



SHAPING THE “BLUE BOOK” ON BUILDING INCLUSIVE FINANCIAL SECTORS FOR DEVELOPMENT

“Food for Thought” for the three roundtable tracks

(Questions that could launch the discussions)

Round Table Track # 1: Demand and Supply Issues at the Client and Retail Institutional Levels (from Issues Clusters 1 and 2)

What Keeps (Potential) Clients from Seeking Greater Access? Why Don’t Retail Financial Institutions Serve the Poor Better?

On the demand side, we know that potential clients, meaning the bankable population, do not express demand for services from financial institutions for a number of reasons, including cultural, socio-economic and gender considerations, lack of confidence and trust in the financial organization, geographic location, their own transaction costs of accessing financial services and the lack of services corresponding to their needs. Also, many clients express demand for fewer services than they might otherwise use.

On the supply side, despite the impressive numbers of new market entrants in microfinance and SME finance, representing a wide range of institutions, including mainstream financial houses, it is recognized that expanding capacity at the retail level is one of the greatest challenges. While many financial institutions serving the poor are well run, there is a sense that management, systems and operations, risk management and performance monitoring need to be improved across the range of institutions.

Questions to Launch the Discussion

- a) Lowering cultural barriers (gender, ethnic groups, age, poverty) is a deep issue. What in your experience has reduced cultural barriers? Are there specific measures to suggest?
- b) Do the poor need “poor-friendly” institutions, i.e., institutions with which they feel a special relationship? Informal and formal institutions typically co-exist. Are there real opportunities for the formal institutions or is there something in the essence of the informal institution that makes it attractive and that the formal institution cannot duplicate?

c) International remittances are a financial activity of increasing importance (and are coming more into formal financial channels from informal ones). Is this an opportunity to bring potential customers into the formal financial institution? Is it a way to promote banking the unbanked, linking remittances to other product offerings? What are the disadvantages and advantages?

d) What are the most promising means of lowering costs to access financial services? What opportunities does technology offer today (mobile banking, ATMs, hand-held computers for loan officers/bank tellers, etc? How fast can you make decisions on loans? How effectively do you monitor clients? Might clients of small, specialized MFIs benefit as well? Could the technologies be introduced while the MFIs still struggle with implementing core information systems?

e) When do interest rates come down? What brings them down? (Entry of competing financial institutions of the same type? Entry of new types?).

f) How do differences in ownership and governance of retail financial institutions serving the poor translate into incentives or impediments for improved performance? The argument has been made that small, private domestically owned banks, as well as certain state-owned banks can hold a relative advantage due to location and their capacity to know their clients due to proximity. What is the potential of proximity banks and other social finance institutions? Are they reaching the poor with products responding to client needs? How can they best reach the “missing middle” of less poor, but finance starved, SMEs?

g) What would you like your country’s financial sector to look like? Would financial services for the poor be provided by profit seeking financial institutions? Is a further development of “double bottom line” institutions possible? What about subsidizing commercial establishments to undertake social functions? How likely are these scenarios? What would be the key actions needed in the next ten years to achieve that end state?

Round Table Track #2: Integration of Micro and SME Finance into Domestic and International Markets (Issues from Clusters 3 and 6)

Why do Institutions Not Draw More Funds From the General Economy? How do private and public international funds fit into a changing landscape?

The financial system serves to transfer financial resources from savers at home and abroad to borrowers (at home and abroad). The institutions specialized in micro and SME finance are relatively unsuccessful in participating in this general process.

Constraints to greater financial market integration include the unfavourable risk assessment of SME and micro-loan portfolios and the inability to raise funds in capital markets. When they do get such access, concerns are raised with regard to the terms of access both in domestic and international markets and the capacity of many MFIs and other financial institutions to manage the risks this access entails.

There has been extensive discussion of the range of financial relationships to better intermediate funds from the broader financial community to institutions specifically serving the poor. Bilateral and multilateral donor agencies face the challenge of positioning themselves on an evolving playing field

Questions to Launch the Discussion

- a) In some countries microfinance operates within a robust financial sector, in others within a weak financial sector. What difference does the strength or weakness of the overall financial sector make for the development of micro and SME finance? What are the specific constraints to operating in the context of a weak financial sector and how can these be overcome?

