



**BUILDING INCLUSIVE FINANCIAL SECTORS
FOR DEVELOPMENT:
A REGIONAL MULTI-STAKEHOLDER DIALOGUE DURING
THE ASIAN DEVELOPMENT BANK'S
"MICROFINANCE WEEK"**

Manila, 16 March 2005

Report

BACKGROUND

The vast majority of “bankable” people in the world do not yet have access to financial services. In many countries, the financial sector reaches only a small fraction of the population, as various constraints hamper or block the inclusion of different population groups needing access to financial services, notably women. Access to well functioning and efficient financial services can empower individuals economically and socially, allowing them to better integrate into the country’s economic activity and actively contribute to economic growth.

The United Nations Capital Development Fund (UNCDF) and the Financing for Development Office of the United Nations Department of Economic and Social Affairs are leading a global process to identify key constraints and opportunities for the promotion of inclusive financial sectors. An inter-agency team composed of the World Bank, the International Monetary Fund, the International Labour Organization and the International Fund for Agricultural Development supports these two agencies. A central part of the investigation is a series of regional multi-stakeholder dialogues, and Asian Development Bank took a leading role in helping to organize the consultation for Asia and the Pacific.

The exercise aimed to identify the constraints in the development and effective functioning of financial institutions and markets that could serve the wide-ranging needs of households and businesses, and identify avenues of opportunity to address those constraints. The results of these consultations will be laid out in a *Blue Book on Building Inclusive Financial Sectors*. Aimed to help developing countries think through their strategies for developing inclusive finance, it is targeted for official release in November 2005.



THE ASIA MULTI-STAKEHOLDER DIALOGUE

The Asian and Pacific Regional Multi-stakeholder Dialogue on Building Inclusive Financial Sectors for Development was held on 16 March 2005 at the Asian Development Bank in Manila, the Philippines. The objective of the meeting was to bring together key stakeholders from the region to identify salient constraints and opportunities in building inclusive sectors from their perspective and experience. This report of the discussions will be used as reference material in the preparation of a *Blue Book on Building Inclusive Financial Sectors*.

The Financing for Development Office and UN Capital Development Fund collaborated with the Asian Development Bank (ADB) to convene the meeting as an event during the ADB's Microfinance Week, 14-18 March 2005, immediately following another event of the Week, the Regional Conference on Expanding the Frontiers of Commercial Microfinance. Participants benefited from stimulating and rich presentations and discussions at the well organized and well attended Regional Conference, which covered a wide range of issues in microfinance and financial exclusion. The conference program and all the panel presentations can be viewed via: <http://www.adb.org/Documents/Events/2005/ADB-microfinance-week>.

In the Multi-stakeholder Dialogue on March 16, key stakeholders organized into three round tables, centered on discussing the following questions: (1) what are the constraints and opportunities in responding to client demand, (2) why is there not a greater supply of financial services for the poor and (3) what is the role of public policy. Roundtable discussions were organized around each of these themes.

National governments, central banks, microfinance practitioners and networks, commercial banks, development banks, private investors, research and academic organizations were represented in the discussion, with 70 participants from 19 countries in the region and 18 from 7 countries outside the region. There were also 25 representatives from multilateral and bilateral organizations and international networks.

SUMMARY OF ROUND TABLE DISCUSSIONS

Roundtable 1: Constraints and Opportunities in Responding to Client Demand

Participants on Roundtable 1, chaired by Jeff Liew of the UNDP, agreed that there is a great unmet demand for financial services by the poor and micro and small enterprises. They noted that **the most underserved groups or demand** are:

- **Populations in remote or sparsely populated areas and mobile groups.** Discussions included examples in the Philippines of 5 million poor farming households in remote and sparsely populated areas that are difficult and expensive to reach and the urban-based methodology of MFIs and the quick-profit orientation of banks are a constraint to extending their reach to these areas. A similar problem in Nepal of adapting methodology of the majority of MFIs operating in the plains near the border with India to the demand of the population in hilly and remote areas was also discussed. A problem with group lending experienced by the ALCEDA Bank in

Cambodia illustrated the special challenge of working with group members who were mobile because of work, making group guarantee unfeasible.

