounts for at least two-thirds of the total labor force, and 70% of the urban labor force. More than half the population is under 20 years of age. Of the total population around 65 percent lives in rural areas.

2. Sierra Leone is composed of 20 ethnic groups, with Temne (30%), Mende (30%), Creole (10%) and Other (30%) making up the composition. The predominant religions are Muslim (60%), Christian (30%) and indigenous beliefs (10%). Although English is the official language, Krio serves as the lingua franca understood by 95 percent of the population.

3. Disarmament was completed in January 2002, civil authority has been gradually restored throughout the country, Presidential and Parliamentary elections were peacefully held in May 2002, and over 300,000 internally displaced persons and refugees have returned to their places of origin. The improved security situation provided through the support of UNAMSIL has facilitated the resumption of economic activities.

4. Ten years of war resulted in a decline in social indicators putting Sierra Leone at the bottom of UNDP's Human Development Index. More than 80% of the population falls below the poverty line of \$1 per day. There is, however, renewed hope that enduring peace has returned. Real GDP is estimated to have risen by 5.4 percent in 2001 and is expected to rise by 6 percent in 2002. The rate of inflation has fallen sharply from 37 percent in December 1999 to -2.9 percent in June 2002. The exchange rate is relatively stable, and interest rates have also declined in line with the fall in inflation.<sup>3</sup> The trade balance has been negative and around 200 million US\$ in 2001 and 2002. In 2002, 34 percent of total imports consisted of food products, 25 percent of mineral fuels and lubricants and 24 percent of machinery and transport equipment. Of the total exports, 89 percent consisted of diamond trade.<sup>4</sup>

## **B. The development of the lower segments of the financial sector**

5. Microfinance is a term that describes the provision of financial services to poor and low-income people and therefore the lower segments of the market. In the broadest sense, microfinance targets customers that are unserved by the existing financial systems. In practice, the average loan outstanding of virtually all microfinance institutions ranges between 50 to 250 percent of the GDP per capita. In many developing countries the financial sector does not provide financial services to the lower end of the market. The financial systems in these countries are mainly developed to exclusively provide services to the wealthiest segments in the market.

6. Developments in the microfinance industry worldwide over the past decade are encouraging as today, there is a general consensus that microfinance should be provided in a sustainable manner in order to ensure outreach and a lasting impact on poverty reduction. Moreover, in recent years, increased emphasis has been placed on microfinance institutions operating on a commercial basis. Governments have made commitments to achieve the Millennium Development Goals (MDG's), including cutting absolute poverty in half by 2015. Mobilizing the financial resources needed to meet these commitments will require a focus on the development of the microfinance sector as an

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<sup>3</sup> Government of Sierra Leone, National Micro-Finance Policy, Draft, November 9, 2002, p.4.

<sup>4</sup> Annual Report 2002, Bank of Sierra Leone

integral part of the financial sector.

7. In order to support the development of the microfinance sector<sup>5</sup> it is critical to identify the stage of maturity of the sector and the constraints or opportunities that effectively influence this development.

8. To determine the support needed to optimally stimulate the development of the microfinance sector it is useful to review how this sector has developed in countries that have a mature microfinance industry. While each country has its own unique characteristics, by and large the sector developed through certain phases, namely a start-up phase, an expansion phase, a consolidation phase and an integration phase (see figure 1).

9. In the start-up phase, semi-formal microfinance activities are introduced as experimental pilot projects. In this phase initial products are developed and tested in the market. The emphasis is to build a human resource base capable of delivering credit products that ensure good repayment. Awareness is built by clients and the public at large that micro and small business entrepreneurs can be creditworthy. Some pilot projects fail often due to low repayment while others have gradually discovered techniques that are applicable to the local context and functioning. In environments where microfinance is, initially, legally not allowed successful pilots often convince local authorities to condone the activities due to the perceived benefits for the livelihoods of poor households, employment generation and economic development.

10. In the expansion phase, successful MFI's mostly concentrate on expanding the scale of their existing operations. The success of their business model allows them to replicate their activities and to capture a large share of the potential market. Their approach is often replicated by other microfinance operators. The emphasis on this stage is on expansion of existing activities and on resource mobilization to finance the expansion. The expansion leads to economies of scale and higher efficiencies with the result that successful MFIs are increasingly able to finance their operations through income generated from interest and fees. At this stage MFIs are still subsidized by grants and soft loans to finance the expansion. The increased scale of operations requires further institutional strengthening particularly in the areas of management systems and procedures. At the end of this phase MFIs have captured a large part of the market with their existing products.

11. In the consolidation phase successful MFIs start to focus on their overall sustainability. The emphasis in the consolidation stage is on strengthening the institution as a whole. This stage is characterized by organizational formalization. Management oversight, organizational policies, procedures and systems are managed in a more formal manner. The microfinance sector also formalizes by gradually establishing generally accepted industry norms. Subsidies of donors of the sector are diminishing in order to avoid continuous subsidization of the market and market prices. As a consequence, MFIs are required to further increase their productivity, to further expand in scale and scope and to adjust their pricing policies to ensure profitability. At this stage, the penetration rate of the existing target markets has become high. Increased competition requires that products are made more flexible and demand oriented. In addition, some MFIs start venturing in markets for microfinance that have been

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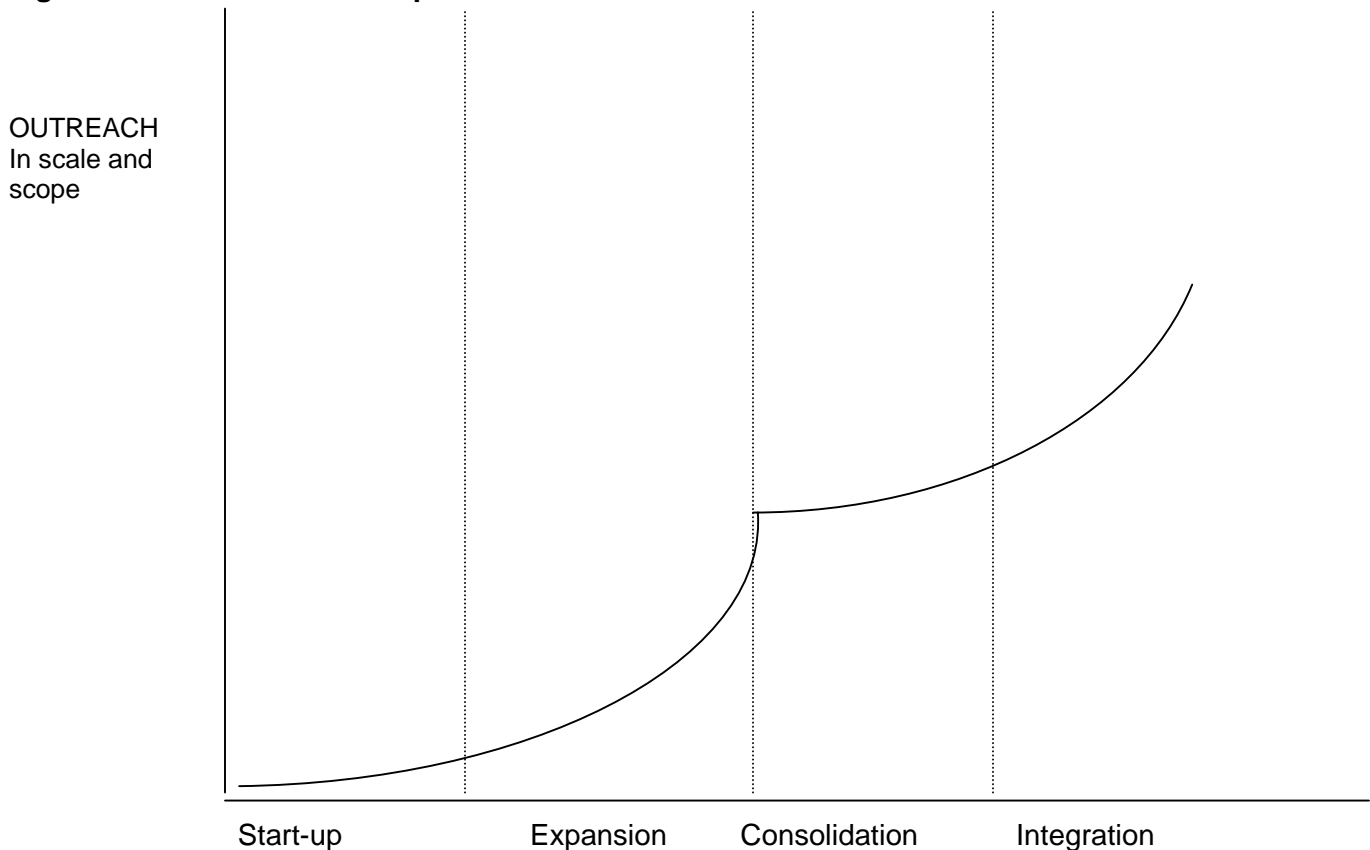
<sup>5</sup> The microfinance sector is considered a sub-sector of the financial system that is specialized in targeting the lower segments of the market. The microfinance sector is sometimes referred to as the pro-poor financial sector.

neglected. One important market is the small business sector that has no or limited access to the formal banking sector<sup>6</sup>.

