Microfinance: leverage or quagmire?

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Abstract. Whether microfinance is all that its proponents claim? Promoters have hailed microfinance as the silver bullet of development. Advocates say that providing small amounts of credit to the world's poor can break their cycle of poverty. However, the mixed results of a wide array of impact assessments leave skeptics wondering whether microfinance really does alleviate poverty beyond anecdotal instances. Some experts have suggested that no more than five percent of microfinance institutions (MFIs) worldwide will ever be sustainable. Maybe, the reality is that microfinance may be guilty of over-promising and under-delivering, but it is still an effective development tool. A number of studies have reached what is now perhaps an obvious conclusion: programs that focus on poverty alleviation rather than those that focus on financial results are more effective at reaching the very poor. The world is still full of poor people, and the problem of underdevelopment remains one of the intractable challenges of the global economy. For the time being we only put questions. In the next issues of journal we will try to find answers on these questions.

Keywords: microfinance, poverty alleviation, microfinance institutions, financial inclusion, social inclusion, middle class, self-employment, extreme poverty, microcredit, inclusive finance sector, debt-trap.

Микрофинансирование: рычаг или трясина?

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Аннотация. Является ли микрофинансирование тем, о чем говорят его сторонники? Сторонники микрофинансирования провозглашают его чуть ли не «серебряной пулей», стимулирующей экономическое развитие. Они утверждают, что предоставление небольших сумм кредита бедным может преломить замкнутый круг нищеты. Однако противоречивые результаты оценки влияния микрофинансирования приводят скептиков к заключению, что микрофинансирование действительно способно устранить нищету. Часть экспертов придерживается мнения, что во всем мире не более 5% микрофинансовых организаций являются устойчивыми. Может быть, в действительности от микрофинансирования слишком многого ожидали, а результаты оказались менее значительными, но, тем не менее, оно оказалось и остается довольно эффективным средством стимулирования развития. Проведенные исследования обнаружили факт, который кажется сегодня очевидным, что программы, нацеленные на устранение нищеты, в отличие от программ, нацеленных на достижение высоких финансовых результатов, являются более эффективным способом борьбы с нищетой. В этой статье автор лишь обозначает вопросы для дальнейшего обсуждения в последующих выпусках журнала.

Ключевые слова: микрофинансирование, устранение нищеты, микрофинансовые организации, финансовое включение, социальное включение, средний класс, самозанятость, крайняя нищета, микрокредит, инклюзивный финансовый сектор, долговая ловушка.

The modern use of the expression "*micro-financing*" has roots in the 1970s when organizations, such as Grameen Bank of Bangladesh with the microfinance pioneer Muhammad Yunus, were starting and shaping the modern industry of micro-financing. Another pioneer in this sector is Akhtar Hameed Khan. The history of micro-financing can be traced back as far as the middle of the 1800s, when the theorist Lysander Spooner was writing about the benefits of small credits to entrepreneurs and farmers as a way of getting the people out of poverty. Independently of Spooner, Friedrich Wilhelm Raiffeisen founded the first cooperative lending banks to support farmers in rural Germany.

Microfinance finds fertile ground in countries and markets where traditional financial institutions have failed to reach the poor. In these countries, the supply of capital to micro-entrepreneurs and low-income households is far below demand. Microfinance addresses this gap by providing previously excluded populations with access to formal financial services such as credit loans, savings accounts and payment transfers. The alternatives to microfinance are either lack of access to these services or reliance on informal sources. The latter includes, at best, family and friends under similar economic duress or, at worst, unregulated private lenders with potentially predatory and usurious practices.

Today microfinance is a source of financial services for entrepreneurs and small businesses lacking access to banking and related services. The two main mechanisms for the delivery of financial services to such clients are: (**1**) relationship-based banking for individual entrepreneurs and small businesses; and (**2**) group-based models, where several entrepreneurs come together to apply for loans and other services as a group. In some regions, for example Southern Africa, microfinance is used to describe the supply of financial services to low-income employees, which is closer to the *retail finance model* prevalent in mainstream banking. So, microfinance is a way to promote economic development, employment and growth through the support of micro-entrepreneurs and small businesses.

In paper "The Paradigm Shift in Microfinance: A Perspective from HIID," which was presented by Marguerite Robinson at the HIID History Conference held in Bermuda in March 1995, she analyzes HIID's role in the *development of sustainable microfinance*. The Harvard Institute for International Development (HIID) was a center within Harvard University between 1974 and 2000. It is about the history of an idea– that the massive demand for microfinance in developing countries can be supplied by **sustainable institutions** providing financial services commercially, and that these services can have important effects on *social* and *economic development*. She stressed that derived from supply-leading finance theory, the "*old paradigm*" of ***subsidized credit*** for lower-income borrowers, especially in rural areas, was well entrenched in most of the developing world. Microfinance as a commercial institutional activity was generally perceived by policymakers and by the formal financial sector as unimportant for the economy, unprofitable for financial institutions, and unnecessary for the poor. This remains the prevailing view in most developing countries today. However, the ***paradigm shift*** in microfinance in the developing world was marked by the change from government and donor-funded subsidized credit to ***sustainable financial intermediation***. Despite the widespread demand for financial services — for both credit and savings facilities– it is estimated that *institutional finance* is unavailable to about **90 percent** of all households in developing countries.

Very small enterprises (**VSEs**) over the world represent a broad and heterogeneous segment, often underserved by formal financial institutions[1]. They are generally informal and often family businesses. The financial needs of these enterprises are typically overlooked by "downscaling" banks, which find larger and often more formal small and medium enterprises (SMEs) to be a more natural market for their products and services. ***Microfinance Institutions*** (MFIs) are starting to move upmarket to serve SMEs, and in particular, VSEs within this segment. However, they use varying definitions, methodologies and products to do so and to date there has been little research or documentation of their experiences. VSEs are considered to be those businesses with financing needs of

[1] See, for example, Experiences of microfinance institutions serving very small to small enterprises in Latin America. International Finance Corporation in Partnership with Dutch Government, 2014.

between US$7,000 and US$30,000. It is a starting point for an institution considering entering the segment, or for one that finds itself having grown into the segment "organically" but with a view to strengthen its position.

For some, microfinance is a movement whose object is "*a world in which as many poor and near-poor households as possible have permanent access to an appropriate range of high quality financial services, including not just credit but also savings, insurance, and fund transfers*"[2]. Many of those who promote microfinance generally believe that such access will help poor people out of poverty, including participants in the **Microcredit Summit Campaign**.

For others, microfinance is a way to promote economic development, employment and growth through the support of micro-entrepreneurs and small businesses.

Microfinance is a broad category of services, which includes microcredit. Microcredit is provision of credit services to poor clients. Microcredit is one of the aspects of microfinance and the two are often confused. Critics may attack microcredit while referring to it indiscriminately as either "microcredit" or "microfinance". Due to the broad range of microfinance services, it is difficult to assess ***impact***, and very few studies have tried to assess its full impact.[3] Proponents often claim that microfinance lifts people out of ***poverty***, but the evidence is mixed. What it does do, however, is to enhance ***financial inclusion***.

Accion International (2015) defines ***microfinance*** as the provision of financial products and services, focused on serving low-income clients, who often lack access to formal financial services. Microfinance is sometimes used as a synonym for microcredit, although microfinance refers to the provision of services beyond credit, including savings, insurance and payments. Microfinance as a segment has evolved from the first microcredit pilots a few decades ago that proved that the poor need to, and can, use *financial services*. Microfinance as a segment has its roots in and advocates the use of financial services in a way that enhances and does not harm the lives of its low-income clients. Despite its rapid growth, there are still over 2bn people who lack access to financial services, and this has inspired the more recent push for financial inclusion.

Microfinance institutions **(MFIs) Accion International** (2015) defines as institutions that provide financial services to low-income populations. MFIs can take many forms including, bank, nonbank financial institution (NBFI), CUs or nongovernmental organisation (NGO). The term MFI often refers to institutions primarily focused on serving low-income populations and who self-identify with the microfinance movement, often with a focus on ***microenterprise credit***. The term can also be used to refer to any financial institution serving low-income populations.

[2] Robert Peck Christen, Richard Rosenberg & Veena Jayadeva. Financial institutions with a double-bottom line: implications for the future of microfinance. *CGAP Occasional Paper*, July 2004, pp. 2–3.

[3] Feigenberg, Benjamin; Field, Erica M.; Pande, Rohini. (2010). Building Social Capital Through Micro Finance. *NBER Working Paper No. 16 018*.

BOX 1

Microcredit Summit Campaign

Founded: 1997

Type: Non-profit

Focus: Microfinance education, Health education, Poverty measurement

Location: Washington, DC

Area served: Asia, Africa, the Americas, Middle East

Key people: Larry Reed, Director; co-Founders are Sam Daley-Harris (also former Director), Professor Muhammad Yunus (Grameen Bank), and John Hatch (FINCA)

Website: http://www.microcreditsummit.org

The Microcredit Summit Campaign, an American non-profit organization, started as an effort to bring together microcredit practitioners, advocates, educational institutions, donor agencies, international financial institutions, non-governmental organizations and others involved with microcredit around the goal of alleviating world poverty through microfinance. The Campaign was founded by Muhammad Yunus, Sam Daley-Harris, and John Hatch on a principle that emphasized a citizen-led approach of establishing and meeting a collective global goal. The Campaign represents more than a single organization and is a social movement that aims to advance the microfinance field and foster a productive learning community.