- **Not currently economically active or beginners in using financial services** - the aged; extremely poor, children and adolescents. The discussion centered on latent demand by these groups that is not articulated and the need to raise their level of financial literacy. Examples were drawn from high-density rural poor areas in **India** where potential clients have little knowledge of financial services and need to be organized to raise the level of financial knowledge. In **Papua-New Guinea**, eighty percent of the population is rural, who save but do not use banks for saving or credit. When some groups, coffee growers, for example, were helped in organizing cooperatives and finding export markets they began to demand banking services.
- **Crop agriculturalists.** Lending to this group is often constrained by the problem of aligning loan repayment schedules with long crop cycles. The case of small growers of coffee and tea in **Nepal** was a particularly severe problem because of the long gestation period and opportunities for short-term economic activities to generate more immediate cash are not generally available. The problem in **Bangladesh** is also deep-rooted as MFIs traditionally shied away from agricultural lending but are now lending to non-crop sectors such as fishery and livestock. The example of an EU funded agricultural development project in the **Philippines** also illustrated the need for mixed businesses that generate daily/weekly income to meet a weekly repayment schedule. Other country experiences discussed were examples of adjustment of the schedule of repayment to the crop cycle. The BRI in **Indonesia** changed its repayment schedule for loans to crop growers to seasonal payments due after harvest. NPLs were reduced from 8 per cent to 4 per cent as a result, although NPLs remain vulnerable to fluctuation of crop prices at harvest time. In India, lending of MFIs and other rural lenders are sector-neutral and the focus on a particular sector depends on the design of the program.
- **Minorities and persons lacking legal identity.** In countries where the overall legal system is weak, including areas of property rights and collateral law, local authorities have a say in who has access to loans. As a result, some political or ethnic minorities have no access. The situation in **Cambodia** was discussed, where ethnic minority groups with no legal identity or no permanent location are excluded from financial services.
- **Women, and also men.** The continuing gender bias in the provision of financial services was discussed. Some participants noted that as most MFIs serve women, men tend to be excluded from microfinance. Others pointed out that MF loans taken out by women are used for the household, including men and children. On the other hand, most loans from agricultural development banks go to men.
- **Microenterprises scaling up to small enterprises,** seeking larger loans. Participants discussed the situation in the **Philippines** where there is strong demand for larger loans of (US\$1000 and above) to scale up microenterprises to small enterprises that

need to be met. These credits can empower the poor to become entrepreneurial. As most MFI loans are for consumption or microenterprises there is a role for other financial institutions. It was also pointed out that in some countries, there is a problem of a lack of collateral in getting approval for these larger loans.

The discussions identified a **range of factors affecting client choice and usage of financial services**: availability of choice of products and provider, price (including all transaction costs), customer service, methodology of provision of financial services, reliability and reputation of provider, proximity or accessibility are characteristics of financial services that are relevant factors. Some participants noted the increasing price sensitivity of clients and the need for service providers to be more aware of their efficiency and costs. Some also suggested that the successes of providers in the informal sector could be lessons in understanding clients' preferences and design of services. The **characteristics and perceptions of clients or potential clients** are all important determinants of their choice and usage of financial services: financial literacy, need for different financial services, absorptive capacity for financial services, information of possibilities of services, cultural background and perception of the class barriers between themselves and financial service providers.