- b) The financial sector may provide opportunities for various types of linkages to micro and SME finance from agency relationships to partnerships to mergers. What have been the experiences of each type of relationship? And what lessons do you draw from this?
- c) Is the process toward the integration of micro and SME finance into formal financial sectors inevitable at this stage? Does it have to embody the marginalization of specialized MFIs that may face increased competition from bigger financial institutions?

- d) Foreign private resources provide opportunities and challenges for funding micro and SME finance institutions. A major question is who bears the exchange rate risk? Would foreign investors take on the currency risk by lending/investing in local currency? Are there relevant experiences in this regard? What measures could be taken to encourage

such a shift in who bears the foreign exchange risk? By the same token are remittances a potential source of funding? (e.g. flow of transfers, non-resident deposits)

- e) What role should donors play? Donors fund financial institutions in developing countries and financial sector policy work. Are donors putting their money in the right place? Should donors play the role of priming the pump as the commercial private sector gains experience? How can donors best contribute to increasing outreach in the most difficult market segments?

- f) What would you like your country's financial sector to look like? Would financial services for the poor be provided by profit seeking financial institutions? Is a further development of "double bottom line" institutions possible? What about subsidizing commercial establishments to undertake social functions? How likely are these scenarios? What would be the key actions needed in the next ten years to achieve that end state?

Round Table Track # 3: The Policy Environment: Government Policy and Roles, Regulation and Supervision, Financial and Legal Infrastructure (Issues from Clusters 4, 5 and 6)

What's missing in the financial and legal infrastructure and the policy, regulatory and supervisory frameworks?

Government policies, laws and regulations can constrain, or foster, the building of inclusive financial sectors, or they can serve to re-engineer the financial sector, with a focus on sustainable inclusion. “First generation” issues (macroeconomic stabilization and financial liberalization, including removal of interest rate ceilings and withdrawal of government from financial service provision), as well as enabling legislation and some regulation covering institutions offering microfinance services, still remain on the agenda. In addition, “second generation” issues focus on institutional strengthening (fine tuning of regulations, treating microfinance as an asset class and activity potentially relevant across financial institutions, improving supervision, taxation issues).

Increased attention has been given to the poor state of “financial infrastructure”, defined in this case not as physical infrastructure, but rather as information infrastructure (accounting rules, auditing, credit information), and legal and judicial infrastructure (collateral and bankruptcy laws, legal protection of creditors, and the existence of competent and impartial courts).

Questions to Launch the Discussion

- a) It seems many governments are re-thinking their role in micro and SME finance. This includes re-imposing interest rate ceilings in some countries. Did the liberalization policy fail to meet expectations? Why? What are the political pressures and economic concerns that governments face?
- b) Is there a future for government intervention? Is there a resurgence of government intervention to serve the poor? Have “*laissez-faire*” policies failed or have they never been convincingly applied? Is there a role for governments in directed lending, priority sector lending, “smart subsidies” (donor grants to commercial institutions) and government ownership of institutions offering fully priced financial services? Are there better ways to intervene with greater benefit and less distortion of market signals?

- c) What are the greatest challenges currently in terms of framing the regulatory environment? What are the regulatory issues emerging with regard to the increased integration of specialized institutions into financial markets? What political processes can be brought to bear in a country so that regulations that are adopted are appropriate, accepted and largely implemented?

- d) It appears that supervisory capacity lags behind the development of regulations, both in methodology and capacity? What are the greatest challenges in terms of applying supervisory tools to microfinance and SME finance as business lines?
 - e) What is the role of the legal environment with respect to microfinance? For example, bankruptcy laws ---is this of practical significance to microfinance institutions in their relations with clients? How should clients and the general public be assured of the transparency and accountability of the financial institutions?
 - f) What information is needed by policy makers to build an inclusive financial sector that they do not have now? How should it be gathered? Who should pay for it?
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- g) There are various initiatives to facilitate the channelling of remittances into financial institutions, such as debit cards and arrangements between savings banks in developing and developed countries (IDB initiative). Do these meet the needs of households? Is additional international cooperation needed?
- h) What would you like your country's financial sector to look like? Would financial services for the poor be provided by profit seeking financial institutions? Is a further development of "double bottom line" institutions possible? What about subsidizing commercial establishments to undertake social functions? How likely are these scenarios? What would you like your government to do in the next ten years to achieve that end state?