The first Microcredit Summit was held February 2–4, 1997 in Washington, DC. The first summit had approximately 3,000 in attendance from 137 countries. The outcome of the first Summit was the launch of a "campaign" to reach **100 million** of the world's poorest families, especially the women of those families, with credit for self-employment and other financial and business services by the year 2005. In January 2009, to coincide with the release of the *State of the Microcredit Summit Campaign Report 2009* (SOCR), the Microcredit Summit Campaign announced that over 100 million of the world's poorest families had received a microloan.

List of Microcredit Summit Campaign Conferences

1997, Microcredit Summit, Washington, DC, February 2–4.
1998, Global Microcredit Summit, New York City, June 24–27.
1999, Global Microcredit Summit, Abidjan, Côte d'Ivoire, June 24–27.
2000, Middle East/Africa Regional Microcredit Summit, Harare, Zimbabwe, October 8–13.
2001, Asia/Pacific Regional Microcredit Summit, New Delhi, India, February 2–5.
2001, 1st Latin America/Caribbean Regional Microcredit Summit, Puebla, Mexico, October 9–12.
2002, Global Microcredit Summit +5, New York City, November 12–13.
2004, Asia/Pacific Regional Microcredit Summit, Dhaka, Bangladesh, February 16–19.
2004, Middle East/Africa Regional Microcredit Summit, Amman, Jordan, October 10–13.
2005 Latin America/Caribbean Regional Microcredit Summit, Santiago, Chile, April 19–22.
2006, Global Microcredit Summit, Halifax, Canada, November 12–15.
2008, Asia/Pacific Regional Microcredit Summit, Bali, Indonesia, July 28–30.
2009, Latin America/Caribbean Regional Microcredit Summit, Cartagena, Colombia, June 8–10.
2010, Africa/Middle East Regional Microcredit Summit, Nairobi, Kenya, April 4–7.
2011, Global Microcredit Summit, Valladolid, Spain, November 14–17.
2013, Partnerships against Poverty Summit, Manila, Philippines, October 9–11.

MICROFINANCE AND POVERTY

Microfinance as the best way of tackling poverty is under attack. It has been accused of failing to help the poor, of treating its clients badly, of charging high interest rates and of encouraging poor people to take on excessive debt burdens. The paradox is that the discussions on the downturn start in South Asia, where microfinance began and has flourished since the 1970s. The reality is that microfinance may be guilty of over-promising and under-delivering, but it is still an effective development tool.

Questions arise: What has all this money bought for so many people? Has the incidence of poverty measurably declined? Can it be said that these hundreds of millions of individuals and their families have lifted themselves out of poverty on the basis of the microloans they have received?

The concept of poverty is complex and strongly influenced by local cultural and socio-economic conditions. The poverty assessment approach ought to support a flexible definition of poverty that can be adapted to fit local perceptions and conditions of poverty. The tool for poverty assessment has to be used as a means neither to target new clients nor to assess the impact of microfinance services on the lives of existing clients. It can provide a useful means to verify — both for the donor and the MFI — the extent to which an existing strategy results in poor clients joining the MFI.

In developing economies and particularly in rural areas, many activities that would be classified in the developed world as financial are not-monetized: that is, money is not used to carry them out. This is often the case when people need the services money can provide but do not have dispensable funds required for those services, forcing them to revert to other means of acquiring them. In their book "*The Poor and Their Money*", Stuart Rutherford and Sukhwinder Arora[4] cite several types of needs:

[4] Rutherford, Stuart; Arora, Sukhwinder (2009). The poor and their money: micro finance from a twenty-first century consumer's perspective. Second edition. Warwickshire, UK: Practical Action Publishing.

Lifecycle Needs: such as weddings, funerals, childbirth, education, home building, widowhood and old age.

Personal Emergencies: such as sickness, injury, unemployment, theft, harassment or death.

Disasters: such as fires, floods, cyclones and man-made events like war or bulldozing of dwellings.

Investment Opportunities: expanding a business, buying land or equipment, improving housing, securing a job (which often requires paying a large bribe), etc.

People find creative and often collaborative ways to meet these needs, primarily through creating and exchanging different forms of non-cash value. Common substitutes for cash vary from country to country but typically include livestock, grains, jewelry and precious metals. As Marguerite Robinson describes in "*The Micro finance Revolution"*, the 1980s demonstrated that "micro finance could provide large-scale outreach profitably," and in the 1990s,[5] "micro finance began to develop as an industry". In the 2000s, the microfinance industry's objective is to satisfy the unmet demand on a much larger scale, and to play a role in reducing poverty. While much progress has been made in developing a viable, commercial microfinance sector in the last few decades, several issues remain that need to be addressed before the industry will be able to satisfy massive worldwide demand. The obstacles or challenges to building a sound commercial microfinance industry include:

- Inappropriate donor subsidies.
- Poor regulation and supervision of deposit-taking microfinance institutions (MFIs).
- Few MFIs that meet the needs for savings, remittances or insurance.
- Limited management capacity in MFIs.
- Institutional inefficiencies.
- Need for more dissemination and adoption of rural, agricultural micro finance methodologies.

Microfinance is also the proper tool to reduce ***income inequality***, allowing citizens from lower socio-economical classes to participate in the economy. Moreover, its involvement has shown to lead to a downward trend in income inequality[6].

Microfinance Poverty Assessment Tool

The Consultative Group to Assist the Poor is a global partnership of 34 leading organizations

[5] Robinson, Marguerite. (2001).The Microfinance Revolution: Sustainable Finance for the Poor (Lessons from Indonesia. The Emerging Industry). The International Bank for Reconstruction and Development/The World Bank, Communications Development Incorporated, Washington, D.C. and San Francisco, California.

[6] Hermes, Niels. (2014). Does microfinance affect income inequality? Applied Economics, 46(9), 1021–1034. Also: Yunus, Muhammad & Jolis, Alan (contributor). (2008). Banker to the Poor: Micro-Lending and the Battle Against World Poverty. Public Affairs.

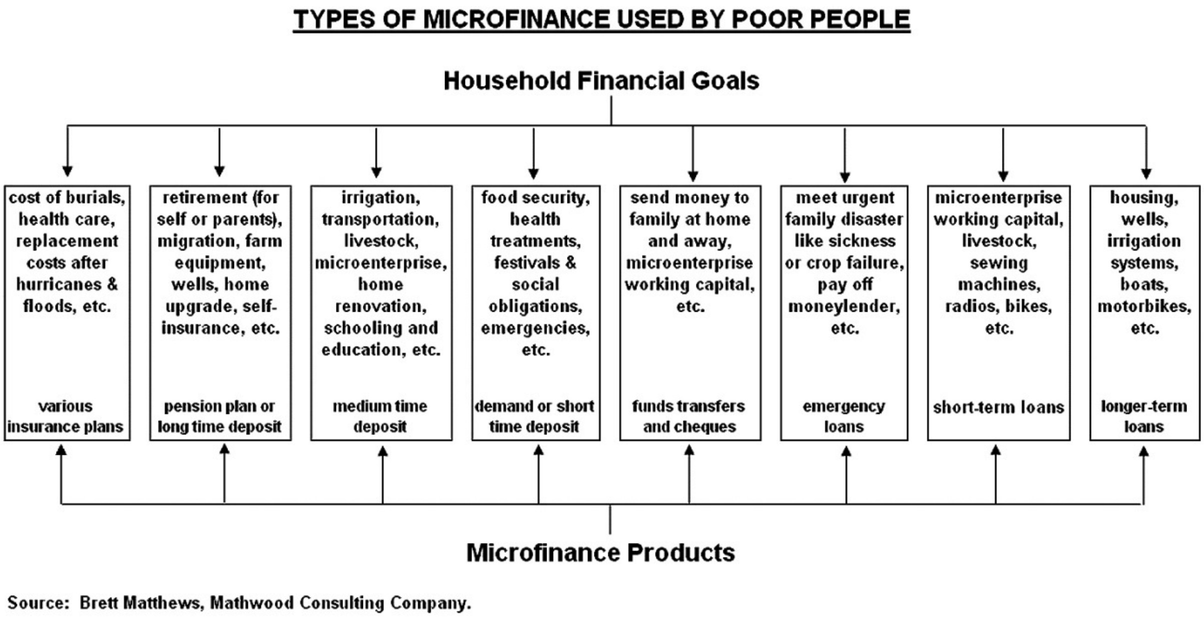

Figure 1. **Financial needs and financial services**

that seek to advance financial inclusion. CGAP develops innovative solutions through practical research and active engagement with financial service providers, policy makers, and funders to enable approaches at scale. Housed at the World Bank, CGAP combines a pragmatic approach to responsible market development with an evidence-based advocacy platform to increase access to the financial services the poor need to improve their lives.

The Consultative Group to Assist the Poor (CGAP) is committed to the twin objectives of increasing the **financial sustainability** of MFIs and deepening their poverty focus — that is, increasing their *outreach* and *impact* on the lives of poorer people. As part of this commitment, CGAP has continually endeavored to provide tools that allow for greater transparency on the performance of microfinance institutions (MFIs) in meeting these objectives. To date, the focus on *transparency* in microfinance has centered primarily on *financial performance*. The *Microfinance Poverty Assessment Tool* was developed as a much-needed tool to improve transparency on the depth of MFI *poverty outreach*[7].