Participants agreed on a **number of priority actions** needed to close the gap between the demand for financial services and their supply:

- **Establish a two-way understanding between MFIs and clients**: MFIs need to undertake market research into the demand of clients and provide information on available services to clients.
- Develop clients and demand through **financial literary education**, community development and business development services for clients and increasing publicity and developing brand recognition.
- Target the household as a unit and develop and adopt **appropriate methodologies** to meet client demand as well as implement **product development and innovation** that are responsive to clients' needs.
- Take advantage of **partnerships with specialized service providers** of other financial services, training and business development services and market research to provide diversified services without overextending available resources.
- Provide **infrastructure support to financial service providers**. They need financial and physical infrastructure to stimulate demand as well as provide services to meet demand. Financial infrastructure development in deposit insurance, payments systems, credit rating services and credit bureaus are key. In addition, information communication technology as well as utilities, transport and telecommunications are necessary to facilitate operations.
- **Build capacity** of MFIs and banks to enable them to scale up operations and open new frontiers in business models and strategic plans. This includes the development

of human resources in banking, microfinance and development through tertiary education and higher learning for competent MF professionals. Financing support from donors in capacity building for innovations would be an important input.

- Expand and deepen knowledge of microfinance through the establishment of **knowledge and research centers**, including MFI in-house research units. Encourage investments to support a diverse range of knowledge centers to produce new ideas.
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Roundtable 2: Why isn't there A Greater Supply of Financial Services to the Poor?

Roundtable 2, chaired by Gil Lacson of Women's World Banking, focused on the greatest constraints to the supply of financial services.

Participants agreed on the need to address **macro-issues defining the environmental prerequisites** for creating the economic opportunities needed before microfinance can take off. Finance by itself does not build economic growth. In **India**, 80% of successful penetration of microfinance is in southern states. In **China** it's coastal. Economic opportunity needs to be there first. Therefore a nexus is needed to create the economic opportunity. This allows tapping into the market with available financial technology, or adapting to the situation.

In countries like **Pakistan**, illiteracy can be the biggest problem, particularly **financial illiteracy**. Illiteracy can lead to lack of trust between the client and the institution providing financial services. In **Vietnam**, people living in isolated and remote mountainous areas cannot understand what a bank is or does. Many times it is not the interest rate level that worries the client. He wants **reliability and timeliness**. Banks need to build **trust** with the customer.

In numerous country contexts, diverse constraints were identified:

- Among the constraints experienced in the **Philippines** is the difficulty in **striking a balance** between **reaching out** to a large number of members, and maintaining **efficiency**.
- In **Mongolia** and **Pakistan**, acceptable **collateral** is limited to permanent assets (e.g., real estate). There is a need to establish a legal framework for acceptable "social" collateral.
- For non-profit institutions in the **Philippines**, **taxation** is a constraint. Therefore government should exempt non-profit institutions— to avoid a social equity mismatch.
- In some cases, **politicians and vested interests** can hinder the expansion of supply of financial services. In **India**, microfinance is concentrated in certain regions due to political interference in others. Top-level government officials can break the bottlenecks and fix the blockage to developing the microfinance industry. There is a strong need for capacity building of politicians, to educate them about microfinance as a development intervention, not charity. Capacity building of politicians must include other sector players.

Participants pointed out that there was a great deal of ignorance and skepticism in the **international banking community** about microfinance and its link to profitability. The perception is that microfinance refers to either a donation to the poor or involves subsidized interest rates (“You can’t make money off the backs of the poor). At the **national level, banks are getting involved at the wholesale level**. But the difficulty is getting them involved in retail. Commercial banks refer from servicing the unbankable because of a lack of understanding about risk-based pricing and transaction costs. In **Nepal**, even after three decades of requirements that 12% of the loans should go to microfinance, most banks prefer to pay the steep penalty to the central bank rather than lend to the poor.

Many **issues at the institutional level** require attention:

- MFIs must **demonstrate profitability** of microfinance, through **systematic and clear data**. The numbers that exist are not considered as transparent.
- In terms of direct operations, participants expressed the needs to build a business case, in order to attract private sector investors.
- Capacity building is key to the expansion of supply by MFIs. The limited number of competent staff impedes the expansion of MFIs.
- Management leadership, vision and commitment were also identified as constraints. Institutions can be far too conservative in taking risks, institutional policies can be far too centralized, and implementing strategy not sufficiently pro-poor. Leadership and vision of top management were considered as key to the expansion of outreach.
- Some participants expressed the need to involve primary stakeholders in managing the institution, to work with banks and bank branches.

