II. RECOMMENDATIONS

The workshop resulted in a number of recommendations for ADB's draft Microfinance Development Strategy. They are the result of deliberations by five working groups (names of working group members are included in Appendix 1). The groups presented their findings (Section III) in plenary session where they were reviewed and discussed (Section IV). Participants also benefited from three presented background papers and their discussion (Section V) prior to forming the working groups. The final recommendations are presented in six categories: fostering a conducive policy environment, developing the financial infrastructure, pro-poor innovations, institutional development, the roles of ADB, and roles of donors.

A. FOSTERING A CONDUCIVE POLICY ENVIRONMENT

It is important to foster the development of a conducive policy environment for MF in the region. However, there is a perceived lack of commitment of government and donors to the importance of mainstreaming MF. This in turn may be due to a lack of awareness and understanding of the roles and limitations of MF in poverty alleviation, microenterprise development, and economic development in general. Key players must understand the current MF situation prevailing in their own areas. The following are requisite steps in fostering a conducive policy environment for MF.

- All key players must understand their country's overall macroeconomic context, including the capability of its financial system to be able to work effectively towards the development of MF services and MFIs. Such efforts should be country specific, taking into consideration the peculiarities of each country.

- All stakeholders in a country must have a common basic understanding of MF. The state of MF in the country must be defined and assessed. This should include an awareness, understanding, and appreciation of the roles of all MF organizational types in a given context (e.g., informal groups, NGOs, cooperatives, rural banks).

- It is important to understand the roles and limitations of MF in poverty alleviation and microenterprise development. The potential of MF to contribute to poverty alleviation must be appreciated. However, MF should not be perceived as a panacea for poverty alleviation.

- Disseminating information on MFI performance and impact will help to increase awareness and understanding of MF in each country and in the region as a whole.

- Donors and MFI networks should play an active role in fostering a conducive policy environment.

1. Interest Rate Reforms

A regulated interest rate regime undermines the development of MF. Therefore, a liberalized interest rate regime is a prerequisite for MF to be effective. This should include the removal of interest rate ceilings and the discontinuation of subsidized credit by government and other agencies.

Specific modalities of advocacy for interest rate reforms will have to be tied to ADB's broader framework for country assistance.

2. Redefining the Role of the State in MF to Facilitate Participation of Private-sector Institutions

Experience has shown that in many instances, the state's participation in the delivery of MF has marginalized MFIs. In part, this is due to the unclear distinction between direct income-transfer programs and credit programs. The role of government in MF must be clarified and rationalized.

Governments should take an active part in the development of MF by providing resources for on-lending and for MFI capacity building. Governments should also work to provide fiscal incentives to MFIs.

As a principle, government should not compete with the private sector. Where there is a thriving MF sector, retail delivery of services is best left to MFIs. While the private sector should be encouraged, it should be noted that the presence of a few start-up institutions would do little to decrease overall supply needs. From outreach considerations, all institutional and noninstitutional forms of supply will have to be considered. This may, in the country-specific context, require an active role of government-owned financial institutions in the provision of retail MF services to the poor. This, however, should be done with much deliberation and consideration of the critical factors affecting the success of such programs and how these could be made sustainable.

3. Encouraging the Entry of a Wide Array of Institutions

In fostering the development of MF, it is important to engage the participation of a wide array of formal (state-owned and private) and semiformal institutions, and informal service providers including savings and credit associations and NGOs. A responsive financial infrastructure and appropriate institution building for MFIs are necessary to foster and encourage such wide participation.

Specific modalities recommended for fostering a conducive and supportive policy environment for MF include the conduct of high-level country-specific dialogues on this issue. There should be maximum stakeholder participation in these policy dialogues. To support a meaningful level of discussion, TA should be provided for database development and research that may include specific country and sector studies and best practices and models.

B. DEVELOPING THE FINANCIAL INFRASTRUCTURE

An appropriate financial infrastructure should be developed to improve MFI performance and quality of service delivery, and expand outreach to provide sufficient confidence in MFIs to encourage the inflow of resources and investments from savers and private investors. The financial infrastructure of MFIs should continue to exhibit flexibility and innovation.

It is necessary to calibrate the phasing and degree of financial infrastructure development, particularly that related to a legal framework and to regulatory and supervisory systems. A lack of financial infrastructure in the early stages of MF development might not necessarily be disadvantageous. Some country experiences show that such a situation provides MFIs with a wide latitude and flexibility for innovation.

1. Developing a Facilitating Legal Framework for MF

Developing a legal framework that legitimizes MFI (semiformal and informal) existence could facilitate their growth. A legal personality is important for mobilizing significant resources.