In addition, the tool supports the comparison of ***poverty outreach*** among MFIs and across countries. The methodology is applicable to all MFIs, regardless of their location, client structure, or outreach approach. When used in conjunction with the *CGAP Format for Appraisal of Microfinance Institutions* (1999), the *Microfinance Poverty Assessment Tool* provides a straightforward means of gauging the likelihood than an MFI can reach poor clients while relying predominantly on *commercial funding*.

In recent years, several tools have emerged to assist donors in their assessment of the institutional performance of MFIs. One example is the *CGAP Format for Appraisal of Microfinance Institutions*, which contains practical guidelines and indicators for measuring MFI performance on a range of issues, including governance, management and leadership, mission and plans, systems, operations, human resource management, products, portfolio quality, and financial analysis. Analysis of these institutional features allows an appraisal to consider an institution's potential for viability and/or sustainability.

At the same time, the proliferation of tools such as the *CGAP Appraisal Format* has encouraged transparency and the development of standards for financial sustainability in microfinance. Currently, no rigorous tool exists to measure the poverty level of MFI clients. In order to gain more transparency on the depth of poverty outreach, CGAP collaborated with the **International Food Policy Research Institute** (**IFPRI**) to design and test a simple, low-cost operational tool to measure the poverty level of MFI clients relative to non-clients. This tool is a companion piece to the *CGAP Appraisal Format;* donors should not use the poverty assessment tool without also conducting a larger institutional appraisal.

Micro-enterprise loans

Grameen Bank is an excellent example of microfinance institution which has steered many poor to cross over the poverty line. The Bank continues to stand by them to help them reach even higher echelons of prosperity. The Bank provides larger loans, called ***micro-enterprise loans***, to these fast moving members. There is no restriction on the loan size. So far 8,640,225 members availed of the micro-enterprise loans. Average loan size is BDT 33,726 (USD 435). The maximum size of a single loan taken so far is BDT 4.0 million (USD 51,606) for fish feed, poultry feed, fish cultivation and fish business. The other major categories of activities financed are grocery shops, pharmacy, dairy farms, auto-rickshaw for transportation and stone business for construction. This programme has initiated a silent revolution in rural Bangladesh by encouraging leadership and entrepreneurial qualities and self-employment opportunities.

The interest rates of the Bank are structured with an eye on the financial status and repayment capacity of the borrowers. It does not subscribe to the conventional wisdom of loading the cost of funds for calculating interest rates for lending to the ultra-poor. On the basis of this principle the interest rates on loans for the 4 categories of Grameen Bank borrowers are as follows[8]:

[7] Henry, Carla; Sharma, Manohar; Lapenu, Cecile; Zeller, Manfred. (2003). Microfinance Poverty Assessment Tool. Consultative Group to Assist the Poor. Technical Tools Series, No. 5.

[8] ANNUAL REPORT 2014. Grameen Bank.

Table 1

Grameen Bank's interest rates

Loan Category	Interest Rate per annum
Loans for Income Generating Activities (IGA)	20%
Housing Loans	8%
Higher Education Loans	
i. During the study period of about 3–5 years	0%
ii. After the study period	5%
Struggling Members (beggars) Loans	0%

Source: ANNUAL REPORT 2014. Grameen Bank.

BOX 2

The Grameen Bank is a Nobel Peace Prize-winning microfinance organization and community development bank founded in Bangladesh. It makes small loans (known as microcredit or "grameencredit") to the impoverished without requiring collateral. The name Grameen is derived from the word gram which means "rural" or "village" in the Bengali Language.

Grameen Bank originated in 1976, in the work of Professor Muhammad Yunus at University of Chittagong, who launched a research project to study how to design a credit delivery system to provide banking services to the rural poor. Based on his results, in October 1983 the Grameen Bank was authorized by national legislation as an independent bank. In 1994, Grameen Bank received the ***Independence Day Award*** in 1994, which is the highest government award. In 2006, the bank and its founder, Muhammad Yunus, were jointly awarded the ***Nobel Peace Prize***. In 1998 the Bank's "Low-cost Housing Program" won a ***World Habitat Award***. In 2011, the Bangladesh Government forced Yunus to resign from Grameen Bank, saying that at age 72, he was years beyond the legal limit for the position.

Last book of Muhammad Yunus with Alan Jolis. (2013). *"Banker to the Poor: The Story of the Grameen Bank"* is enthralling story of how he did it: how the terrible famine in Bangladesh in 1974 focused his ideas on the need to enable its victims to grow more food; how he overcame the sceptics in many governments and among traditional economic thinking; and how he saw his micro-credit extended even outside the Third World into credit unions in the West. Such is the importance of his book that HRH the Prince of Wales has contributed a Foreword in which he hails "a remarkable man [who] spoke the greatest good sense".

The Bank's 2,568 branches serve over 81,000 villages constituting close to 97% of the country's landscape. About 100,000 new members joined Grameen Bank in 2014 swelling the aggregate number of members to a staggering **8.64 million**. Women continue to remain in the forefront to carry forward the Bank's mission for empowerment of the poor. During the year 2014 their ratio grew further to 96.26% from 96.19% of 2013. More detailed information you can find at "ANNUAL REPORT 2014" of Grameen Bank.

While the success of the Grameen Bank has inspired the world, it has proved difficult to replicate this success. In nations with lower population densities, meeting the operating costs of a retail branch by serving nearby customers has proven considerably more challenging. Hans Dieter Seibel, board member of the *European Microfinance Platform*, is in favour of the ***group model***. This particular model (used by many microfinance institutions) makes financial sense, he says, because it reduces ***transaction costs***. Very poor people only ever make minimum payments, so if you work with groups of five clients, for example, your expenses are spread accordingly. That is why many MFIs work that way. Once the most urgent need has been met, however, the need for individual loans grows, and customers no longer want to guarantee payments of other customers. Microfinance programmes also need to be based on local funds.

The fundamental error is to believe that development can be achieved in the same way as reconstruction. Development, however, is quite different — and far more difficult. The idea was that developing countries first and foremost needed capital which their banks would distribute sensibly. Accordingly, no serious attempts were made to mobilize capital in the countries themselves. Furthermore, there were hardly any private-sector banks, so government-run banks distributed the funds. For political reasons, they would grant loans at very low interest rates or even simply cancel debts. They made funds available for large prestige projects, but did not finance a broad range of small-scale and mid-sized industries. So, says professor Seibel, the financial systems of most developing countries never served their main purpose: they failed to **mobilize savings** in order to enable local investment and thus get self-supporting economic development going[9].

Self-supporting **financial institutions with strong local roots are of utmost importance for economic development — and, as a consequence, for poverty reduction too**. Today, there is a trend away from long-term donor-dependent models, even though these models are very convenient for donors with their chronic need to disburse massive funds.

ILO: MAKING MICROFINANCE WORK

ILO vision for the 21st century is **decent work for all**[10]. Decent work embraces various aspects of daily life of the working poor — productive employment, safe working conditions, equitable access to employment opportunities, absence of child labour, abolition of bonded labour, formalization of informal enterprises, access to social protection and the right to organize. The International Labour Organization (ILO) invests in microfinance, and in the capacity building of MFI managers in particular, because it believes that microfinance can help realize its vision of decent work for all.

Microfinance is an important strategy for the ILO because it contributes to the decent work agenda in a variety of ways. Microcredit and micro-leasing products provide opportunities for small investments in *self-employment* and *job creation*. Emergency loans, savings and micro insurance provide the means for poor people to better cope with risk. When microfinance is delivered through group-based models, it can provide opportunities for the poor to organize and have a voice. Some MFIs, particularly those that partner with other public or private actors in pursuit of a social mission, are actively discouraging child and bonded labour, and helping micro entrepreneurs to grow and formalize.

Entrepreneurs in the informal economy, and the employees that work in those businesses, are often exposed to difficult and dangerous working conditions. The tools used to identify, prevent and rectify such conditions in the formal economy — including social dialogue between employers and employees, labour inspection and other applications of labour law–generally do not apply to the unregistered enterprises that proliferate in many emerging economies. Consequently, alternative approaches are required. But how can one reach these enterprises and influence their conditions?

Microfinance institutions (MFIs) are a potential conduit. In many emerging markets, they have significant outreach, providing financial services to thousands, if not millions of small and micro enterprises. Since their primary relationship with these entrepreneurs often involves an enterprise loan, they could theoretically use that leverage to encourage or entice improvements to conditions in the business.

From 2008 to 2012 the International Labour Organization collaborated with 16 microfinance institutions (MFI) to test a range of approaches to foster social impact through the delivery of innovative financial and non-financial services. Eliminating child labour, fostering the formalization of enterprises, reducing vulnerability and enhancing business performance through improved working conditions — these are decent work objectives that the MFIs addressed in the

[9] "Local roots". Interview with Hans Dieter Seibel. D+C/E+Z, 2010 at: http://www.dandc.eu/en/article/why-microcredit-programmes-should-be-based-local-savings.

[10] ILO. (2014). Microfinance for Decent Work. Enhancing the impact of microfinance: Evidence from an action research programme. Social Finance Programme & Mannheim University 2014.

framework of the "*Microfinance for Decent Work*" (MF4DW) action research programme.