Participants agreed that there is a high level of **information asymmetry**, where policymakers and regulators still lack information on what microfinance is or does. This is also due to the lack of consensus on issues such as **interest rate level** and the **impact** of microfinance. **Negative perceptions** of microfinance are still prevalent. Corporate nonfinancial service providers (e.g., insurance) are not sensitive to microfinance. In **India**, people think microfinance means social work. They see it as a “hobby,” not as something that should be taken seriously. It is necessary to break through the mental blocks against microfinance.

Products need to be more responsive to local situation and client demand. They agreed that there was a lack of new products to service new markets, such as sparsely populated uplands or on remote islands, or to assure deeper poverty outreach. There was also a strong agreement that MFIs need to be more efficient in **product delivery**. Participants agreed that there is a need to increase **innovation**, both in product and efficiency in delivery. Lowering the costs of **technology** (computers, palm pilots, etc.) can bring about economies of scale and reach out to rural areas. Mobile banks need to be promoted, money should be taken to the communities to resolve the main problem of access to isolated and remote regions. The view was that donors

must continue to provide seed money in this area, since R&D in microfinance, financed by donors, has been success historically.

Numerous participants expressed the view that to reach remote areas, **coordination** among financial institutions or other service providers such as agriculture institutions was required in order to be more efficient in delivery. Some participants agreed that **mergers and consolidation** across institutions and different sectors should be encouraged. At the same time, small and agile players were still needed to reach out to the niche market segments.

Participants debated issues associated with the **commercialization** of microfinance concerning the **profit vs. social developmental objectives**. Continuous dialogues with the stakeholder groups in the industry – donors, banks, MFIs, NGOs, and clients – and building linkages with MFIs and other development agencies, were seen as necessary to achieve the social/commercial linkage. Some participants strongly emphasized the **social development aspect** in developing competent, trained people who share the same mission. In terms of financing lines to MFIs, creative, socially-driven packages, not commercially-driven packages, were needed. Other felt the need to recognize that the concept of “favorable returns” is outdated as the industry moves toward “commercialization”. From the viewpoint of investors, helping provide financial services is by definition acting “socially.” Investors in microfinance do not seek profit-maximization, but return on their investments. Since funding from investors is a possible source of financing lines to MFIs and address problems due to lack of funds, institutions must “cater” to the investors.

Participants also saw the need for greater **dialogue between commercial entities and development agencies** (e.g., governments and donors have not found a way to relate to for-profit providers) - as they are “nervous” about each other - and the need for greater acknowledgement of corporate social responsibilities, to build shared strategies. Commercial entities and development agencies haven’t yet found a way to work together.

With increased regulatory requirements from the central bank e.g., doubling paid-in capital by 2007, MFIs in **Mongolia** need commercial investors to survive. Whereas donors impose conditionality, commercial investors only require MFIs to pass certain quantitative measures. **Improvement of institutional capacity** was seen as a precondition to attract commercial investors. The necessity of subsidy for strengthening management operations, such as in MIS and capacity building was emphasized. Donor support was still needed for capacity building, standardization, and impact assessments.

Concern was raised about traditional donors slipping away towards excessive privatization – the large number of less successful groups of microfinance institutions could be abandoned. A problem stems from the **‘80/20’ principle**, where the top 20% of the MFIs get 80% of the funds, and the rest (80%) get the remaining 20% of the funding. Donors are supporting some really bad, bad MFIs. This donor intervention keeps consolidation from happening.

In some areas of **India**, the market penetration rate is only 10%. Market forces should decide which organizations survive. Therefore, who to support is not really an issue because consolidation will happen naturally, according to market forces and competition. In India, the problem is that there are too many organizations, which sometimes cause confusion among

clients. Some felt that the operational quality and competitiveness of organizations providing financial services to the poor should be under regulation. In India, some MFIs operate on informal “black” money, which hurts the microfinance process. Currently 25,000 MFIs serve not even 1 million clients and operate under difficult, ineffective regulations. There is definite need for uniform policy, regulated, and monitored by the central bank.