12. In order for the sector to enter into the integration phase it is important that at the end of the consolidation phase a special regulatory framework is in place that is conducive to the development of the microfinance sector and allows for effective prudential regulation by the Central Bank. The development of such regulations normally takes place at the end of this phase when a critical mass of MFIs are willing and able to integrate into the formal financial system.

13. In the integration phase leading MFIs have become an integral part of the formal financial sector, regulated by the central bank and offering a range of demand oriented products for the lower segments in the market. This integration is required for the sector to be able to further finance their growth by attracting capital from commercial sources (deposits from the public, loans and equity). Instead of drawing on public funds and subsidies, these MFIs contribute to public funds by paying the taxes common to the financial sector. The integration phase is characterized by transformation of MFIs into regulated financial institutions, the disappearance of subsidies for the microfinance sector; the up-scaling of microfinance institutions and the downscaling of commercial banks that, due to an unsubsidized microfinance sector, are now able to operate on a level playing field<sup>7</sup>. Licensed MFIs continue efforts to downscale their services, especially with respect to offering savings services to the very poor.

**Figure 1. Phase in the development of the microfinance sector**



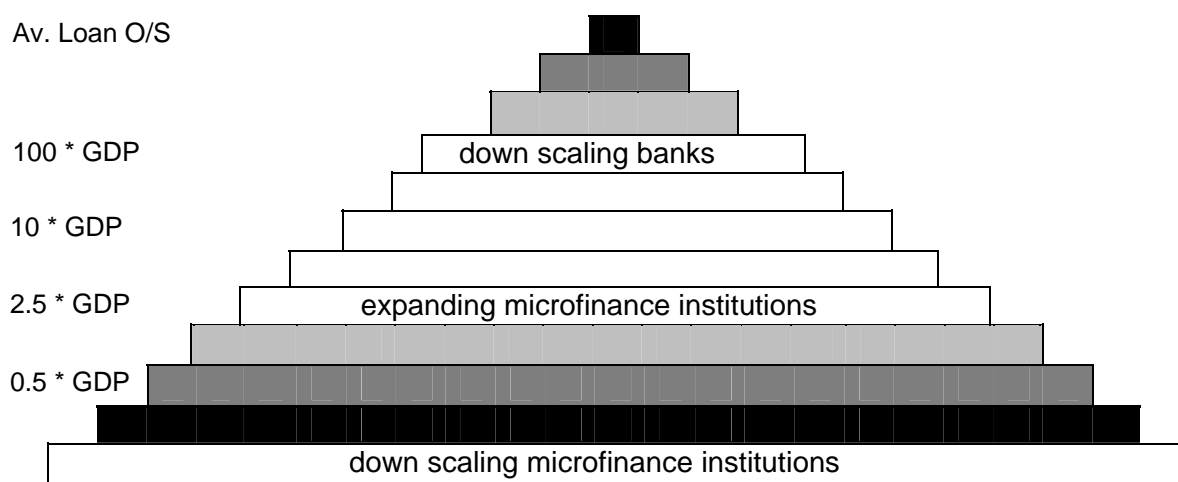
<sup>6</sup> To support access to microfinance for the small businesses often translates into job creation for poor people that prefer to be wage employed rather than to be self-employed

<sup>7</sup> See figure 2

14. Formal financial institutions will become increasingly engaged in microfinance by establishing separate banking units or other modalities to provide financial services to poor and low-income people. Unregulated microfinance operators are moving towards formalization and commercialization in order to be able to finance their growth by attracting capital from the private capital markets and deposit taking from the public.

15. There is a general consensus among key players in the field that the trend towards integrating microfinance as part of the formal financial system will continue and eventually prove dominant. It is expected that the number of commercial and regulated financial institutions that provide microfinance services will increase.

**Figure 2. Downscaling of high-end commercial banks and up-scaling of microfinance banks in the integration phase**



### C. Microfinance sector development in Sierra Leone

16. In this chapter a review is made of the nature and activities of financial services providers in Sierra Leone and their plans with respect to their involvement in microfinance. Most of the microfinance operators meet on a regular basis in the Sierra Leone Microfinance Forum, established in October 2002, to share information on a regular basis. In this chapter, estimations are made of the volume of the demand for microfinance. The present policy and regulatory environment for microfinance is reviewed. Furthermore, a brief evaluation is made of the strategy and support of the Government and donors in support of the development of the microfinance sector.

#### C.1 Supply of Microfinance

17. With respect to the providers of microfinance a study was made of the present and future role of commercial banks, development banks and government programmes, microfinance institutions or projects and the informal sector.

### **C.1.1 Commercial Banks**

18. Six commercial banks are registered and operational in Sierra Leone namely: Chartered Standard Bank, Rokel Bank, Sierra Leone Commercial Bank, Union Trust Bank, the International Bank of Sierra Leone and the Guarantee Trust Bank. The financial sector forms an important part of the formal economy and pays about 30 percent of the annual company tax collected by the Government.

19. Commercial banks provide mostly basic financial services. Most banks have invested a large part of their assets in risk free treasury bills. The banks provide credit, deposit accounts, transfer services and currency exchange services. The combined client base of the commercial banks is estimated between 60,000 – 70,000 clients. Most banks require minimum deposits for savings. Two banks provide Automated Teller Machine services to their customers. All commercial banks have branches in Freetown while some have a limited branch network elsewhere in the country. At present commercial banks are not active in microfinance although some provide loans as low as 5 million Le. Some banks expressed an interest in lending to microfinance institutions provided sufficient security is offered. The Sierra Leone Commercial Bank is the only commercial bank that is planning to engage in microfinance.

#### Sierra Leone Commercial Bank (SLCB)

20. Sierra Leone Commercial Bank was established in 1973 with the primary goal to support the development of the private sector and small businesses in particular. Currently the bank includes the informal sector as a core activity in order to contribute to the socio-economic development in Sierra Leone.

21. The bank is wholly owned by the Government but is allowed to operate as a commercial bank. The Government plans to gradually privatize the bank although it is not yet determined the percentage the government will retain as a shareholder. The total equity was Le 20 billion (US\$ 8 million) in 2002. Total assets were Le 114 billion and the profit after tax was Le 6.3 billion in 2002.

22. The Board of the bank has seven members and is composed of a farmer/politician, an international banker, two local bankers, an accountant, a lawyer and a paramount chief. The senior management is composed of four persons; the managing director, a deputy managing director, an executive director for finance and an executive director for banking.

23. The bank has 290 employees. The branch network consist of 5 branches of which 3 branches are located in and around Freetown, one branch is in Bo and another branch in Kenema. The bank provides basic banking services. In April 2003, the bank had a client base of 650 borrowers. The total portfolio outstanding is LE 15.5 billion (US\$ 6.2 million). Around 160 clients have a loan outstanding of less than LE 5 million. The bank is allowed to lend unsecured up to 10 percent of total equity. The total deposits and current accounts at the end of 2002 was Le 88 billion.

24. At present the bank is in a preparatory phase to provide microfinance services directly to customers. A study took place in 2002 to assess whether the internal capacity of the bank and the external environment was appropriate for the bank to engage in microfinance. It was recommended that the bank will start a 3 year pilot.

25. The bank plans to establish a microfinance unit in July 2003. It is expected that a group guarantee methodology will be used for groups with around 50 members. Loans ranging from US\$ 20,000 to US\$ 50,000 will be provided each group. The initial loan sizes to the individual members will range between Le 500,000 and Le 2 million. In

addition, the bank plans to provide financial services directly to MFIs and SAPA as a wholesaler.