One of the first necessary steps is a review of the adequacy and applicability of existing laws and regulations of the formal financial system and their impact or effect on the growth of MFIs. For example, there may be laws limiting bank lending to collateral-based transactions and regulations on savings mobilization that may limit the growth of capable MFIs wishing to tap savings for expansion. The review should also assess organizational options for the formalization and transformation of MFIs. The rationale is to start within the existing system and work towards improving or revising it if possible. Otherwise, it may be necessary to develop separate MF-specific laws.

With the development of an appropriate legal framework, MFIs should be encouraged to convert into legal financial institutions and clear guidelines for this process developed. Frameworks for the establishment of small financial institutions as banks or finance companies that provide responsive services to the poor should also be developed where applicable and helpful.

ADB could assist in the development of appropriate legal frameworks by using TA to support policy and legal framework review studies, and the identification, documentation, and dissemination of best practices.

2. Performance Standards

Promoting the development of MFI performance standards is a prerequisite for improving MFI performance and the development of appropriate supervisory and regulatory mechanisms. Such standards should be specific to the sector and to the organizational type of the MFI. Performance standards serve as tools to improve operations of MFIs and not just for supervision and control. They must also be used for providing incentives and as a basis for monitoring and enforcing MFI compliance to minimum standards.

MFI networks could be the vehicles for the development of performance standards and indicators. Rating agencies could be established as an option for encouraging compliance with performance standards.

An ADB regional technical assistance (RETA) should be instituted to develop performance standards for the different categories of MFIs. Standards should be based on a survey of the existing situation in an area. The RETA could assist MFI networks to develop standards and define performance indicators as well as to explore the need for and help establish MFI rating agencies. In addition, the RETA could also explore ways of motivating MFIs to meet minimum performance standards. Examples include the development of guarantee schemes and insurance services for MFIs and the provision of fiscal incentives.

3. Regulatory and Supervisory Systems for MFIs

Some form of regulation and supervision of MFIs is prerequisite for promoting the sector's growth, particularly for savings mobilization. Two main areas need to be addressed: establishing self-regulating organizations (SROs) and developing an appropriate system to allow nonbank MFIs, in particular NGOs, to mobilize savings. Such regulation and supervision should not stifle innovation and growth of MFIs but rather should encourage and allow the development and offering of other innovative financial services for the poor. It is important, therefore, to determine the appropriate timing and level of regulations with regard to the context and stage of development of the MF sector.

a. Self-regulating organizations

Self-regulation is the preferred mode for MFI supervision and regulation. Existing MFI networks could be starting points for such an initiative. Regional technical assistance from ADB could be used to support the development of SROs.

b. Savings mobilization

Savings services are important as a resource mobilization strategy for MFIs. NGOs should be allowed to mobilize deposits under a suitable supervisory framework. One option for the prudential regulation of savings is to use a two-tiered supervisory arrangement. The SRO would be responsible for supervising small-scale MFIs. Additional safeguards would include the requirement to set up liquidity reserves in banks and the development of mutual insurance systems. Underpinning all of these would be the development and enforcement of performance standards. For larger MFIs, the central bank or other appropriate authority should be in charge of supervision.

4. Facilitating Resource Mobilization for MFIs

Financial constraints continue to be a major hurdle to the growth of most MFIs. While addressing the financial infrastructure issues outlined above would lay the groundwork for substantial resource mobilization, there are other options that could enhance the access of MFIs to sources of funds.

One option is the establishment of wholesalers such as an apex institution or a second-tier financial institution focused on MFIs, e.g., the Pally Karma Shayak Foundation of Bangladesh. ADB could play the roles of linking wholesalers with multilateral agencies and of encouraging government counterpart. For these arrangements, it is important that MFIs have access to loans with realistic but concessionary rates. In the case of foreign fund sources, the issue of foreign exchange risks must also be addressed. The government should preferably cover these risks.

Another option is to develop mechanisms that could facilitate private-equity financing and attract venture capital for MFIs. These represent opportunities for involving the Private Sector Group of ADB in microfinance operations.

Mechanisms that will encourage formal financial institutions to lend to informal institutions were also suggested as resource mobilization alternatives. This may require a supporting legal framework.

C. PRO-POOR INNOVATIONS

Providing MF services, particularly to the poorest, poses even more challenges for MFIs. The poorest are geographically dispersed and located in remote areas, which increases the costs of reaching them. They may also require financial products other than loans and savings. Efforts to serve these potential clients must be based on considerable market research. Product development priorities should, thus, include designing more appropriate financial products for the poor and women in particular, and effective methodologies for identifying and reaching the poorest, e.g., use and upgrading of informal and community-based approaches. ADB should use TA and the proposed Microfinance Development Fund (MDF) to encourage these pro-poor innovations.