Participants agreed that there was need for **segmented analysis of microfinance industry**, so as to facilitate the development of concrete and objective selection criteria for support and performance indicators. **Mongolia** is planning various stakeholder group meetings to design performance indicators for donors and commercial banks. In the case of **Pakistan**, market intelligence is available on whether institutions conform to the benchmark set by the state banks. Usually, the institutions that meet the benchmark criteria are part of larger microfinance networks. The role of rating agencies such as MicroRate is also important in the objective assessment of the different categories of players in the industry and determination of whom to support. The focus of the selection criteria for support must be on potentially sustainable organizations. However, small practitioners with potential to be integrated into the formal sector must not be neglected.

The last segment of the roundtable session focused on defining participants’ vision of an **“inclusive financial sector”**. A number of country considerations were raised at the outset of this segment of the roundtable

- **Nepal** is currently in the 2nd year of implementing the “5-year plan”, where the final goal is to have 50% of total rural finance (rupees 101 billion total) to microfinance.
- An “inclusive financial sector” in **India** would be achieved when microfinance grows like any other finance sector, and is accepted by all sectors – from politicians to bureaucrats. It would be well regulated, transparent and professionalized, with highly accepted form of services (governments etc.), where at least 80% of the population has access. By 2008, 100 million poor should be financed with rupees 25 billion.
- MFIs in **Bangladesh** only cover 30% of the demand. The government has initiated a collaborative project to promote access to rural areas through 24 local intermediaries, which provide financial and technical support. This program targets 5 million beneficiaries by the end of 2005, and 50% of the poor by 2007. Thus far only 2.7 million has been reached.
- Inclusive financial sectors in **Mongolia** would be built when microfinance is mainstreamed into commercial finance, with full range of financial products, and with strong institutions.

Participants’ visions focused on the right **enabling environment**, the need for a **broad range of quality financial services**, with **outreach** to the unbanked:

- An inclusive financial sector is not just about the numbers, but also the quality of services, and access to policy dialogues.

- Building inclusive financial sectors requires an enabling environment—political, social, and financial, with emphasis on women. Success will be achieved when 25% of “hardcore” poor are “better off”.
- An inclusive financial sector would have a conducive environment, and reinforcement of the legal framework for professionalized operations. Government should look at the microfinance sector as a profit making industry by cost and risk.
- An inclusive sector should not only serve the bankable clients, but also integrate the “unbankable” clients by making them “bankable”.
- “Inclusive” means having a wide client base, a broad range of financial services, available at competitive prices.
- The government must help create supply of financial services and facilitate their distribution. Microfinance should also be built into the Millennium Development Goals, giving a jump-start impetus to the supply side. In Pakistan, where four different bodies regulate microfinance, consolidation of regulatory agencies is a priority.
- To convince the commercial side that microfinance is not a matter of charity, a shared prosperity agenda should be developed among the various stakeholder groups. There should also be specific timelines on what needs to be achieved.

In summary, participants agreed that an inclusive financial sector is where **microfinance is mainstreamed and accepted as an industry**. Under an inclusive financial sector, the majority of target clients have access to competitive and broad variety of financial services and products, and microfinance institutions operate under an effective and conducive policy environment, not influenced by political agenda. Stakeholders collaborate under a shared policy agenda, and a common achievable timeline to measure progress.

Roundtable 3: What is the Role of Public Policy?

Participants in the roundtable on the role of public policy, chaired by Joselito Almario of the Philippines National Credit Council, shared the experiences and concerns in their respective county contexts. Questions addressed during the roundtable touched on the country economic environment, policy legal and regulatory environment, financial sector reforms, and linkages between MFIS and larger institutions.

A number of issues were raised by several participants, around which there was apparent consensus in the group:

- **Broader issues of country context** were identified as critical for the sound development of microfinance: physical and spatial constraints of size, population density (sparsely populated areas), and geographic dispersion. To these were added **physical**

infrastructure constraints. Of concern in several countries are questions of **law and order** in rural areas and insurgency.

