BEAM EXCHANGE

June 6, 2017

Financial market development in protracted crisis: beyond the humanitarian response


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Inclusive financial market development faces new and growing challenges, especially in fragility-affected regions and in protracted crisis.

On 4 May in London, one of Africa's premier investor events – African Financial Services Investor Conference (AFSIC) - hosted a session dedicated to financial sector development in frontier markets for the first time. This builds on renewed interest by FSD Africa, DFID and other donors in poverty reduction through long-term financing and capital market development (see: DFID's recent Economic Development Strategy), but also in fragility-affected states in Africa (FASA) – where the development challenges are acute, but the need is greatest.

Inclusive financial market development faces new and growing challenges, especially in fragility-affected regions and in protracted crisis. In Sub-Saharan Africa, there are 20 countries currently considered fragile in one way or another and over 19 million people that are either refugees or internally displaced. FSD Africa and Mercy Corps teamed up to produce 'Financing the Frontier: Inclusive Financial Sector Development in FASA' to provide market facilitators with practical guidance in developing inclusive financial markets in these environments.

This research represents a shift in thinking about how development actors interact with financial systems in crisis settings, taking a market systems approach.

We approached the research asking five main questions detailed below.

What and where are fragility-affected regions?

The concept of fragility is fluid and complex. While there is no standardized definition, there are characteristics that fragile regions generally display including poor governance, weak capacity and institutions, high risk of conflict and insecurity, and poverty. Taking it further, the OECD bases its understanding of fragility 'as a heightened exposure to risk combined with a low capacity to mitigate or absorb these risks.'

For the 'where' we utilized DFID's four categories of fragility. Out of 64 countries, 30 are in Africa. Many countries are dealing internal conflicts (with cross-border implications) rather than conflicts between countries. Also, the reality is that countries facing situations of fragility often do not experience clear-cut phases of 'pre' and 'post' conflict; rather they exist in a 'complex crisis' situation for protracted periods.

What is distinctive in these financial market systems?

Each context is unique but fragility does affect the sustainability of the financial market system. There are fewer formal financial providers, limited supporting functions and customer recourse, low levels of competition, and often minimal financial product innovation.

Exclusion from the formal financial sector is high. In Cameroon, Chad, DRC, Sierra Leone, Sudan, 80% of adults are excluded and over 90% in Burundi and Niger. However, mobile money account usage is actually higher, on average, in fragile countries at 11%. Remittances are critical to FASA economies with 25% of adults receiving remittances regularly compared to 14% in non-FASA countries. Credit demand is very high, especially for emergency or health purposes.

Other distinctives include: weak market incentives, high rates of informal finance, and market distortion from short-term humanitarian interventions. Transaction costs are high and finding entry points for investors can be difficult. There are also often low levels of trust between individuals and institutions.

What does this mean for market facilitators?

Documented evidence of market systems approaches in fragile regions is limited but growing. From our own experiences, and those of other development actors, we have some key lessons. Most important, we recognise that how we implement in fragile contexts is as, or more, important as what we implement. In the think piece, we detail the steps (and interaction between the steps) of a project cycle. Below are a few highlights:

- The high level strategy must be flexible reflecting 'Do No Harm' and conflict sensitivity principles recognising the financial sector can exacerbate conflict. This includes setting a future vision that is realistic to the dynamics of 'who will do' and 'who will pay' for key functions.

- The diagnostic process must include continuous analysis of conflict dynamics and the political economy and focus on specific financial services sectors rather than be too broad.

- Facilitating systemic change is difficult, even more so in fragile regions, as financial market systems are not linear with minimal evidence on the timing of financial interventions, especially where there are recurring humanitarian crises or population movements.

Practice trends: What is showing promise?

We found there is need for investments in personal ID solutions and 'fit for purpose' regulations that encourage inclusion and innovation in the financial sector. While interventions are highly context specific, we found seven promising practices for market programming:

Growing market segments -

1. Displaced populations: SSA has the world's highest rate of displaced populations – over 19 million people – which equates to 26% of the global total. In the region there has been a 29% rise in 'persons of concern' with numbers increasing due to crises in Burundi, Central African Republic, Nigeria, and South Sudan. With extensive displacement, these populations need to access finance for productive and consumption needs.

2. Islamic finance: Islamic finance is still nascent in SSA but has a formal and growing presence in 21 African countries. The expansion of Islamic finance, and especially microfinance, may have more potential to offer effective tools for improving financial inclusion.

Innovative financial delivery channels –

1. Impact investing: Development actors, through blended finance models can address the 'gap' between early-stage grant funding and later-stage commercial investments to build and strengthen pipelines of SMEs ready for investment. This allows shared-risk and financing between impact investors and development actors.

2. Payments and remittances infrastructure: Payments serve as an optimal entry point into the formal economy as well as a means to access remittances and

store money. For cross-border remittances to flow, a strong payment system is required. Current usage levels of digital payments is mixed due to lack of infrastructure and dependency on cash, both prevalent factors in fragile contexts.

Financial Products –

1. Inclusive insurance: Uninsured losses can lock people into vicious debt cycles. Several emerging insurance schemes relevant include loyalty-based mobile insurance and index insurance; and at the meso–level catastrophe insurance.

2. Liquidity and credit guarantees: These facilities can be stand-alone or with combined interventions, adapting lessons from existing programmes in non-fragile environments. Liquidity facilities serve an immediate need to stabilize, reduce losses, and ensure the resiliency of financial providers. Credit guarantees can mitigate risk for financial providers to lend to underserved businesses.

3. Diaspora investment platforms: With an estimated US$40 billion of funds held globally in diaspora savings; they are a potential source of long-term investment in fragile regions in Africa. Investment may be direct into a single business, co-investment with other diaspora members, or mutual funds. There is also the potential for shared-risk development impact bonds – especially for low-to-medium regions.

What's next?

The issues raised above provide food for thought for FSD Africa. From 2017, FSD Africa will increase the intensity of its work in fragile regions in Africa. To begin, it will focus on: the Democratic Republic of Congo, Sierra Leone and Zimbabwe. It will also prioritise two themes: forcibly displaced people and remittances. This selection reflects a combination of: a) need – where financial market failures are deepest and poverty levels highest; b) additionality – where few, similar organisations have a footprint, and c) feasibility – where FSD Africa can practically operate and has existing partners.

Mercy Corps works across 30 countries globally in market development increasingly in fragility-affected and protracted crisis markets.

Mercy Corps, FSD Africa, DFID, and BEAM Exchange hosted a webinar on financial market development in protracted crisis In June 2017. Recording and presentation available here.