Options include participatory targeting methods, identifying and facilitating networking among informal savings and credit associations, and upgrading such associations (in the legal, human, operational, and financial areas). Methods that allow the building up of the credit history of the poor would also be useful, as would developing social insurance schemes for them.

The importance of social intermediation in reaching the poor should be acknowledged and mechanisms for sharing the social cost involved among stakeholders (MFIs, government, and private sector) should be worked out.

The tools for implementing social audit among MFIs must be developed to ensure their relevance and appropriate impact.

Finally, the roles and limitations of MF and its impact on microenterprise development, particularly for the poorest, must be clarified and understood in order to have reasonable expectations for MF. This includes defining the roles of minimalist vs. integrated approaches in reaching the poorest.

D. INSTITUTIONAL DEVELOPMENT

There is a critical need for significant development of MFI institutional capacity to foster the development of MF in view of the observed lack of professionalism and transparency among some MFIs and the continuing struggle of the majority of MFIs to attain viability and sustainability. Such capacity building should also include apex organizations, networks, informal-sector savings and credit associations, potential clients, the formal financial sector unfamiliar with MF, and legislative bodies and government regulatory agencies that are involved in or influence MF development.

The scope of institutional development required by MFIs includes ownership and governance of MFIs, technical skills, appropriate management information systems, the management of portfolio quality and growth, transaction cost-reduction technologies, and continuing product development. Additional areas include business planning, policy advocacy, financial management including the setting of sustainable interest rates, internal controls, and human resource development and management.

Other means of institutional development include secondments among MFIs and the provision of support for physical facilities such as equipment, vehicles, and software.

1. Savings Products Development

Responsive savings products are important to MFIs as they aim to meet the savings service requirements of the poor. These products also constitute a potent resource mobilization strategy for MFIs. More investment should be made in their development, particularly for the poorest. There is a need to continue the development of innovative savings products (e.g., mobile collectors, cumulative deposits), for which purpose it would be helpful to understand the savings needs of local communities and to collect and disseminate information on both formal and informal savings products. ADB could provide TA for developing such products.

2. Research and Training Facilities in MF

National and regional research and training institutes could be the vehicles for research and the development and delivery of training and other institutional development activities. Capabilities of existing institutions should be upgraded and centers for MF should be established in them.

These centers should develop courses and programs that are tailored to meet the requirements of different MFI categories. They should engage in research and disseminate information on best practices, best programs, and service-delivery methodologies. They may develop and oversee exchange programs and secondments among MFIs, facilitate access to modern technology, and serve as a venue for networking between government and MFIs. They may also assist in the development and improvement of in-house capability of MFIs for training.

3. Information Systems for MF

It is important to develop databases and information systems to support the various priorities discussed thus far. Information is needed to address effectively all the issues identified, including development of financial infrastructure, institutional capacities, pro-poor innovations, and support for policy reform. ADB TA could be used for the conduct and dissemination of best practice studies, for developing research and information systems, and for establishing databanks.

E. ROLES OF ADB

From the above recommendations, ADB should have several roles critical to the development of MF in the region: as a funding agency for financing MFIs; as a catalyst and lobbyist to bring about policy and financial infrastructure changes conducive to MFI growth, particularly through support for various networking efforts among MFI stakeholders; as a source of information and expertise on best institutional forms and practices; and in encouraging the development of innovative approaches by supporting pilot models and initiatives.

To carry out its roles, ADB should make use of the implementation modalities identified in its draft MF strategy paper. These include the use of loans for financing MFIs and the use of TA to catalyze MF development efforts as identified above. The proposed MDF could also be an important mechanism for this purpose, but should have clear conditions and direct access by MFIs. In addition, ADB must develop its own internal capacity in MF by recruiting specialists and setting up a specialized MF unit.

ADB's Private Sector Group could play an important role in the development of MF, particularly in encouraging commercial financial institutions to downscale to MF and in helping develop and establish venture capital funds for investment in MFIs.

F. ROLES OF DONORS

The presence of flexible and supportive donors has been a key factor in the development of MF. Donors should continue supporting MFIs by taking on a longer-term perspective of institutional development. Support should continue to be timely, transparent, and sufficient to meet the MF sector's plans and requirements. Donor efforts should also be coordinated. ADB could play an active role in this regard among donors in DMCs.