As the focal point for microfinance within the ILO, the ***Social Finance Programme*** initiated also the development of the Making Microfinance Work training series in 2003, building on another area of ILO expertise and concern–***management***. The ILO has a long history of involvement in strengthening management practices as a strategy for improving labour relations and working conditions. Its **International Training Centre** (**ITCILO**) in Turin, Italy has been developing and delivering management training curricula for more than four decades. The ITCILO brought this experience to bear when it joined forces with the Social Finance Programme to produce this book and its accompanying training curriculum.

The end result is a quality product that draws from management experiences both within and outside of the microfinance industry. It incorporates the perspective of a wide range of actors, including regulated financial institutions, governments, trade unions and non-governmental organizations. The ILO's unique governance structure, in which workers, employers and governments participate equally in decision-making, puts it in a privileged position to explore how public and private sector actors can work together to expand the outreach and impact of microfinance. With this course, the ILO hopes to facilitate broader and more innovative use of financial services to help create decent work for all low-income people. The course is a natural complement to other training packages created by the Social Finance Programme and ITCILO, most notably on leasing, micro insurance and guarantee funds.

What is Making Microfinance Work?

Making Microfinance Work (MMW) is a management training program that is designed to strengthen microfinance managers' ability to increase the quality and scale of their institution's outreach. The program consists of two volumes:

Volume I: Managing for Improved Performance. This course, supported by a 400-page manual, helps managers develop a holistic understanding of the different functions that contribute to successful microfinance operations. It provides tools and guidance that managers can use to improve the strategy, marketing, risk management, organizational architecture, efficiency and productivity of their unit, branch or institution.

Volume II: Managing Product Diversification. This course, supported by a 600-page manual, aims to inspire and prepare managers to expand their institutions' outreach beyond what has already been achieved. It explores the opportunities and challenges presented by ten different types of products and eight market segments. It provides tools and guidance for managing the product diversification process as well as the ongoing delivery and maintenance of a diverse product portfolio.

The MMW program draws from the experiences and techniques of microfinance service providers worldwide. It is delivered through a network of more than 100 ITC ILO certified trainers in 38 countries and nine languages (Arabic, Bahasa Indonesia, Chinese, English, French, Portuguese, Russian, Spanish, and Vietnamese).

In 2000, the International Labour Organization began providing management training courses to MFIs, both at its International Training Centre in Turin and in developing and transition countries. However, it soon became evident that the demand for this type of training far exceeded what could be supplied by the ILO itself. MFIs were growing and were typically staffing their growth by promoting their best loan officers into middle management positions. Very few received training or systematic coaching on how to manage before assuming their management responsibilities, and this was increasing MFIs' risk exposure as well as limiting their growth. Weak middle managers were liable not only to make poor decisions, but also to be ineffective at empowering others to implement wise decisions. Institutions needed a quick and cost-effective mechanism for strengthening their middle management capacity.

Although numerous training curricula existed for microfinance managers, they tended to focus on specific technical areas, were delivered only in one country, or were available only in one or two languages. To quickly and massively build capacity at the middle management level, the industry needed a holistic curriculum that could be delivered with quality by local trainers in many locations and in many languages with adaptations that were appropriate for the local environment.

Between 2003 and 2006, the ILO re-packaged its microfinance management training materials into a format that could be rolled out to training providers in developing and transition countries, and it created a rigorous three-phase certification process for building the capacity of local resource persons to deliver the content with specific quality standards.

The first volume of training materials was published as *Making Microfinance Work: Managing for Improved Performance* in 2006. The second volume was published as *Making Microfinance Work: Managing Product Diversification* in 2011. Originally designed as a sixth section of the first volume, the content of the second volume was removed and elaborated after participants in the Volume I pilot tests asked for more information on product options and more time to discuss issues related to product diversification.

Is MMW needed today?

Despite its well-known accomplishments, the microfinance industry has come under increasing criticism for failing to meet expectations. More than 2.5 billion people still have no access to formal financial services and those who do have access are not necessarily moving out of poverty. This begs an important question: why is microfinance not meeting its potential as a mechanism for facilitating *financial inclusion* and *poverty alleviation*?

There are many answers to this question, some of which include:

- Sustainability and profitability pressures that have led MFIs to prioritize growth in the most familiar and easy-to-reach markets.
- A heavy focus on microenterprise credit rather than on meeting the varied financial service needs of low-income households.
- Limited skills and strategies for survival in increasingly competitive markets.
- Systems and staff development that do not keep pace with growth.
- Inadequate MFI and client risk management.
- A lack of awareness about products and delivery strategies that can meet the needs of more difficult-to-reach markets cost-effectively; and
- Lack of interest and/or investment in systems that can measure the impact of microfinance on the incomes and poverty rates of clients.

The *Making Microfinance Work* training curriculum helps microfinance managers recognize these performance gaps and acquire knowledge, skills and attitudes that enable them to do something about those gaps. The program is designed to get managers away from their offices and day-to-day responsibilities to a place where they can question their assumptions, see alternatives to the status quo, and be inspired by what others have proven to be possible. It creates a space within which managers can refocus on their mission and collaborate with others to identify ways of making their microfinance operations work better for the clients they already serve, as well as those who are still waiting to be served, while simultaneously strengthening their institutional performance.

Microfinance is no panacea for poverty alleviation, but it has demonstrated the potential to facilitate risk management, asset acquisition and decent work for low-income households. Until it realizes that potential for all low-income households, there is a role for MMW to play in making microfinance work better.

BOX 3

Accion International

Accion was founded in 1961 to empower the poor with the knowledge and tools to improve their lives. Begun as a grassroots community development initiative in 22 shantytowns in Venezuela, Accion today is one of the premier microfinance organizations in the world, with a network of lending partners that spans Latin America, Africa, Asia and the United States. Though Accion's approach has changed over the years, the driving force behind our mission remains the same. Accion still aim to serve hardworking men and women left behind by the world's economic systems. It is their courage and ingenuity, and the tremendous power of their dreams that continue to inspire in the search for ***full financial inclusion***.

2000: New Millennium, New Horizons

In October 2000, Accion began working in partnership with micro-lending organizations in sub-Saharan Africa, marking its first initiative outside the Americas. Recognizing the vital need for microcredit throughout Africa, Accion committed itself to increasing financial inclusion for poor, self-employed Africans throughout the continent. In 2006, Accion launched a landmark partnership with Ecobank, the leading regional bank in West Africa. EB-Accion Savings and Loans launched operations in Ghana in 2007 and is expanding to neighboring countries.

In 2005, Accion set off on a new venture to reach another vast, underserved group: urban small business owners in India. Since establishing an office in Bangalore, Accion has partnered with local financial institutions in Patna and Mumbai, guiding them in applying individual and group lending and tailored credit scoring, among other microfinance methodologies. In India, as elsewhere, Accion's work is built on the premise that sustainable, responsible institutions beget empowered clients able to improve their futures for the long term.

Aided by returns from our investment, through the **Accion Gateway Fund**, in Mexican partner Compartamos Banco, Accion began pursuing new projects, including creating a critical strategic reserve, developing new products and technologies, increasing staff recruitment and training, launching new initiatives around the world, and investing in less-mature MFIs to bring microfinance to even more of the world's entrepreneurial poor. In particular, Accion established the **Center for Financial Inclusion** in 2008, an "action tank" focused on advancing the commercial model of microfinance while upholding the interests and needs of poor clients worldwide.

Today, the Center works with a wide variety of actors–microfinance experts, banks, investors, regulators, technology firms, universities and others–to address challenges related to financial inclusion. Center staff members collaborate with experts across industries, many of whom have not yet applied their strengths to microfinance or worked at the same table; to research, develop and share solutions that enhance the lives of the world's poor. The Center's goal is to connect the microfinance community with the major drivers of the global economy–capital markets and technology–and harness their capabilities to address the financial needs of poor people. By bringing these elements together, the Center for Financial Inclusion serves as a bridge between today's microfinance and a future of economic opportunity for all.

2010s: Focusing on Full Financial Inclusion

In 2009 and 2010, Accion continued to expand its reach around the globe. Key milestones included helping to start microfinance institutions in underserved areas of Inner Mongolia, Cameroon and Brazil to empower the vulnerable poor in those regions with economic opportunity. In December 2009, Accion inaugurated **Accion Microfinance China** (AMC) in Chifeng Prefecture, Inner Mongolia, to deliver financial services in a region where 40 percent of the population remains below the poverty line. In January 2010, Accion received the green light from the Brazilian government to launch microfinance operations in Manaus, in the poor Amazonas region of the country. And in April of that year, Accion worked with Ecobank to establish EB-Accion Microfinance in Cameroon.

Today, Accion's work is far from over. More than 2 billion of the world's poor still lack access to financial services. Accion is more committed than ever to using its 50 years of experience in order to help build a more financially inclusive world. To this end, Accion will continue to focus sharply on reducing vulnerability and on increasing opportunity for poor households by helping to deliver full financial inclusion–credit, savings, insurance, payments, remittances, financial education, and more–provided at affordable prices, in a convenient manner, and with dignity for clients.

Accion's goal is to build microfinance institutions that are committed to generating both social and financial value. It seeks partner institutions that demonstrate the potential to be the industry's future leaders in financial inclusion. This includes both institutions with a focus on low-income households and other retail organizations and technologies that provide financial products and services to this same market segment in various ways.