### **C.1.2 Development banks**

26. There are two development banks, the National Development Bank (NDB) and the National Cooperative Development Bank (NCDB). Both banks are engaged in microfinance. In addition, two community banks have been established with the support of the Bank of Sierra Leone. A post office savings bank operated in the past as a major financial service provider and used to have 65 branches. At present nearly all its branches are closed.

#### National Development Bank

27. The National Development Bank was established in 1968. The bank is owned by the government for 99 percent and for 1 percent by private shareholders. The Board has 6 directors: a retired professor in agriculture (chairman), an agronomist, a retired executive of a cooperative, a politician, a mining entrepreneur and the executive director. The Bank has a total of 32 staff and two branches in Freetown, one of which is located in the head office.

28. Since 2000, the Government started a restructuring programme of the Bank. The present executive director, who retired from the Central Bank, was recruited to reorganize the bank. The main tasks were to sanitize the existing accounts, to recruit capable staff, to rationalize financial and human capital, to build capacity, to provide the necessary infrastructure and to prepare for privatization. The Bank receives technical assistance and is negotiating a line of credit from the Islamic Development Bank (IDB).

29. The bank wants to focus on providing financial services to small and medium enterprises in the formal and informal sector to help develop the SME sector. At present, however, the NBD does not provide loans to the SME sector and is predominantly involved in retail microfinance. The bank has around 1,600 active borrowers. The outstanding portfolio amounts to 130 million Le (US\$ 52,000). The loan product uses group loans with around 10 members. The loans are backed by physical security. The interest rate is 15 percent flat on three months loans paid upfront.

30. Given the severe liquidity problems of the bank, the interest income from microfinance are appreciated to help cover part of the operational costs of the NBD during the restructuring period. NBD does not plan to expand in microfinance but, instead prepares itself to target the SME sector. The NBD considers that retail microfinance does not fit with their future business model. The NBD does, however, envisage becoming active in wholesale finance to MFIs.

#### National Cooperative Development Bank (NCDB)

31. NCDB was established in 1971 as a cooperative society with a share capital of Le100,000. The bank is owned by 380 cooperative societies. The annual meeting of members provides overall guidance to NCDB. Over time, many of the cooperative societies disintegrated. Management views that about 95 percent of the cooperatives have become defunct. It is estimated that around 25 cooperatives still have activities.

32. The objective of NCDB is to provide financial services to its member cooperatives. The NCDB does not supervise the cooperatives. On a recently held annual meeting with its remaining members NCDB approved to transform the cooperative bank into a privately owned company that will specialize in microfinance. Plans are prepared to list the bank as a company and to capitalize this company.

NCDB employs 31 staff and works with mobile units in Waterloo, Tumbu and Komzige. The bank has basic policies and procedures for credit and financial administration. The administration is done manually.

33. The bank provides credit and savings services. At present, the bank has around 650 saving accounts, 1200 current accounts and around 600 loans outstanding. NCDB provides a barray<sup>8</sup> credit product. Groups are formed of 25 to 30 members. Members receive training and save for 5 weeks before becoming eligible for a loan. The loan period ranges from 3 to 12 months. The loan size of the first loan is Le 100,000 and rises with 100,000 Le for each subsequent loan. The interest on the loans is 30 percent flat per annum. Repayment of interest and principal is weekly. Members are required to continue paying weekly deposits in a group fund that is held by NCDB as a security on the loan. After all loans have been paid back the group fund is returned to the depositors.

34. Although the government does not provide direct subsidies to the NCDB anymore, the building in which NCDB is located belongs to the Government and is provided free of charge to NCDB. If NCDB transforms into a company the government will discontinue providing this implicit subsidy. NCDB has received funding support from the Government, SAPA, Action Aid and the EU rehabilitation programme

#### Community banks

35. With support of the Bank of Sierra Leone two community pilot banks have been established in two districts February 2003. The Bank of Sierra Leone plans to open an additional two community banks as a pilots. It is envisaged that after these four pilots establishment of other community banks could be supported by the National Bank of Sierra Leone on a demand basis. Communities would be required to contribute (part of) the paid-up capital required for a license.

36. Officially, the shareholders of the community bank located in Yoni are the (representatives of) the members of the community of three Chiefdoms; Yoni, Malal Marah and Mabang. The bank is registered by guarantee. The bank has been granted a banking license which included a waiver for the minimum paid up capital. At present the community members have not yet bought any of its shares but it is foreseen that, over time, community members might be willing to invest in the community bank.

37. The Board of the community bank consists of nine board members: two former bankers, a teacher, a development worker and persons who work at the Department of Presidential Affairs, the Financial Department of the Sierra Leone Roads Authority, the Council of Churches, the Ministry of Finance and the Bank of Sierra Leone. Only the BoSL staff serve on the Board as representatives of their institution. The board members were elected by fifty representatives (promoters) from the three Chiefdoms. These representatives were elected during community meetings.

38. The major objective of the community bank is to provide access to financial services to the community of three Chiefdoms. The bank expects to break even in 2008. The bank is staffed with three senior staff (a manager, a financial officer and an operations manager) and auxiliary staff. The bank is preparing a financial manual and recently finalized a credit manual. The data are processed with the software program SUN accounting system

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<sup>8</sup> A barray is a place in a village where people regularly meet to discuss issues

39. The bank provides credit, deposit services and savings services. The bank offers group loans, individual loans and institutional loans. The loan period ranges from 1 and 12 months. At present the loans to groups are 4 million Le on average. The interest is 15 percent effective per annum. The group loans are provided to groups of around 10 to 25 members. A group is required to administer loans of its individual members and bear collective responsibility for repayments. For this purpose a group has to elect a president, secretary and treasurer. In addition, each group needs a guarantor, which is often the political leader of the Chiefdom. At present the bank has 17 loans outstanding. Ten loans are provided to 10 groups with have an average of 17 members. Seven loans are provided to individuals. The total amount of loans disbursed between February 2003 and May 2003 is Le 34 million.

40. The bank provides three savings products: a current account with a minimum of 100,000 Le and an interest rate of 0 percent per annum; a savings account with a minimum deposit of 50,000 Le and an interest rate of 5 percent per annum and; a fixed deposit with minimum deposit of 500,000 and an interest rate of 6 percent per annum. At present the bank has 158 accounts. The total amount of deposits in May 2003 is 17 million Le.

41. The community bank has been fully capitalized by a 40 year loan from the National Bank of Sierra Leone with an annual interest rate of 0.75%. The loan has a ten year grace period on principle repayments and a five year grace period on interest repayment. The loan size is 800 million Le. (US\$ 320,000). This loan is used for land, a building, infrastructure, working and loan capital and treasury bills.

## **C.2 Semi-formal Sector and Programmes**

42. The landscape of microfinance operations in Sierra Leone is typical of a county that has only recently come out of a long term conflict, and comparable to post conflict situations in for instance Mozambique, Angola and Cambodia. The present capacity is basic while none of the operations are yet sustainable. The outreach of microfinance is still limited.

43. A shift has been made recently from a relief orientation towards a business like orientation with a focus on sustainability. This shift has been accelerated by the microfinance policy that has been approved by the Government (see chapter C.6). There are around 50 to 60 microfinance NGOs, projects and programmes in Sierra Leone. Most of these microfinance operations are very small and weak with an outreach of less than 200 clients. The operations with the relatively highest outreach are managed by SAPA, World Hope International, ARD, ARC, and Primed.

### **Social Action and Poverty Alleviation Programme (SAPA)**

44. The Social Action and Poverty Alleviation Programme (SAPA) is the microfinance window of NaCSA. NaCSA fully subsidizes the operating and capacity building costs of SAPA. SAPA manages two programmes: the chiefdom programme and the NGO programme. SAPA has 15 staff members. Three staff members attended a microfinance training programme at Boulder, Colorado in July 2002.

45. SAPA assumed responsibility for monitoring the Chiefdom programme in September 2001. At chiefdom level committees were formed as part of the programme. A typical Committee is composed of a paramount chief, a chief, and representatives of women, youth and elderly. The government disbursed grants to 149 Chiefdom Micro-credit Committees. Each committee received an amount ranging from Le 9,000,000 (US\$ 4,500) to Le 23,000,000 (US\$ 11,500). Loans are provided to individuals selected

by the committee. The loan size provided by the Committee started at Le 100,000 (US\$ 400) and had a loan period of 9 months. The interest rate is 15 percent for the loan period. Repayments are made at regular intervals, often monthly, in equal installments. To encourage good repayments, committees select loan collectors that receive a stipend for monitoring repayments and default management. SAPA employs twelve loan monitors to monitor the programme and to provide support to loan collection and record keeping.