- Issues around **interest rate ceilings** were termed as “societal issues” as well as policy issues (**India, China**). In addition, government subsidies were cited as distorting the microfinance market (**China**).
- Participants referred to concern about **competition between small rural banks and big (usually urban) commercial banks**, which can offer cheaper services. In **Indonesia**, these smaller institutions have requested the government to limit the expansion of these larger banks.
- An additional problem for regulated specialized and rural institutions is that the **requirements under the legislation** are hard to meet (**Sri Lanka**). In order to comply with regulations, they tend to migrate to larger loan amounts. Regulatory requirements should not discriminate against these specialized and rural institutions.
- Inadequate regulation and supervision of cooperatives was cited as a concern (**Nepal, Philippines**). The Philippines is working on new cooperatives legislation.
- Institutions that are not regulated may be disadvantaged in terms of **tax treatment**. Unregulated MFIs in **India** cannot deduct provisions as a cost for tax purposes, whereas the regulated financial institutions are allowed to do so. This is also a problem for institutions in **Nepal** that register as corporations rather than financial institutions.

Two important themes were the subject of **divergent views**. This suggest the need for further analysis and dialogue:

1. Several speakers raised the issue of the **role of government** in the supply of microfinance services in poorer rural area, questioning what the role of government should be in promoting the offering of microfinance services in more difficult market segments.
2. The question of **microfinance legislation and regulation** came up often. The experiences reported regarding the enactment of microfinance legislation were diverse. There appeared to be a **lack of clarity on the question of when to regulate**. A representative of the **ABD** underlined the point that the need to regulate is linked to voluntary savings mobilization and the financial intermediation of these savings. In some country contexts (**Indonesia, India**), there was unwillingness on the part of the public authorities to attempt to regulate the large numbers of MFIs, due to a lack of capacity to supervise so many institutions and due to the concern that they would be eligible for government bailout in the event of difficulties. The **Fiji** Development Bank was not allowed to be licensed in order to take savings.

Related to this concern is the fact that microfinance institutions that are not regulated do in fact take deposits and should therefore transform into regulated formal financial institutions. In the case of the **Philippines**, the National Credit Council and the Central

Bank are looking for ways to make NGOs more transparent in their reporting; there is a concern that it is difficult to know when MFIs are exceeding deposit limits when they are unregulated, i.e. below the radar screen of the regulatory authorities because they fall below the minimum size for oversight by the central bank.

In **India** and **Bangladesh**, the governments have only recently begun developing microfinance regulatory frameworks. In India, a study of governance issues showed that it was preferable to create a new microfinance law, rather than attempting to amend numerous existing laws covering the range of institutions offering microfinance services in India

The basic issue was how to strike a balance between too little regulation and too much regulation. In addition to the question of regulation, the issue of **when and how to license unregulated MFIs** was raised; the Government of **China** is considering licensing MFIs.

A third issue where there was no resolution in the group was the question of **deposit insurance** for micro-savings. Countries are only beginning to address the questions of offering deposit insurance for MFIs; the question has been raised in Viet Nam and is yet unresolved.

In terms of avenues of opportunity, the discussion of **linkages between MFIs and larger banks** clearly suggested that these linkages are viewed as significant opportunities to help MFIs in numerous ways, such as reporting, managing savings with MFIs acting as agents for regulated financial institutions, lines of credit, referral of clients, transfer of technology and technical assistance. **Collateral requirements** were cited as a problem for the linkage approach in India in cases where banks are lending to MFIs, although ways have been found to circumvent this requirement. The question was raised of what public policy measure could address linkages between MFIs and larger institutions.

The need for increasing transparency was raised by several participants. In **Sri Lanka**, a new NGO center will increase transparency through reporting requirements.