Who supports MMW?
MMW is a collaborative effort. The original design was made possible by the ILO's Social Finance Unit and International Training Center with financial support from AGFUND, the Government of Italy and USAID. With additional core support from the EU/ACP Microfinance Programme, and with local support from numerous other donors and partners, Volume I was translated into multiple languages and 25 certification processes were implemented. Volume II was later developed and pilot tested with funding from the EU/ACP Microfinance Programme, the Government of Luxembourg, the Government of Italy and the United Nations Capital Development Fund (UNCDF).

Much of the content presented in MMW was originally developed by other organizations and individuals who generously allowed their ideas and tools to be repackaged for the purpose of this training curriculum. This made it possible for the MMW authors to weave together the best of what already existed and to build on that expertise rather than start from scratch. Numerous content experts contributed original material for the course and dozens more professionals helped review it. Certified trainers from around the world invest their own time and energy to keep the materials relevant and up-to-date. Participants often contribute suggestions that make the course stronger.

Course delivery is decentralized so that content can be made available in multiple languages and locations simultaneously at an affordable price. Trainings are organized and implemented by a network of certified trainers and local partners in 40 countries. In general, courses are priced at local market rates to cover their costs. In some cases, donor support makes it possible for those with very limited resources to participate.

Managing Product Diversification course evolved from material that was originally included in the International Labour Organization (ILO) 's training package, *Making Microfinance Work: Managing for Improved Performance*. In that training, product diversification was discussed as one of the strategies through which microfinance managers can improve their institution's outreach. By expanding the range of products offered, MFIs can serve more poor people, meet more of their clients' financial service needs and, as a result, make greater progress towards the achievement of their commercial and social objectives.

During pilot testing of the original training, participants requested that more time be devoted to the discussion of various product options and the management of product diversification. Rather than lengthen an already intense two-week course, the ILO responded by removing product diversification content from the original curriculum and creating a separate training to explore that material in more depth. The book *Making Microfinance Work: Managing Product Diversification* is the outcome of that decision. Readers can find detailed information at the course website: http://mmw.itcilo.org.

The book *Managing Product Diversification* and the training course it supports are designed to achieve four main objectives: 1) raise awareness of the opportunities and risks that product diversification presents; 2) explore options for improving the outreach of microfinance institutions (MFIs) through product diversification; 3) provide tools and strategies for managing the product diversification process success fully; and 4) encourage more proactive management of MFI product portfolios over time. The term "microfinance institution" is used to describe a wide range of regulated and non-regulated providers of microfinance services. This includes commercial banks that have a microfinance window, non-bank financial institutions that specialize in microfinance, cooperatives and credit unions that serve the low-income market and non-governmental organizations that provide financial as well as non-financial services to the poor, among others.

WHY MFIs OUGHT TO SERVE SMALL ENTERPRISES?

The top two reasons why MFIs are moving into serving small enterprises is to grow their business and to follow their micro clients as they themselves grow. External incentives from funders and governments are not a major driver. Opportunities for MFIs to grow their organizations and their continued relationships with established clients lead the reasons MFIs do business with small enterprises. This is the point much discussed by Dani Rodrik in his "*Work and*

Human Development in a Deindustrializing World" and other Rodrik's publications. The question is whether small enterprises tend to be the sectors that generate the technological benefits and growth effects. The countries that create and support those export-oriented, tradable enterprises profitable tend to induce in turn more investments from the private sector and therefore more dynamic benefits, more economic growth. It generates structural change, structural transformation, which is what these developing countries need most: to get resources from low-productive economic activities towards higher-productivity activities which can serve world markets. And that ***process of structural transformation*** **is what lies at the heart of the growth process in developing countries**.

The key implication of the structural transformation imperative from a policy perspective is that while the **composition of output** may be of second-order importance in a rich country, it is of first-order importance for economic performance and economic growth in a developing country. **It is crucial for developing countries to achieve the right mix of economic activities.**

We ought to investigate one of the most surprising things that we have seen in the last few decades–that in large parts of the world today, structural transformation is taking place in reverse. People are moving from high-productivity activities to low-productivity activities and not the other way around. What is the role of microfinance in this process? So, we have to ask what happens to the workers who are displaced from these firms that become more productive by rationalizing production, upgrading technology, and substituting capital for labor. These workers end up not in more productive activities but in less productive activities.

Many economists believe that **poverty** itself is a barrier to development, given the limitations of credit and insurance markets — the poor are too poor to save or invest in either human capital or businesses that spur growth. Such a view takes as given financial institutions, however. And it is true that existing formal institutions such as banks find it unprofitable to offer financial services to the poor, and the poor also appear not to be interested in insurance products and to have low ***savings rates***.

We know that poor people don't have access to credit, they don't have access to health facilities, they can't or don't send their children to school and therefore they tend not to get educated and skilled. So **there is a whole set of syndromes associated with poverty**. And the fundamental question here is — are people poor because they don't have access to credit, because of their health status or their education, or are those things really the consequence of poverty? This complicated relationship between poverty and its syndromes has to be untangled before we can actually make progress. Because in development it has been really tried everything–from massive state intervention to massive foreign aid, to massive scale microfinance. The issue is that these interactions are fairly complicated and also tend to be fairly *context-specific* and therefore it's very hard to go anywhere with very general, blanket recommendations and grand strategies without understanding that the details on the ground are what really differentiates countries and what determines success.

Maybe, the principal barrier to providing the poor with financial resources is the absence of delivery mechanisms that appropriately take into account market imperfections, informal institutions, and behavior. One well-known institutional innovation in finance was "***microcredit***," but evidence of its success is mixed and an understanding of why and whether the specific features of microcredit mechanisms contribute to solving the fundamental problems of credit markets is incomplete. Designing the appropriate financial institutions and delivery mechanisms, of course, requires a deep understanding of behavior and informal sources of finance. So, it is important to look at how differing mechanisms of delivery for savings, insurance, and loan products affect both ***take-up rates*** and ***sustainability*** (e. g., repayment rates in the case of loans), as well as how such products affect savings, contribute to consumption smoothing, and spur business investment.

However, in the absence of effective *social programs*, high growth may not deliver much real development. So, in assessment of impact of microfinance we ought to take into consideration the **human capital effects on growth**. For example, a program redistributing income to the poor alleviates poverty to some extent, but it does not address the root cause of poverty and thus may not be sustainable in the long run. In most low-income countries, school attendance and school inputs are also at low levels. There may be many ways in which schooling can be increased, and there is now increased evidence on the "effectiveness" of various mechanisms, through cash transfers that condition on schooling, via polices that relieve credit constraints, or through improvements in school availability or school quality. But **if schooling demand is low**, principally because payoffs to schooling are low, such interventions will have little effect on poverty reduction and growth. So, an understanding of the contexts in which schooling and health contribute to long-term growth is needed along with evidence on the effectiveness of polices that induce increased schooling demand or increase healthiness.

Another question, on the demand side, is whether development of MFIs activities can create a ***middle class*** and spur its development. Recently, the middle classes have been (re) discovered as innovators and bearers of new values and life-styles on a global scale. Middle classes are believed to boost economic growth, promote desirable social dynamics, and safeguard democracy. They are regarded as *modernizers* who embody a positive vision of social mobility. With respect to the middle classes in Europe and North America, pessimistic narratives of stagnation, if not deprivation and victimization due to transformations of the world economy dominate. Do these middle classes in different parts of the world nevertheless share some characteristics and experiences? Those commonly grouped under this label seem to constitute a heterogeneous collection of people with a wide range of occupations, income levels, lifestyles and political ambitions. Are they really to be viewed as a single social formation, whose members share situational characteristics, a sense of belonging together, common attitudes and values, as well as a disposition for common behavior and actions?

One of the major features shared by all middle classes is their "**boundary work**". The history and current dynamics of the middle classes have been, and continue to be, marked by the drawing of boundaries vis-à-vis those "above" and those "below", although who precisely constitutes this "below" and "above" vary. Furthermore, **work is a central boundary marker**. Belonging to the middle class is generally regarded as an achieved, rather than an inherited status. **Employment and work** thus are central themes. Further aspects concerned the role of education in the intergenerational transmission of middle-class status; intra-class distinctions through certain ideals of domesticity; gender relations; the role of consumption for demonstrating middle-classness; and the interrelationship between the state and the middle classes.

The next question is whether microfinance can help a country to become a **democratic** country. Democracy was a sort of meta-institution, allowing each society to choose and shape its institutions in contextually appropriate ways. Democracies do indeed generate high-quality growth, providing greater predictability, stability, and resilience and better distributional outcomes[11].

Rodrik also stated that ***manufacturing* might be an escalator for poor countries for several important reasons**. *First*, there tends to be a positive productivity dynamic in many manufacturing industries. Establish a beachhead in one of the "easy" manufacturing sectors — such as garments — and the chances are that you will experience steady increases in productivity, and will be able to jump on to other, more sophisticated industries in time. *Second*, manufacturing is a **tradable sector**. This means that your successful manufacturing industries can expand almost indefinitely, by gaining market share in world markets, without running into demand constraints. *Third*, manufacturing is a great absorber of unskilled labour, a low-income country's most plentiful resource. Activities such as garments, footwear, toys and electronics assembly require few skills, so farmers can easily be transformed into assembly line workers.