46. Records of SAPA indicate that around 30,000 loans have been disbursed in 2001 and 2002. In 2003 between 5,000 and 10,000 loans were disbursed. It is estimated that the programme has weak performance in at least 2/3 of the chiefdoms. SAPA estimates that around 50 committees report a repayment of more than 85 percent. SAPA plans to continue to monitor and support these 50 committees.

47. SAPA started the NGO programme in September 1998. SAPA provides loans to 50 NGOs for the purpose of on-lending to individuals or groups. SAPA has developed strict guidelines on the use of loans which includes the terms under which the loans can be on-lent.

48. NGOs have to adhere to the following terms. Loan periods are between three and six months for first loans and can increase to nine months for subsequent loans. Loans sizes start at Le 100,000 (US\$ 40) and Le 100,000 more for each following cycle. Repayments of principal and interest should occur at least once per month. The interest rate is 15 percent flat on the loan size irrespective of the loan period. The principal and interest received should be reimbursed to SAPA upon collection in full. Once the total principal of the loan and interest has been disbursed the NGO can request for a second loan. The NGO bears the credit risk. The NGO receives an administrative fee for its services of 7.5 percent on the principal of the loan. Given these conditions, the effective interest rate per annum of a three months loan from SAPA to an NGO is around 45 percent. From its inception the NGO programme disbursed Le 710 million until April 2003 to microfinance NGOs for onlending. An amount of Le 1.376 million has been paid back to the programme by the NGOs.

49. This scheme effectively makes SAPA a government run retail MFI with NGOs as semi-autonomous branches given that SAPA determines the interest rates and loan terms of the NGOs. The structure of SAPA, however, is not suited to function as a head office of an MFI. In addition, the present national microfinance policy prohibits Government from being directly involved in retail microfinance. SAPA's operations do have characteristics of a wholesaler. If, however, SAPA would assume a wholesale function it would not be allowed to enforce interest rate ceilings or product methodologies given the present policy on microfinance. As a wholesaler it would also be questionable whether the donors of NaCSA would appreciate that the effective interest rate of a three months loan from SAPA to an NGO is around 45 percent per annum. The management of SAPA recognizes that the recently approved national policy on microfinance has an impact on the present procedures and already is preparing measures to address these issues.

50. At present the financial situation of SAPA is sufficient to continue. The ADB is in the process of renewing continued subsidies for the operational costs of SAPA (US\$ 200,000 per year) while a large budget is available for technical assistance and training. Although it has not yet been decided whether additional capital will be granted to SAPA for onlending to NGOs, the management estimates that the present scheme will increase the capital base of SAPA to around one million US\$ at the end of 2003. SAPA plans to continue providing training and technical assistance to NGOs for which a fee will be charged. SAPA also plans to be more active in information sharing, facilitating coordination, and surveys.

## Association of Rural Development (ARD)

51. ARD was established in 1986 and started operations in 1989. ARD is registered as an NGO and a member of the Sierra Leone Association of NGO's (SLANGO). ARD is also a member and one of the founders of the Microfinance Forum. The NGO is a well known microfinance institution in Sierra Leone.

52. The Board of ARD is composed of 7 members. The chairman is a secretary general of the council of churches. The other members are the Bishop of Kenema, a nutritionist, a banker, the paramount chief of Makini, a development practitioner and the Executive Director of ARD. The Board convenes twice a year and has a main responsibility to guide the overall policy. In practice, the Board functions as an advisory body.

53. ARD used to operate as a multi purpose development NGO until 1998. In 1998 management took the decision to specialize as a microfinance institution. The present objective is to transform ARD into a first-class microfinance NGO that eventually will become independent of subsidies. In 2002 ARD prepared a five year business plan in which financial projections indicated that ARD will become profitable in 2005. Management and staff are committed to reform ARD into a profitable microfinance institution.

54. Management foresees that the present mandate will require that the Board needs a skill profile that is stronger in banking and finance. Management plans to strengthen its governance structure, to upgrade the capacity of staff and to develop the systems and procedures required for a well functioning microfinance institution. Management also plans to expand its client base by 15 to 25 percent per year.

55. At present, ARD has three branches: a head office in Freetown, a branch in Bo and a recently established branch in Makini. The head office is staffed with an Executive Director, a deputy, a finance manager, an MIS manager, three accountants, a data processing officer, 2 credit clerks, 3 office assistants, 2 drivers and three guards. The two field branches have a total staff of two regional managers and five loan officers. The total number of staff is 25 and is expected to be extended with an internal auditor, a legal advisor, human resource manager, an operations manager and loan supervisors.

56. ARD has a credit manual and a human resource manual. ARD does not have an accounting manual and financial policy. Its management information systems are basic and prepared manually.

57. ARD offers a group loan product. Clients have to form groups of 5 to 10 members. New members have to attend weekly meetings for three months during which they are requested to accumulate savings which are deposited in a special account. Several groups form a center that meets on a monthly basis. After three months the members are entitled to a loan of which the maximum loan size is three times their savings. The savings are held as a security on the loan. Repayments take place on a weekly, bi-weekly or monthly basis.

58. The minimum loan amount is Le 200,000 (US\$ 80) and the maximum loan amount is Le 5 million (US\$ 2,000). The loan period ranges from 3 to 1 month. The interest rate is 25 flat calculated on an annual basis and has to be paid upfront. The annual effective interest rate is 47.5 percent for a six months loan. Per April 2003, ARD has around Le 200 million outstanding (US\$ 80,000) and 1500 clients which translates into an average loan outstanding of US\$ 53.

59. ARD reported that over 2002 the total interest income was Le 94 million (US\$ 37,600). The total operational cost was Le 67 million (US\$ 26,800). ARD does not calculate its portfolio at risk. It estimates that of the 1,500 clients around 75 have late repayments. At present no loans have been written off. Funding has been provided by Christian Aid of Le 266 million (US\$ 121,000) and Le 40 million (US\$ 18,000) from the Ministry of Finance.

60. ARD is a start-up microfinance NGO. Major strengths of ARD are its committed management and staff, its clear focus on becoming a professional and profitable microfinance institution and its brand. Major weaknesses are its weak capital base and lack of liquidity, its systems and procedures and the present capacity of staff on microfinance.

#### World Hope International

61. In Sierra Leone, World Hope International is a multi-sectoral organization with programmes in health, education and microfinance. The distribution of activities is roughly 10%, 10% and 80% respectively across these sectors. World Hope International is headquartered in Springfield, Virginia in the U.S. and is registered in Sierra Leone as an International NGO since 1999. The mission of World Hope International is to bring hope and healing to people hurting. Its microfinance operations began in February 2002.

62. While World Hope International has its own governing body in the U.S., in Sierra Leone, there is an advisory body. The composition of the advisory body includes a retired professor, a lawyer, the head of a church, the treasurer of a church, the head of development for the Council of Churches, and the (Sierra Leonean) Country Director for World Hope International. World Hope International has a microenterprise coordinator who assisted the Sierra Leonean staff in the development of their initial business plan covering 2002. World Hope International has the target of reaching 5,000 active clients by the end of 2003.

63. World Hope International's Sierra Leone office is comprised entirely of Sierra Leonean staff. The microfinance operations is staffed by: a micro-credit coordinator, the head of accounts (who also services the other sectors), and twelve field staff. Eight field staff members are located in Freetown and four in Makeni. The Makeni operations commenced in October 2002. The Makeni staff members are under the supervision of the World Hope International regional head.

64. A finance manual is not finalized at present. Checks and balances are maintained through co-signature by the head of accounts and micro-credit coordinator. Accounts are still manual, although the office has numerous computers. The operations are growing beyond the currently available excel and quickbooks software. Internal audit is carried out by management, an external audit is planned for 2003. The Sierra Leonean office reports on a monthly basis to the U.S. headquarters on activities in the 3 sectors, and a journal of income/expenditures over the prior 30 days. There are normally annual visits from the U.S. to Sierra Leone, or vice-versa. The Sierra Leonean team has full responsibility to take operational decisions.