The role of and the potential for **credit bureaus** were discussed. There was general agreement of the principal that credit bureaus should remain a private sector instrument. While often cited as an important tool, it was noted that there are difficulties with credit bureaus in densely populated areas of Asia (many people have the same name, client relationships with MFIs are personal and once an attempt is made to aggregate information, it becomes difficult re recognize individuals). An additional concern raised was a actual functioning of credit bureaus (**Philippines**). It was proposed that government can support the development of credit bureaus through enabling legislation (**Nepal, Philippines**).

In conclusion, the most significant concerns were the issues of when to regulate, the need to increase transparency among unregulated NGOs, the options for public policy to increase outreach to areas more difficult to serve. In terms of legislation and regulation, it is important to

note that significant developments are underway in such large countries as India, China and Bangladesh.

MAIN CONCLUSIONS OF THE ASIA MULTI-STAKEHOLDER DIALOGUE

There was agreement that there is a **large unmet demand for financial services by the poor and micro- and small entrepreneurs**. The most underserved groups include those living in remote or sparsely population locations, minorities and those lacking legal status, as well as mobile groups. In addition, economically inactive individuals or beginners in using financial services have a latent demand for services that is not articulated. Workers in certain sectors, such as crop farming, are often not served because the long production cycle of their economic activity does not align with loan repayment schedules required by lenders. Emerging entrepreneurs who need larger loans to scale up their microenterprises to small enterprises are usually not served by MFIs and also encounter problems with larger financial institutions because of a lack of collateral.

Participants identified a number of salient **factors that influence clients' choice and usage of financial services**: the price, quality and diversity of financial services offered. At the same time, they noted characteristics of clients, including their need and absorptive capacity for services, information of available services, cultural background and perceptions of the accessibility of financial institutions are also important determinants.

The discussion highlighted a number of **priority actions to close the gap between the demand for financial services and their supply**. These are directed at improving mutual understanding between financial institutions and potential clients regarding the need for services and the availability of services, developing client demand and undertaking product development that is responsive to client needs. In support of these actions, the capacity of MFIs and banks has to be enhanced through human resource development and research. Donor financial input in these efforts would be an important resource. In addition, strengthening of support and the overall financial and physical infrastructure strengthened is also conducive to the development and provision of financial services.

Regarding **gaps in the supply of financial services**, participants agreed that it is necessary to identify the **macro-issues that determine the environment** needed for microfinance to take off and be profitable. Because of the ignorance and skepticism in the international banking community about the profitability of microfinance, MFIs must demonstrate their profitability with **systematic and transparent data**. **Capacity building**, in staff and management competency and the development of innovative products, are crucial in the expansion of supply and outreach of financial services. Continued donor support in research and development of financial products is critical.

The issue of **commercialization versus the social development objectives** of microfinance was highlighted. Participants underscored the need for continued dialogue among all stakeholders in the industry and linkages between the industry and development agencies to maintain the focus on both social and commercial goals. To enable donors to better assess the results of MFIs, there is a need for the development of objective performance and selection criteria.

According to participants' **vision of an inclusive financial sector**, microfinance is mainstreamed and the majority of potential clients have access to a competitive and broad variety of financial services. Moreover, financial institutions operate in a conducive policy environment where stakeholders collaborate under a shared policy agenda and a common measurable schedule of progress.

With regard to **the role of government policy in the supply of financial services to the poor**, participants agreed that interest ceilings and government subsidies both distort the market for microfinance and suppress supply. They also noted that discriminatory regulation and supervision of specialized and rural financial institutions imposes burdensome requirements on them, often forcing them to move out of microfinance to markets of larger loan amounts. At the same time, it was observed that other financial institutions, such as cooperative, were inadequately regulated and supervised.

There were **differing opinions on the role of government** in promoting the supply of microfinance services in more difficult market segments. There was also **varying views on when government regulation of MFIs is appropriate** given the demands of regulating large numbers of small institutions on usually limited government regulatory capacity. **The stakes are high**, with three large countries, **Bangladesh, China** and **India**, currently addressing issues regarding the regulatory framework for microfinance.