However, **today this path looks both less desirable and less feasible. A new path will have to be invented**. The broad contours of this alternative are easy to state. It will be a model based on services. It will focus more on ***soft infrastructure*** — learning and institutional capa-

[11] Dani Rodrik. (2016). Is Liberal Democracy Feasible in Developing Countries? Springer Science+Business Media, New York (Paper was prepared for the 50th Fiftieth Anniversary Conference of Studies in Comparative International Development, Brown University, October 30, 2015).

bilities — and less on physical capital accumulation — plants and equipment in manufacturing industries. Beyond that, however, much remains up for grabs.

What is clear, therefore, is that policy makers will face an altogether new challenge when they turn to the future of work and human development. More of economic growth will have to come from **productivity advances in services**. This means in turn that the partial, sectoral approaches that worked so well to stimulate export-oriented industrialization during the early stages of rapid growth in Asia and beyond will have to be replaced (or at least complemented) by **massive economy-wide investments in human capital and institutions**. When manufacturing is the engine of the economy, selective reforms such as export incentives, special economic zones or incentives to foreign investors can be highly effective. After all, it is enough to have a few export successes, facing nearly infinite demand on world markets, to pull the economy along. But when growth has to rely on (mostly) *non-tradable services*, selective efforts will not work. **Reform efforts will have to be more comprehensive, targeting productivity growth in all services simultaneously**. The leader will take all.

MICROFINANCE UNDER MICROSCOPE

The Economist Intelligence Unit (EIU) issued last time "Global Microscope 2015: The enabling environment for financial inclusion." This work was supported by funding from the Multilateral Investment Fund (MIF), a member of the Inter-American Development Bank (IDB) Group; CAF — Development Bank of Latin America; the Center for Financial Inclusion at Accion, and the MetLIfe Foundation.

As recognition of the role of accessible and diverse financial services has grown in recent years, The Economist Intelligence Unit's Microscope series has become an important tool for those seeking to understand the field.

The Global Microscope 2015: The enabling environment for financial inclusion, formerly known as the *Global Microscope on the Microfinance Business Environment*, assesses the **regulatory environment** for financial inclusion across 12 indicators and 55 countries. The Microscope was originally developed for countries in the Latin America and Caribbean region in 2007 and was expanded into a global study in 2009. Most of the research for report, which included interviews and desk analysis, was conducted between June and September 2015.

About The Global Microscope 2015

Financial inclusion, in its broadest sense, requires much wider access to a range of financial products for traditionally underserved or excluded populations. Accordingly, in the past few years, the substantial importance to economic development — and the potential to improve the lives of individuals — of tools such as savings instruments, payment systems (notably electronic cash), and micro-insurance has become increasingly well understood.

Financial inclusion has come a long way. A little less than a decade ago, discussion in this area centred almost entirely around ***microcredit*** — small loans allowing entrepreneurs at the bottom of the pyramid to expand their activities. While still a crucial service for these individuals, research by many institutions globally has shown that this was only one element of broadening access to *financial services* for the world's poor. Today, the ability of financial inclusion to empower low-income populations worldwide has pushed it near the top of the ***sustainable-development agenda***.

The latest demonstration of the growing consensus of the importance of financial inclusion is found in "***Transforming our world: The 2030 Agenda for Sustainable Development***" — the unanimously adopted UN General Assembly plan that succeeds the *Millennium Development Goals*. Not only does its preamble specifically mention financial inclusion, but five of the 17 overarching *Global Sustainable Development Goals* that the agenda champions (specifically, Ending Poverty; Ending Hunger; Gender Equality; Sustainable, Inclusive Economic Growth, and Sustainable, Inclusive Industrialization) note the need for improved or universal access to financial services. In short, financial inclusion is now recognized as one of several essential building blocks supporting key elements of the sustainable-development agenda. As such, it is part of the foundation for the world's wider hopes for progress.

BOX 4

Global Sustainable Development Goals

This year the Global Goals for Sustainable Development come into effect to achieve three extraordinary things by 2030 — end poverty, combat climate change and fight injustice and inequality.

1. End poverty in all its forms everywhere
2. End hunger, achieve food security and improved nutrition and promote sustainable agriculture
3. Ensure healthy lives and promote well-being for all at all ages
4. Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
5. Achieve gender equality and empower all women and girls
6. Ensure availability and sustainable management of water and sanitation for all
7. Ensure access to affordable, reliable, sustainable and modern energy for all
8. Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
9. Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation
10. Reduce inequality within and among countries
11. Make cities and human settlements inclusive, safe, resilient and sustainable
12. Ensure sustainable consumption and production patterns
13. Take urgent action to combat climate change and its impacts*
14. Conserve and sustainably use the oceans, seas and marine resources for sustainable development
15. Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss
16. Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels
17. Strengthen the means of implementation and revitalize the global partnership for sustainable development

Financial Inclusion is such an important topic that organizations like the IDB/MIF, Accion, CAF and the MetLife Foundation support the Microscope. As with the sector itself, the publication has evolved and broadened from an initial focus on *credit* and *savings*. *Microscope 2015* is the second edition to offer this expanded scope, which assesses the overall environment for financial inclusion in more than 50 countries. To do so, it examines policies and regulations for a range of financial products and services; a wider set of institutions providing these services; the full array of delivery methods; and the institutional support that ensures the safe provision of services to low-income populations. These criteria are scored using a dozen indicators, based on more than 40 individual data points, which look at the existence and implementation of *formal policy and regulation* around different aspects of financial inclusion. The *overall score* is then adjusted for the effects of political, economic, and policy stability. Together, these give a nuanced picture of the practical realities of financial inclusion in the markets covered.

As with earlier editions, *Microscope 2015* is directed towards practitioners, policymakers, investors, and other stakeholders in the area of financial inclusion — to help them evaluate a country's progress in these areas and to establish where further efforts should be made in order to yield additional benefits.

It does this in two ways. *First*, using a detailed and transparent scoring system, its results provide a useful comparison between countries on financial inclusion overall, as well as on specific elements of it. *Second*, *Microscope 2015* allows readers to track changes in the performance of countries since 2014 in a world in which the pace of change is quite rapid. (Comparisons to previous years are less valuable due to a major revision of methodology.)

Without pre-empting the presentation of findings, one point is worth noting here. Despite a growing appreciation of the importance, and potential value, of financial inclusion, most countries can still improve their enabling environment. Only a handful score more than 75 out of 100 in our rankings, and a majority finish at or below 50. The intellectual argument for financial inclusion may have become conventional wisdom; putting it into practice will require ever more innovative and effective policies and tools — a process that future editions of *Microscope* will follow with interest.

Explanation of the report's methodology

The latest edition of the Index includes a small number of data revisions, although not enough to disrupt comparisons between the two years. The most important of these revisions were additional indicators, or adjusted scoring methods, that yield a better picture of insurance targeting low-income consumers, regulation of electronic payments, and consumer protection.

For seven years (2008–13), the *Microscope* has evaluated the regulatory and structural framework for microfinance institutions (MFIs), as well as the business operating environment for microfinance across 55 countries. In 2014 The Economist Intelligence Unit expanded the analytic framework of the *Microscope*, going beyond microfinance to incorporate indicators reflecting the enablers of financial inclusion. The intention is to maintain the *Microscope*'s relevance to stakeholders who serve low-income populations and broaden the scope of the index to financial inclusion — an important emerging topic and a driver of economic development.

Although microfinance remains an important way of providing financing to individuals, the methods and tools for accessing finance continue to develop. Indeed, financial inclusion has emerged as a key public-policy theme[12].

For the first time the indicators and methodologies used to evaluate the microfinance environment were developed in 2007, in co-ordination with MIF and CAF. The real-world relevance of these indicators was evaluated through in-depth interviews with country experts and microfinance practitioners from the Latin American/Caribbean (LAC) region. The indicators were further validated in 2007 and 2008 by their high positive correlation with some microfinance-penetration figures. The original index included 15 countries in the LAC region, which was subsequently expanded to 21 LAC countries, plus an additional 34 countries around the globe, in co-operation with the IFC. The 2011, 2012, 2013 and 2014 versions of the index cover 55 countries.

As a first step in revising the methodology, we convened an expert panel in January 2014 to discuss changes to the Microscope benchmarking framework, so as to capture financial inclusion. Around 20 experts were drawn from international research organizations and from among independent consultants in the financial inclusion community. The experts discussed key financial inclusion topics and their suitability for use in the revised indicator framework that forms the foundation of the *Microscope*. After gathering inputs from the panel and consulting the funding organizations, we revised the indicator framework and methodology for this year's report. The revised *Microscope* includes 12 indicators, which assess a country's government, and its political, regulatory and supervisory capacity to enable an environment of financial inclusion, as well as a 13th indicator used as an adjustment factor to reflect political instability, which impacts the country's financial inclusion environment.