65. At present, World Hope International has 4,337 active clients (2,987 active clients in Freetown, and 1,350 in Makeni) which makes World Hope the largest microfinance operator in Sierra Leone in terms of active client base. The outstanding loan portfolio is Le 615,100,000. There are 413 groups of borrowers with a minimum of 5 and a maximum of 15 members. Clients are primarily traders. Clients must initially register with a Le 2,000 registration fee. Five percent of the loan amount must be paid by the client before loans are disbursed. First loan amount is for a minimum of Le 100,000 and

a maximum of Le 200,000. Each group member signs to guarantee the loans of other group members. Loan terms are for 120 days with an interest of 3% flat per month. At the end of each cycle, clients may increase the loan amount by 20% each step. Clients with full repayment can receive their next loan the same day final payment is paid on the previous loan. Present planning is for loan amounts to level off at Le 500,000. Clients could continue to stay in the system at that level. Payments are made daily of principle, interest and savings. Clients are encouraged to add savings (minimum of Le 500) with their daily payment to increase their guarantee toward the loan. On time repayment varies between 90-95%.

66. World Hope International started its Sierra Leone micro-credit pilot with an initial grant of U.S.\$22,000, and reports that, within a month, the credit operations were covering all of their operational costs with the exception of rent and utilities. Grants received to date total US\$200,000. World Hope's strengths include its committed management and staff, and the appeal of its loan product for market women. Its weaknesses include that its governance and institutional structure is that of the project of an international NGO. Management also notes the need to increase their capacity in microfinance and systems.

#### American Refugee Committee (ARC)

67. The American Refugee Committee (ARC) is American multi-sector relief and development organization with its head office in Minneapolis in the United States. In Sierra Leone ARC is registered as an international NGO with the Ministry of Economic Development and Planning since 2000.

68. Initially ARC managed a microfinance programme through three selected indigenous NGOs. After a brief period ARC decided to implement the microfinance programme themselves directly. Although ARC has also been active in a variety of programmes like HIV awareness and skill training, at present ARC's programme is mostly focused on microfinance.

69. ARC Sierra Leone does not have its own Board of Directors but reports directly to the ARC vice president and the ARC operations manager who are located in Minneapolis. The vice president and the operations manager do have board type functions as they have to approve the business plan prepared by ARC, its budgets and also the staffing of the expatriate management in ARC Sierra Leone. At present the microfinance component of ARC Sierra Leone is managed as a microfinance project.

70. The management has recently prepared a business plan which has been approved by its national staff during two strategic planning sessions. The branch operational plans and targets were prepared by the branch managers. The business plan envisages transforming the programme into a local institution. The name of this microfinance institution will be Finance Salone. The management is studying different options with respect to legal entity and the ownership and governance structure of the MFI like credit cooperative, a company structure or an MFI NGO. It is important to ARC management that ARC's investment and influence is secured. Management envisages a tight control for the first five years after which ARC will gradually phase out to stay with only a minority share after more ten years. It is planned that Finance Salone will register itself as a legal entity in early 2004.

71. The senior management of ARC Sierra Leone microfinance programme is composed of four expatriates: a programme manager, a financial manager, an operations manager and with technical backstopping from a global microfinance

technical advisor, based in Sierra Leone. The programme manager functions as acting general manager. ARC management has not yet recruited a local general manager of the MFI. ARC has an additional 12 auxiliary staff in its head office in Freetown.

72. ARC has a branch network of five branches. Two main branches are located in Kenema and Kambia. These branches are staffed with a branch manager, credit supervisor, five credit agents, a cashier and an administrative assistant. Three small branches are located in Freetown, Port Loko and Kailahun. These branches are staffed with a credit supervisor, two to three credit agents and cashier. The total branch staff is 24 of which 18 are credit officers. Management considers that the national staff capacity is sufficient to manage the present basic standard operations.

73. ARC processes its financial administration with an accounting software program at head office and manually at the branch level. ARC has a credit manual and an ARC manual for financial administration which has to be adapted once Finance Salone is registered. ARC is in the process of developing financial policies. The senior management conducts internal audits. The supervisors in Minneapolis conduct an external audit of ARC Sierra Leone on an annual basis.

74. ARC provides a solidarity group loan product. Loans are given to groups of 5 to 10 members. The members must conduct a business activity. The initial loan size is Le 200,000 (US\$ 80) per group member. The loan period is fixed at eight months for first loans and is increased to up to ten months on repeat loans. Loan sizes and amounts are similar for members in one group. Members are required to save 10 percent of the initial amount borrowed. The interest rate is 30 percent flat per year and 54 percent effective per annum if cash collateral is included. Repayments of principal and interest are made bi-weekly in equal installments. The group leader is responsible for on time repayments. The borrowers can withdraw their savings if they discontinue lending. In case of continuation clients cannot withdraw their savings and have to deposit an additional 10 percent of the loan amount requested for before receiving the loan. An amount of Le 500 is charged for pass books and Le 500 for the first loan application. A three half day training programme is obligatory in order to access the loans. In case of late repayment the group is charged a fee of Le 10,000.

75. The number of active clients was 2,440 at the end of April 2003, which makes ARC the second largest microfinance operator in Sierra Leone in terms of active client base. The total loan portfolio was US\$ 150,000. ARC projects that in 2007 the total number of active clients will be 15,000 with a loan portfolio outstanding of US\$ 1.5 million. The portfolio at risk of more than 30 days is 4.7 percent. In 2002, ARC had a total write off on loans of US\$ 7,000.

76. Management reports that, at present, ARC is 33 percent financially self-financing when implicit subsidies are not taken into account. The total assets amount to US\$ 438,000 of which US\$ 150,000 in loan assets, US\$ 150,000 in equipment and the remaining amount in cash. ARC has received loan funding from UNHCR for a total amount of US\$ 317,000. ARC has received US\$ 417,000 grant funding from the Bureau of Population, Refugees and Migration (BPRM) and UNHCR to cover its operational costs. A grant of US\$ 6,000 was received from the Foundation Alchemy. ARC management reported that they have funding available till the end of January 2004. At present there are no donors that have made a firm commitment to support ARC after that date. For that purpose ARC management is considering to establish a micro enterprise development fund where donors could donate their funding. This fund would be managed by the microfinance technical advisor as fund manager. The fund could potentially be a shareholder of Finance Salone.

77. ARC is a start-up microfinance project. A major strength of ARC is its growing loan portfolio, the quality of its portfolio and committed and capable staff to manage the existing product. A major weakness is that it is still a project for which financing has been arranged only till the end of January 2004. Management and national staff seem committed to localize and institutionalize operations. It is yet unclear what the governance and ownership structure will be of the planned MFI.

#### Promoting Initiatives for Micro Enterprise Development (PRIMED)

78. In 1998, the Grass Field Women's Development Association was established to provide job opportunities for women most of whom had lost their husband in the war. One of the main activities were baking, distributing and selling bread. Most of the beneficiaries demonstrated a need to have access to credit. In 2002, the Board decided to transform into a microfinance NGO called PRIMED (Promoting Initiatives for Micro Enterprise Development). PRIMED was officially registered as an NGO in January 2003.

79. PRIMED has a Board composed of three members: a lawyer, an accountant and a businesswoman. The Board convenes twice a year. The objective of PRIMED is to provide access to financial services for small scale entrepreneurs.

80. PRIMED provides group guarantee loans to individual borrowers. Initial borrowers have to attend a three day business training programme. Groups have to form a center. A group loan within a center is disbursed once a previously disbursed group loan shows good repayment.

81. The loan size for first loans is Le 100,000. The loan period ranges from 3 to 6 months with weekly equal repayments. The interest rate is 15 percent flat over the loan period. The loan terms are determined by SAPA that has provided a loan to PRIMED. In May 2003, PRIMED had 657 clients and an outstanding loan portfolio of Le 44.5 million (US\$ 17,800). Around 20 clients have repayments due of more than one week. Management expects to break even in 2003.

82. PRIMED is a start-up microfinance NGO. A major strength of PRIMED is that it has a fast growing portfolio. Financial projections demonstrate that PRIMED would become financially self-financing this year. Management and staff seem committed and capable to manage present operations. A weakness is that delinquency is increasing although this is properly addressed by staff. Another weakness is the limited capital base and the high dependency on one single lender (SAPA) and its systems and procedures. PRIMED did not receive any subsidies or grants from donors.

### **C.3 Informal Sector**

83. Sierra Leone has two indigenous financial mechanisms that provide access to credit. First, Osusu or rotating savings and credit associations (ROSCAs), are common throughout the country and serve as a mechanism for people to save for medical, bundu society, bride price, or school fees. Credit discipline is enforced by group members who may claim any part of a defaulter's assets. For example, members may cut a defaulter's rice at harvest. Given the low-income of most members, the amounts of funds mobilized by most ROSCAs are not sufficient to generate significant funds.

84. In addition, moneylenders are also found throughout the country, with the common terms of borrowing being a 2 for 1 system. Because borrowers often come for pressured reasons, paying a fine issued by the village chief, or during the hungry

season, when they may borrow a bag of rice with 2 bags due at harvest, indebtedness can rapidly build. Repayment is also strongly enforced.

#### **C.4 Wholesale Finance to the Sector**

85. At present there is no wholesaler to microfinance providers. As explained in Chapter C2, SAPA is functioning as a hybrid between a wholesaler and retail MFI. The National Development Bank and the Sierra Leone Commercial Bank both noted their intention to operate as a wholesaler to microfinance institutions. Other banks also expressed interest provided that sufficient security or guarantee is made available.

#### **C.5 Demand for Microfinance**

86. To obtain an indication of the size and volume of the potential demand for micro-credit, numerous credit officers, branch managers and general managers were asked to indicate the percentage of adults in their area of operations that would qualify for a credit. In addition, it was asked to segment this potential market in terms of loan sizes that would be requested. The outcomes of the interviews demonstrated a wide spectrum of estimations varying from 15 percent to 60 percent of the adult population (one manager ensured that 90 percent of the adults could qualify for a loan).

87. With respect to the segmentation of the potential client base there was remarkably more consensus. Differences were noted between urban areas and rural areas, the latter showing a much higher demand for loan sizes less than Le 500,000.

88. The exercise resulted in three scenarios that provide, in our view, an indication of the size and volume of the demand for micro-credit. A more conservative view is taken with respect to the potential client base. First, the assumption it taken that no more than one loan is disbursed per household. Second, a further deduction was made to adjust for the number of active borrowers as opposed to the number of potential borrowers. Third, in the assessment of the number of the potential households that would be an active borrower we have taken into consideration the experience from two countries that have a mature microfinance sector. In 2002 the number of active households that borrowed from microfinance institutions was approximately 13 percent in of the total number of households in Bolivia and 14 percent of the total number of households in Cambodia.

89. Scenario 1 assumes a national active loan portfolio that covers 12 percent of the total households. This results in a potential active client base of 90,750 households and a total active loan portfolio of Le 62 billion. (US\$ 24.8 million). Scenario 2 assumes a national active loan portfolio that covers 16 percent of the total households. This results in a potential active client base of 126,500 households and a total active loan portfolio of Le 86.6 billion. (US\$ 34.6 million). Scenario 3 assumes a national active loan portfolio that covers 20 percent of the total households. This results in a potential active client base of 159,500 households and a total active loan portfolio of Le 109.2 billion. (US\$ 43.7 million).

90. **Scenario 1.** The potential demand is 12 percent of the households which translates in 90,750 borrowing households benefiting 545,000 household members

Loan size range Le *1,000		Average Loan size LE 1,000	Loan O/s as %% of loan size	%% of total clients	Number of active clients	Loan Portfolio O/S *Le 1,000	Loan Portfolio O/S US\$
100	500	300	55%	39%	35392.5	5,839,763	2,335,905
500	1000	750	55%	33%	29947.5	12,353,344	4,941,338
1000	3000	2000	55%	19%	17242.5	18,966,750	7,586,700
3000	5000	4000	55%	5%	4537.5	9,982,500	3,993,000
5000	10000	7500	55%	4%	3630.0	14,973,750	5,989,500

<b>TOTAL</b>	<b>100%</b>	<b>90,750</b>	<b>62,116,106</b>	<b>24,846,443</b>
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91. **Scenario 2.** The potential demand is 16 percent of the households which translates in 126,500 borrowing households benefiting 759,000 household members

Loan size range Le *1,000		Average Loan size LE 1,000	Loan O/s as %% of loan size	%% of total clients	Number of active clients	Loan Portfolio O/S *Le 1,000	Loan Portfolio O/S US\$
100	500	300		55%	49335	8,140,275	3,256,110
500	1000	750	55%	33%	41745	17,219,813	6,887,925
1000	3000	2000	55%	19%	24035	26,438,500	10,575,400
3000	5000	4000	55%	5%	6325	13,915,000	5,566,000
5000	10000	7500	55%	4%	5060	20,872,500	8,349,000

<b>TOTAL</b>	<b>100%</b>	<b>126,500</b>	<b>86,586,088</b>	<b>34,634,435</b>
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92. **Scenario 3.** The potential demand is 20 percent of the households which translates in 159,500 borrowing households benefiting 957,000 household members

Loan size range Le *1,000		Average Loan size LE 1,000	Loan O/s as %% of loan size	%% of total clients	Number of active clients	Loan Portfolio O/S *Le 1,000	Loan Portfolio O/S US\$
100	500	300	55%	39%	62205	10,263,825	4,105,530
500	1000	750	55%	33%	52635	21,711,938	8,684,775
1000	3000	2000	55%	19%	30305	33,335,500	13,334,200
3000	5000	4000	55%	5%	7975	17,545,000	7,018,000
5000	10000	7500	55%	4%	6380	26,317,500	10,527,000

<b>TOTAL</b>	<b>100%</b>	<b>159,500</b>	<b>109,173,763</b>	<b>43,669,505</b>
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## C.6 Legal Environment

93. The Government embarked on a comprehensive economic reform programme in 1992. The structural reforms undertaken during 1992-97 focused generally on reducing the Government's role in the economy and improving the environment for the private

sector. Financial sector reforms were a key component of these reforms. The reforms implemented in the financial sector included the liberalization of interest rates and the elimination of directed credits and credit ceilings. Direct controls were also replaced with indirect market-based instruments of monetary control.

94. The Bank of Sierra Leone Act and the Banking Acts were revised in 2000. The Other Financial Institutions Act designed to strengthen the Bank of Sierra Leone Supervisory Authority over non-bank financial institutions was introduced in 2001. New banking regulations were also introduced and all banks are now required to maintain a capital adequacy ratio of 15 percent. The Bank of Sierra Leone is reviewing with the commercial banks, the possibility of setting up a Credit Bureau to improve the flow of information on current and potential bank customers.<sup>9</sup>

## **C.7 Host Country Policy and Strategy**

95. The Government's National Recovery Strategy (2002-03) includes microfinance as one of the four key areas of intervention for restoration of the economy, given that the 'country's large informal economy has the potential to absorb huge numbers of the working population.'<sup>10</sup> The Interim Poverty Reduction Strategy Paper stresses the importance of promoting micro-enterprises, and the extension of microfinance and banking services within the context of developing the private sector to stimulate recovery and growth.<sup>11</sup>

96. A Government Task Force<sup>12</sup> developed a National Microfinance Policy that was discussed at a National Workshop during 19-20 September 2002, and subsequently approved by Cabinet. The policy states that the past lack of guidelines has led to a tendency of 'undermining good initiatives in the sector', and acknowledges that 'the Government will therefore disengage from any direct involvement in the provision of micro-credit'<sup>13</sup>. It is thus necessary to clearly define the country's vision for the sector, and how it could 'be integrated within the mainstream national economy.' The stated vision of the policy is: "To develop and integrate micro-finance into the broader financial system and facilitate the provision of viable and sustainable micro-finance services to low income Sierra Leoneans in a transparent and accountable manner for meaningful productive activities and thereby contribute to economic growth and reduce poverty."<sup>14</sup>

97. The policy describes the following key principles': 1) Disciplined management; 2) Transparency, with donors, government, clients and public having the right to know status; 3) Reporting and accountability, with regular operational, financial and audit reports; 4) Pricing, with MFIs free to set prices reflecting the prevailing market conditions and their internal costs; 5) Delinquency control, capability for timely and full loan repayment; 6) Appropriate techniques and products, a variety of collateral substitutes and repayment incentives can be used; 7) Gender consideration, enabling the participation of women; 8) Governance, sound structures suitable to the institutional type, and largely free from government and political interference.

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<sup>9</sup> Government of Sierra Leone, National Microfinance Policy, November 9, 2002, p.5.

<sup>10</sup> National Recovery Strategy, Sierra Leone, 2002-2003, p.57.

<sup>11</sup> Interim Poverty Reduction Strategy Paper, June 2001, p.36.

<sup>12</sup> Comprised of members from the Ministry of Development and Economic Planning; Bank of Sierra Leone; Ministry of Finance; SAPA; Sierra Leone Commercial Bank; and Association for Rural Development.

<sup>13</sup> Government of Sierra Leone, National Microfinance Policy, November 9, 2002, p.10. Note, the Ministry of Finance Budget submitted to Parliament end November 2002 excluded a previous budget line for Government micro-credit.