Examining the various definitions of financial inclusion across countries, regulators and financial institutions revealed several common elements essential to achieving financial inclusion. For financial services to be more inclusive, the financial and regulatory environments need to:

- **Offer a wide range of products**: There is a consensus that financial inclusion goes beyond microcredit. The environment needs to expand its financial services to include access to savings, insurance, payment systems and pensions.
- **Have a wider range of providers**: Technological advancement demonstrates that many types of companies can provide non-traditional financial services, such as mobile-banking and payment systems (M-Pesa and payments).
- **Target diverse groups and sub-populations**: An inclusive financial environment is one in which people are not solely defined by income. Although the literature on financial inclusion has not reached a consensus as to whom,

[12] There are many definitions of financial inclusion and this report does not adopt any particular one. The aim is to measure the enablers of financial inclusion and not the outcome per se. In this report, we characterize "financial inclusion" as the availability of a wide range of financial services to all populations, especially the disadvantaged.

specifically, financial inclusion should target, the *Global Microscope on Financial Inclusion* will focus on the underserved market for financial products (people "at the bottom of the pyramid", minorities and micro-businesses).

- **Facilitate new ways to deliver financial products or services**: The concept of financial inclusion entails innovative approaches to the way financial services are delivered to traditionally excluded or underserved populations. In this sense, the role of technology is key; the development of platforms using digital technologies means that, for example, transactions can be processed through mobile devices in remote areas.
- **Provide adequate financial education**: In order to expand financial products and services to the traditionally underserved and under-banked populations, it is essential also to provide proper education and information about the financial system, consumer rights and pricing, so consumers can make informed decisions. Financial literacy is an important and growing part of consumer protection in microfinance and expanded access to low-income populations.

Microscope indicators

While the indicator scores and the data behind them tell an important story, it is, inevitably, incomplete. Therefore, as in past editions, Microscope 2015 includes country summaries describing the specific efforts to enhance financial inclusion, as well as the factors that might assist or impede these efforts. The study also includes an Excel-based model of the Index, which allows users to evaluate and compare results by indicators, sub-indicators, countries, or regions.

The 12 indicators and supporting sub-indicators for this index are as follows:

1. Government support for financial inclusion

Sub-indicator 1: Existence and implementation of a strategy

Sub-indicator 2: Data collection

2. Regulatory and supervisory capacity for financial inclusion

Sub-indicator 1: Technical capacity to supervise

3. Prudential regulation

Sub-indicator 1: Appropriate entry and licensing requirements

Sub-indicator 2: Ease of operation

4. Regulation and supervision of credit portfolios

Sub-indicator 1: Interest rates

Sub-indicator 2: Risk management of credit portfolios

Sub-indicator 3: Risk management framework for microcredit portfolios

5. Regulation and supervision of deposit-taking activities

Sub-indicator 1: Ease of offering savings products by regulated institutions

Sub-indicator 2: Existence of in-depth deposit-insurance coverage

6. Regulation of insurance targeting low-income populations

Sub-indicator 1: Existence of regulation of insurance for low-income populations

Sub-indicator 2: Delivery channels for insurance targeting low-income populations

Sub-indicator 3: Consumer protection for insurance targeting low-income populations

7. Regulation and supervision of branches and agents

Sub-indicator 1: Ease of setting up a branch

Sub-indicator 2: Ease of agent operation

8. Requirements for non-regulated lenders

Sub-indicator 1: Information reporting and operational guidelines

9. Electronic payments

Sub-indicator 1: Available infrastructure for financial inclusion

Sub-indicator 2: Digital financial services

10. Credit-reporting systems

Sub-indicator 1: Comprehensiveness of information

Sub-indicator 2: Privacy protection for both borrowers and lenders

11. Market-conduct rules

Sub-indicator 1: Existence of a framework and institutional capacity to protect the financial consumer

Sub-indicator 2: Existence and content of disclosure rules

Sub-indicator 3: Existence of fair treatment rules

12. Grievance redress and operation of dispute-resolution mechanisms

Sub-indicator 1: Internal complaint mechanisms

Sub-indicator 2: Existence and effectiveness of a third-party-redress entity

ADJUSTMENT FACTOR: STABILITY

Sub-indicator 1: General political stability

Sub-indicator 2: Shocks and policies impacting financial inclusion

Scoring methodology. Each of the indicators contains between one and three sub-indicators and, in turn, each sub-indicator is composed of between one and four questions that were scored from 0–4, 0–3 or 0–2 where the highest number is the best and 0=worst. Once indicator scores had been assigned, these were normalized and weighted according to a consensus among clients and experts, then aggregated to produce an overall scoring range of 0–100, where **100 = best** and **0 = worst**. Each of the 12 indicators was given equal weight, while sub-indicator weights varied according to importance and the number of sub-indicators included.

Finally, the adjustment factor, Stability, adjusts each country's score for political stability and policies that impact financial inclusion.

The index

The *Microscope* is an exercise in benchmarking countries, with the goal of identifying areas for improvement in the legislative and regulatory frameworks that support financial inclusion, as well as a means by which to evaluate conditions that may be conducive to, or inhibit, expanded access to, and understanding and usage of, financial services. The *Microscope* focuses on the enablers of financial inclusion: the laws, regulations and types of products being offered that support or demonstrate financial inclusiveness.

The *Microscope* is broadly patterned after other indices that measure the openness of the regulatory, legal and business environment to private-sector participation. However, the *Microscope* relies to a larger extent on qualitative measures of the financial inclusion environment. This places a special obligation on researchers to design an index that captures relevant aspects of the environment, and that does so in a defensible and consistent manner. Despite insufficient and often incomplete data regarding the financial inclusion environment, much effort has been made to combine available secondary sources and primary legal texts with insights and information from segment stakeholders in each national context. Additional measures are taken to ensure that the qualitative scores are consistent across countries and regions.

Sources

To score the indicators in this index, data were gathered from the following sources:

- In-depth, personal interviews with regional and country experts, as well as practitioners and regulators.
- Texts of laws, regulations and other legal documents.
- Economist Intelligence Unit proprietary country rankings and reports.
- Scholarly studies.
- Websites of governmental authorities and international organisations.
- Websites of industry associations.
- Local and international news-media reports.

A goal for this year's *Microscope* was to increase the number and scope of practitioners interviewed per country, to obtain the widest possible range of perspectives on the financial inclusion environment.

This year, we interviewed over 200 experts. A large proportion of these interviewees were drawn from in-country sources, especially local banks and MFIs, national microfinance networks and financial regulators, mobile-network operators (MNOs), and local offices of multilateral organisations.

These additional consultations provide a multifaceted perspective and a nuanced portrait of the environment for financial inclusion. Moreover, the 2015 report continues to draw on new data and secondary sources, so as to be able to provide the most up-to-date and in-depth analysis of the financial inclusion environment in 55 developing countries around the world.

Scoring criteria

Indicators in the *Microscope* index are qualitative in nature, and defined through a set of 41 questions. These questions seek to measure not only the laws and standards governing the segment, but also their enforcement, implementation and effectiveness. An experienced team of international-development researchers, microfinance practitioners and country experts analyzed regulations, laws, news articles, government sites and other resources to provide objective, comprehensive, informed answers to each question. In addition, the researchers interviewed over 200 experts to provide color and insight into the overall environment of financial inclusion in each country. Economist Intelligence Unit research staff supplied sources, contacts and a detailed set of guidelines outlining the criteria and goals, as well as a scoring scheme for each question.

While the criteria are detailed, they are subjective in nature. Economist Intelligence Unit research staff reviewed each response thoroughly, calibrated scores and conducted cross-country comparisons, so as to ensure that scores were properly justified and consistent across all countries. Consequently, scores are best understood by reading both the scoring criteria and the written justifications provided for each indicator found in the accompanying excel model available at: www.eiu.com/microscope2015. The indicators and scoring scheme are outlined below.

1. Government support for financial inclusion

1. Existence and implementation of a strategy:

a) Is there a documented strategy on financial inclusion?

Scoring: 0 = There is no documented strategy for financial inclusion OR recent activities in two or more areas of financial inclusion; 1 = The government has a documented financial inclusion strategy, but it does not contain specific commitments OR there is no documented strategy, but there are recent activities in two or more areas of financial inclusion; 2 = The government has a documented financial inclusion strategy, containing specific commitments that have been partially implemented; 3 = The government has a documented financial inclusion strategy containing specific commitments, including G2P payments and financial capability, and it has been substantially implemented.

2. Data collection:

a) Does the government collect customer-level data that helps to understand low-income populations' demand for financial services?

Scoring: 0 = The government does not collect customer-level data from financial institutions; 1 = The government collects EITHER customer-level data from regulated institutions or household data; 2 = The government collects customer-level data and household data.

2. Regulatory and supervisory capacity for financial inclusion

1. Technical capacity to supervise:

a) Is there a specialized capacity in place in the regulatory agency?

Scoring: 0 = There is no specific mandate to supervise financial services and products that facilitate financial inclusion OR there is no specialized capacity for financial inclusion in place; 1 = Limited specialized capacity for financial inclusion is in place; 2 = Some specialized capacity for financial inclusion is in place; 3 = Specialized capacity for financial inclusion is in place.

b) Is the financial regulator politically independent?

Scoring: 0 = The financial regulator is often influenced by political dynamics; 1 = The financial regulator is generally independent of political influence; 2 = The financial regulator is always independent of political influence.

3. Prudential regulation

1. Appropriate entry and licensing requirement:

a) Are minimum-capital requirements appropriate to allow new entrants and ensure the safe provision of financial services?

Scoring: 0 = Minimum-capital requirements are not appropriate; 1 = Minimum-capital requirements are somewhat appropriate; 2 = Minimum-capital requirements are appropriate, but not effective; 3 = Minimum-capital requirements are appropriate and effective.

b) Are there any impediments to entering the market, such as funding or ownership restrictions?