<sup>14</sup> Ibid.

98. The strategies to realize these objectives include: 1) Market oriented financial and credit policy conducive for broadening and deepening of micro-financial services for effective and efficient functioning of the financial market; 2) Establishment of a legal framework that promotes increased intermediation; 3) Developing national capacity for sound policy review, programme design, implementation, management, supervision and monitoring; 4) Coordinating activities in the micro-finance sector in order to avoid duplication and over-subscription and enhance fair distribution of micro-finance resources available in country.<sup>15</sup>

99. In conclusion, the present legal and regulatory environment does not seem to pose any major constraints for the development of the microfinance sector for the coming years. The policy provides a sound initial framework within which microfinance can develop in Sierra Leone. The policy has been approved by Cabinet and is now considered operational. Implementation of the policy will require support, including reviewing current legislation, as well as amendments needed as the microfinance sector develops, and further constraints are identified. A Microfinance Coordinating Committee has been established as a successor of the Task Force, to monitor and operationalize the policy.

## **C.8 Prior and Ongoing Assistance to the Microfinance Sector**

100. Donor funded support to microfinance has been limited to date. The World Bank and African Development Bank supported the microfinance policy process. The World Bank provided for a consultant to carry out an initial assessment and the training of several Task Force members at the microfinance training programme in Boulder, Colorado. The African Development Bank (AfDB) contributed to the policy process through its support to the stakeholder meeting to review the draft policy. AfDB has also, through its support to the National Commission for Social Action (NaCSA), supported the SAPA programme. AfDB and SAPA are currently discussing continued support. The World Bank has made available potentially up to \$6.5 million of additional support to SAPA that would be approved on a specific request basis.

101. Various NGO-MFIs have received limited support from few donors, for example ARD (Christian Aid, U.K., Cause Canada); ARC (UNHCR and U.S.State Department). There has been no other significant donor support to microfinance. Most donor support to date has focused on recovery and resettlement. There has been very limited private sector financial (corporate or foundation donor) support to the sector to date.

## **D. Opportunities and Constraints for Development of Microfinance Sector**

### **D.1 Opportunities**

#### High unmet demand

102. The potential demand is high in Sierra Leone. The indicative estimates of Chapter C illustrate that there is a large gap between the demand and supply of credit for micro and small business activities. Entrepreneurial activities are wide spread and microfinance has been an inherent part of the Sierra Leone local culture through widespread ROSCA's and traditional money lenders.

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<sup>15</sup> Government of Sierra Leone, National Microfinance Policy, November 9, 2002, p.4.

### Supportive government

103. Poverty alleviation, private sector development and employment generation are high priorities for the Government. The Government has decided to focus its support on establishing an enabling environment for the development of a financial sector that also provides access to financial services for the poor and low-income people. For this purpose, the Government has recently adopted a national policy on microfinance. This policy provides a framework which is conducive for the development of the microfinance sector and its integration into the commercial financial sector. The Government has decided to refrain from engaging in retail microfinance.

### Liberalized financial system

104. The legal and regulatory framework is conducive for a microfinance industry to emerge and expand. Microfinance operators are allowed to operate under different legal forms. It is, for instance, not complicated to establish a microfinance NGO. Collection of cash collateral from clients is allowed. Interest rates are liberalized. The Bank of Sierra Leone is supportive of developing an inclusive commercial financial system.

### A diverse range of microfinance operators has emerged

105. In a short period around sixty players have emerged in the field of microfinance. Most of these operators are very small NGOs that recently entered the area of microfinance. Some of the operators transformed from multi purpose NGOs into microfinance NGOs. One commercial bank has started to establish a microfinance unit. Four pilot community banks are being established.

### Many operators have a clear focus on sustainability and outreach

106. Although operators are still small in size and require additional investments, many expressed a strong commitment to manage their organization as a business with the longer term objective to become independent of subsidies.

## **D.2 Constraints**

### Absence of leaders that demonstrate that microfinance is commercially viable

107. At present, none of the microfinance operators is commercially viable. Virtually all operators use product methodologies developed in other countries which are not yet fully adapted to the market realities of Sierra Leone. International experience shows that the emergence of market leaders that demonstrate commercial viability and substantial scale is essential for a rapid expansion of the microfinance sector. These leaders function as role models for peers by having demonstrated that customers at the lower end of the market are bankable. At present such leaders have not yet emerged in Sierra Leone.

### Insufficient funding is available to build a sustainable microfinance sector

108. A major constraint is the lack of funding needed by microfinance operators to professionalize and expand their operations. Only SAPA and a few other minor donors provide limited funding. Most of these donors have not yet adapted their policies in line with the national policy on microfinance as recently approved by the Government. Most major donors have concentrated their programmes on relief, rehabilitation and reintegration. Microfinance operators need financing for expansion, infrastructure and capacity building in order to be able to reach sustainability.

109. In the start-up and emerging phase, donors often provide grants and soft loans to help build the capacity of microfinance operations. Investment in the start-up phase is normally more risky than in later phases because of the absence of microfinance institutions that have a proven track record to be able to successfully target the lower segments of the market.

#### Capacity of operators and support infrastructure is limited

110. As is common in the start-up phase of the development of the microfinance sector, the institutional, managerial, technical and financial capacities of all operators are at the early stages of development. The present capacity of operators is insufficient to allow for a considerable expansion of their operations. The Boards of virtually all operators have limited familiarity with microfinance. Virtually all staff have had limited exposure to operations of professional MFIs. In addition the supportive infrastructure for microfinance is weak at present. In addition, the capacity in microfinance is limited with most (potential) stakeholders. "Capacity building of institutions and individuals in the sector is by far the most pressing and needed intervention given the developmental stage of the sector"<sup>16</sup>.

#### Grant/loan confusion at client level

111. Virtually all microfinance operators mentioned that the market was distorted due to grant and subsidized credit programmes from government and donors. The sudden shift from grants to loans is difficult to understand for some people. Time will be needed to shift people's perception from charity reliance to self reliance.

#### Coordination among stakeholders is limited

112. Despite the limited number of donors, the lack of coordination is perceived as a constraint. Some donors do not adhere to internationally accepted best practices in microfinance by setting interest rate ceilings, providing highly subsidized interest rates and by exclusively targeting customers with predefined common characteristics. At present there is no professional and permanent focal unit for microfinance in the Bank of Sierra Leone to ensure inclusive financial sector development. A lack of standards and transparency also hampers coordination.

#### Absence of regulation to integrate microfinance in the financial system

113. Given the early stages of the development of the microfinance sector, this is not an immediate constraint. However, over time when the microfinance sector matures, it is important that regulations are formulated that stipulate the prudential and licensing requirements. These regulations would take into account the unique characteristics of microfinance and would allow further integration of the microfinance sector into the commercial and regulated financial sector.

#### High expectations

114. Many stakeholders viewed as a potential constraint the high expectations at government level with respect to a rapid expansion of microfinance. Clearly time is needed for the sector to build the capacity to be able to expand in a sustainable manner. Some perceived a risk that, if donors would not engage in supporting microfinance, political pressures could force the government to re-engage in microfinance, given the high priority of microfinance on the government agenda. Such development would not be

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<sup>16</sup> National Policy of the Government of Sierra Leone, page 20

in line with the present national policy on microfinance and would not be conducive for the development of a sustainable microfinance sector.

## **E. Conclusions**

115. At present the microfinance sector in Sierra Leone is at a nascent stage. The financial sector is mainly developed to cater to the higher segments in the market and salaried people. Over the past three years numerous operations have started to venture into the microfinance sector. The present supply of microfinance services only reaches a fraction of the total demand. The more advanced operators expressed a strong commitment to become sustainable and to increase their outreach considerably.

116. It is estimated that the demand for credit for productive purposes ranges between 90,000 and 160,000 customers with a combined loan volume ranging from US\$ 24.8 to 43.5 million. The present supply reaches less than 10,000 customers with a combined loan portfolio of less than US\$ 500,000. Experience shows that this considerable gap between demand and supply can only be overcome by building robust and professional institutions or bank units that are specialized in providing sustainable financial services to the lower segments of the market.

117. The nascent microfinance industry is in need of considerable support to build their capacity, capital base and plans for expansion. At present the industry is fully dependent on subsidies. At this stage many of the operations would probably not survive without additional investments. This situation is common in the start-up phase of microfinance sector development. Many operators have adopted a business like approach and are committed to reach profitability and scale.

118. The Government of Sierra Leone recognizes the importance of microfinance as an effective tool to fight poverty among the economically active poor. The Government gives high importance to the development of a self-reliant microfinance sector. With the government approval of the national policy on microfinance, the stage has been set for the microfinance sector to develop. The policy strongly advocates adherence to sound microfinance principles with the objective to eventually integrate microfinance into the commercial financial sector. The policy is built on the experience that unsustainable microfinance programmes distort the market and undermine the emergence of a sustainable microfinance industry. The present legal and regulatory framework is conducive for the microfinance industry to develop and expand.

119. Some important constraints for the development of the microfinance industry are not yet addressed. The capacity of microfinance operators needs to be enhanced considerably. Significant funding would be required to create sustainable microfinance institutions with a large outreach. Such funding would be needed for building capacity and financing an expansion of the customer base. Measures should be taken to ensure optimal coordination among stakeholders in order to effectively advance the microfinance sector.

120. At present three scenarios are conceivable. In the first scenario the above mentioned constraints are not addressed and the microfinance sector will remain in the start-up phase. A second scenario is that donors go alone without much coordination and provide modest support to selected microfinance institutions. In this scenario the development of the microfinance sector will be slow and will not contribute in a considerable manner to poverty alleviation and economic development. In both scenarios the risk is prevalent that political pressure will force the Government to abandon its well designed policy on microfinance and to resume direct provision of microfinance.

121. In the third scenario the constraints are addressed. Government and donors combine their efforts with a vision to build an inclusive financial sector whereby the microfinance sector develops as an integrated part of the financial system. In this scenario it is feasible that within a period of 5 to 7 years a large and self-financing microfinance industry will be built from scratch.

## **F. Recommendations**

122. It is recommended that donors make considerable funding available to potentially viable microfinance institutions and microfinance banking units for capacity building, capitalization and expansion. It is recommended that programmes are designed for joint donor support to ensure collaboration and aid effectiveness.

123. It is recommended that Government and donors further strengthen the enabling environment through dissemination of best practices, improved coordination, policies and regulations that allow for rapid microfinance sector development and its integration into the financial system.

124. It is recommended that the Bank of Sierra Leone establishes a microfinance unit to ensure an optimal development of the microfinance sector as an integrated part of the financial sector. This unit would function as a permanent focal point for microfinance and will establish a databank on microfinance activities, will set standards to ensure transparency, will provide advice to policy makers and regulators, establish audit procedures and will draft and monitor regulation in collaboration with major microfinance operators.

125. It is recommended that NGOs and Programmes that are involved in microfinance will need to be registered as a microfinance provider with the Ministry of Development and Planning. It is recommended that the entry level to receive such registration will be low in order to allow for an optimal development of the microfinance sector.

126. A simple form could be designed for registration purposes, whereby the management and (if applicable) donors of the microfinance provider declare that, to the best of their knowledge, their activities in microfinance will be in line with the Government's policy on microfinance. Microfinance providers could forward the following basic information at the end of each year to MODEP: 1) Number of active borrowers; 2) Active loan portfolio outstanding; 3) Total number of clients with payments due of more than one month; 4) Number of active depositors; 5) Total deposits outstanding; 6) Total interest income; 7) Total operational costs. The mission sees no need for MODEP to verify whether the information provided is correct. Instead the mission recommends that the above information will be made public to further enhance the self-regulatory pressure on microfinance providers and their donors.

127. It is recommended that institutions that report to the Bank of Sierra Leone and that are involved in microfinance activities provide the information needed as required by the Bank of Sierra Leone.

128. It is recommended that the Microfinance Coordinating Committee, that is responsible for monitoring the national microfinance policy, promotes transparency of all donor and government subsidized programmes and institutions. It is recommended that both the Bank of Sierra Leone and MODEP report to the Committee based on the information received from microfinance providers on a yearly basis. It is recommended that the Committee coordinates efforts to address potential constraints for the

development of the microfinance sector. It is recommended that the Committee publicizes its findings on a regular basis.

129. It is recommended that SAPA reviews its present policies and procedures in order to adapt to the recently approved national policy on microfinance and to ensure optimal support to the development of the microfinance sector. It is therefore recommended that SAPA abolishes its present policy to fix the product methodology and pricing of the microfinance providers that borrow funding from SAPA. Instead it is recommended that SAPA allows microfinance providers to decide on their own product methodologies and pricing. It is recommended that SAPA considers its role as a wholesale programme to the microfinance providers. It is recommended that SAPA, as a wholesaler, continues to provide basic training for start-up microfinance providers and new entrants.

### List of Persons Interviewed

Vandi Abu, Branch Manager, ARC, Kambia

Jonathon Andrews, Programme Officer, UNHCR

Alimamy Bangura, Senior Economist, Economic Policy and Research Unit, Ministry of Finance

Ms. Kenyeh Barlay, Director, Social Action & Poverty Alleviation (SAPA Programme) National Commission for Social Action (NaCSA)

Agnes Bassie, Credit Supervisor, Freetown

Mr. Serge Beaudry, Program Manager, ARC

Rahman S. Bureh, Loans Officer, Yoni Community Bank, Mile 91

Ian Byram, European Union, Delegation of the European Commission

Alphonso Campbell, MSSP Expert, Social Action & Poverty Alleviation (SAPA Programme) National Commission for Social Action (NaCSA)

Shirlene Carew, Director, PRIMED, Promoting Initiatives for Micro-enterprises Development

Victor Keith Cole, Director – Business Development, Rokel Commercial Bank

Michael A. Collier, Advances Director – Head Office, Rokel Commercial Bank

John G. Connelly, Country Representative, World Relief

Hassan Conteh, Credit Officer, Social Action & Poverty Alleviation (SAPA Programme) National Commission for Social Action (NaCSA)

Sulay Conteh, Accountant, World Hope International

Mr. Bertrand Coppens, Deputy Resident Representative, UNDP

Chrispin B. Deigh, Operations Director, Sierra Leone Commercial Bank Limited

Jefferson Dincharley, Branch Manager, ARC, Port Loko

Christian Dorner, Project Manager, Financial Markets, Sub-Saharan Africa, KfW (in Frankfurt)

Mr. Alan Doss, Resident Representative, UNDP

Karl-Heinz Flesichhacker, Vice President, Finance, Sub-Saharan Africa, KfW (in Frankfurt)

Mr. Fofaneh, ARD, Makeni Branch Manager

Alie B. Forna, Executive Director, Association for Rural Development

Mary Gutmann, Country Director, ARC

Miriam Houtert, UNHCR, Geneva

Daniel Kamara, Senior Banking Officer, Bank of Sierra Leone

David Kamara, Credit Manager, Association for Rural Development

Ibrahim S. Kamara, Poverty Programme Specialist, UNDP

Mr. Kangetchu, Banking Department, Bank of Sierra Leone

S.D. Kanu, Country Director, World Hope International

Momodu L. Kargbo, National Co-Operative Development Bank, Ltd

Mabel N.S. Kartusche, National Organization for Women

Andrew Kutubu, Branch Manager, ARC, Kenema

Julie Koenen-Grant, Country Program Manager, USAID

Mr. D.O. Kormoi, Supervision Department, Bank of Sierra Leone

Idriss Koroma, Association for Rural Development

James Romeo Koroma, Ministry of Development and Economic Planning

Konah C. Koroma, Development Secretary, Ministry of Development and Economic Planning

Albert Lamin, Sierra Leone Commercial Bank

I.K. Lamin, Director, Banking Department, Bank of Sierra Leone

Bengt Ljunggren, Senior Programme Advisor, UNDP

Isatta K. Mansaray, Branch Manager, ARC, Kailahun

William N. Massaquoi, Program Director, World Relief

Sao-Kpato Max-Kyne, Poverty Expert (PRSP/PASCO), MODEP

Simon Millet, Managing Director, Standard Charter Bank

Tim Nourse, Technical Advisor for Microfinance, ARC

Nana Pratt, National Organization for Women

Dr. J.D. Rogers, Governor, Bank of Sierra Leone

Jacob Jusu Saffa, Human Development Specialist, World Bank

Martha Saldinger, Country Director, ARC

Aliesious F. Sesay, Manager, Yoni Community Bank, Mile 91

Juliana Sidique, Sierra Leone Commercial Bank

Mrs. Esther Smith, Head, Microfinance Division, Bank of Sierra Leone

Mr. Ian Stuart, Director, DFID

Mohamed M. Turay, Managing Director, National Development Bank, Ltd.

George Gordan Younge, Microenterprise Coordinator, World Hope International

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