Scoring: 0 = BOTH funding restrictions and ownership restrictions are barriers to entering the market; 1 = EITHER funding restrictions or ownership restrictions are barriers to entering the market; 2 = There are no funding and ownership restrictions to entering the market.

2. Ease of operation:

a) Are capital-adequacy standards appropriate to ensure both financial stability and the operation of a variety of providers?

Scoring: 0 = Capital-adequacy standards are not appropriate; 1 = Capital-adequacy standards are somewhat appropriate; 2 = Capital-adequacy standards are appropriate.

b) Are reporting requirements reasonable in light of the specific nature of the services provided?

Scoring: 0 = Reporting requirements are not reasonable; 1 = Reporting requirements are somewhat reasonable; 2 = Reporting requirements are reasonable.

4. Regulation and supervision of credit portfolios

1. Interest rates:

a) If there are interest-rate caps for credit, do they distort the market?

Scoring: 0 = There are interest-rate caps and they affect the provision of all types of credit; 1 = There are interest-rate caps and they affect the provision of microcredit and consumer credit; 2 = There are interest-rate caps and they affect EITHER microcredit OR consumer-credit provision; 3 = There are no interest-rate caps OR they do not distort the market for microcredit and consumer credit

2. Risk management of credit portfolios:

a) Does the regulator actively supervise the status of over-indebtedness for credit portfolios?

Scoring: 0 = There is no evidence of over-indebtedness monitoring in the past year; 1 = There is some evidence of over-indebtedness monitoring in the past year; 2 = There is clear evidence of over-indebtedness monitoring in the past year.

b) Is there a differentiated risk-management framework for consumer-credit portfolios? Does the regulator supervise the status of consumer-credit portfolios?

Scoring: 0 = There is no differentiated risk management framework for consumer credit; 1 = There is a differentiated risk-management framework for consumer credit, but supervision of its status is limited; 2 = There is a differentiated risk-management framework for consumer credit and the regulator supervises its status.

3. Risk-management framework for microcredit portfolios:

a) Is there a differentiated and comprehensive risk management framework for microcredit?

Scoring: 0 = There is no definition of microcredit; 1 = There is a definition of microcredit, but no differentiated risk-management framework; 2 = Differentiated risk-management framework is not comprehensive; 3 = Differentiated risk management framework is comprehensive.

5. Regulation and supervision of deposit-taking activities

1. Ease of offering savings products by regulated institutions:

a) Are account-opening requirements for savings products proportionate?

Scoring: 0 = Account-opening requirements are not proportionate; 1 = Account-opening requirements are somewhat proportionate; 2 = Account-opening requirements are proportionate.

b) Are there any interest-rate restrictions on deposits that generate market distortions?

Scoring: 0 = There are interest-rate restrictions and they discourage deposits (from savings) in general; 1 = There are interest-rate restrictions and they discourage deposits (from savings) from low-income populations; 2 = There are interest-rate restrictions and they discourage some deposits (from savings) from low-income populations; 3 = There are no interest-rate restrictions OR they do not discourage deposits (from savings) from low-income populations.

2. Existence of in-depth deposit-insurance coverage:

a) Is deposit insurance applicable to all institutions authorized to take deposits and with the same conditions?

Scoring: 0 = There is no deposit-insurance system in place for small depositors; 1 = There is a deposit-insurance system in place that gives differentiated treatment to deposits in terms of institutions AND in terms of coverage; 2 = There is a deposit-insurance system in place that gives differentiated treatment to deposits in terms of institutions OR in terms of coverage; 3 = There is a deposit-insurance system in place with no differentiated treatment for any client.

6. Regulation of insurance targeting low-income populations

1. Existence of regulation of insurance targeting low-income populations:

a) Is the regulation comprehensive and has it been implemented?

Scoring: 0 = There is no regulation of insurance for low-income population, nor any incipient activity under a general insurance law; 1 = There is no specific regulation of insurance for low-income population, but there is some incipient activity OR regulation exists, but it is not comprehensive and it has not been implemented; 2 = Specific regulation exists, it is not comprehensive and has only been partially implemented; 3 = Specific regulation exists, it is comprehensive, but has only been partially implemented; 4 = Specific regulation exists, it is comprehensive and has been fully implemented.

2. Delivery channels for insurance targeting low-income populations

a) Do regulations facilitate a variety of channels for distribution?

Scoring: 0 = There is no regulation; 1 = There is regulation BUT it does not facilitate a variety of distribution channels for micro-insurance; 2 = There is regulation AND it facilitates a variety of distribution channels for micro-insurance.

3. Consumer protection for insurance targeting low-income populations

a) Does the regulator monitor key indicators for consumer protection?

Scoring: 0 = There are no consumer-protection standards for insurance targeting low-income customers or the regulator does not monitor any data on consumer protection; 1 = The regulator monitors key indicators, BUT it does not take any action; 2 = The regulator monitors key indicators AND it takes action.

b) Are there clear rules that require insurance providers to disclose information about the overall cost of the products and consumers' rights and obligations

Scoring: 0 = There are no disclosure rules; 1 = Disclosure rules exist, BUT they are either not comprehensive or not enforced; 2 = Disclosure rules exist, they are comprehensive AND they are enforced.

c) Are there any dispute-resolution mechanisms available for insurance targeting low-income customers?

Scoring: 0 = No, there are no dispute-resolution mechanisms; 1 = There are general dispute-resolutions mechanisms that work for insurance for low-income population, or there are specific dispute-resolution mechanisms for micro-insurance, BUT they are not effective; 2 = There are dispute-resolutions mechanisms AND they are effective.

7. Regulation and supervision of branches and agents

1. Ease of setting up a branch:

a) How easy is it for financial-services providers to open a branch or direct-service outlet owned and operated by the financial institution?

Scoring: 0 = There are significant obstacles to opening a branch or financial outlet; 1 = There are some obstacles to opening a branch or financial outlet; 2 = There are no significant obstacles to opening a branch or financial outlet.

2. Ease of agent operation:

a) Does the regulation allow a wide range of actors to serve as agents and does it enable all providers of financial services to have agents?

Scoring: 0 = Regulations on agent banking are non-existent; 1 = Regulations on agent banking are limited; 2 = Regulations are limited and agents are active in the field OR regulations are comprehensive and agents are not active in the field; 3 = Regulations are comprehensive and agents are active in the field.

b) Are agents allowed to perform a wide range of activities?

Scoring: 0 = Agents cannot perform cash-in transactions and account-opening activities; 1 = Agents can perform some activities, but cannot perform EITHER cash-in transactions OR account opening; 2 = Agents can perform a wide range of activities, including cash-in/cash-out transactions AND account opening.

c) Do regulations on agent exclusivity constrain the market?

Scoring: 0 = There is no regulation of agent exclusivity or regulation on agent exclusivity constrains the market; 1 = Regulation on agent exclusivity partly constrains the market; 2 = regulation of agent exclusivity does not constrain the market.

d) Do financial institutions retain responsibility for the actions of their agents?

Scoring: 0 = Financial institutions do not retain any responsibility for the actions of their agents; 1 = Financial institutions retain responsibility for some of the actions of their agents; 2 = Financial institutions retain responsibility for all of the actions of their agents

8. Requirements for non-regulated lenders

1. Information reporting and operational guidelines:

a) Are reporting requirements reasonable?

Scoring: 0 = Non-regulated credit providers are not required to report any information to the regulator; 1 = Reporting requirements for non-regulated credit providers are not reasonable; 2 = Reporting requirements for non-regulated credit providers are somewhat reasonable; 3 = Reporting requirements for non-regulated credit providers are reasonable

b) Do these providers comply with accounting-transparency standards?

Scoring: 0 = Non-regulated providers are not required to have good accounting practices OR some of the non-regulated credit providers are required to have good accounting practices, but compliance is low; 1 = Some of the non-regulated credit providers are required to have good accounting practices and compliance is moderate; 2 = All non-regulated credit providers are required to have good accounting practices, but few of them comply; 3 = All non-regulated credit providers are required to have good accounting practices and most comply.

9. Electronic payments

1. Available infrastructure for financial inclusion:

a) Does the payment infrastructure serve the needs of the low-income population?

Scoring: 0 = The payment infrastructure is unreliable and does not serve the needs of the low-income population; 1 = The payment infrastructure is reliable and partly addresses the needs of the low-income population; 2 = The payment infrastructure is reliable and effectively addresses the needs of the low-income population.

2. Digital Financial Services:

a) Are regulations on e-money or similar digital financial services adequate and are not constraining the market?

Scoring: 0 = Regulations on e-money or digital financial services do not exist OR they are in the early stages of development; 1 = Regulations on e-money or digital financial services are inadequate OR they constrain the market; 2 = Regulations on e-money or digital financial services are adequate AND they do not constrain the market.

10. Credit-reporting systems

1. Comprehensiveness of information:

a) Is the information stored by credit-reporting systems comprehensive, regularly updated and accessed by providers?

Scoring: 0 = Credit-reporting systems do not exist OR credit bureaus store information that has none of the items required for a score of "3"; 1 = Credit-reporting systems store information that has one of the items needed for a score of "3"; 2 = Credit-reporting systems store information and it is both comprehensive and accessed by providers, but not updated regularly OR is regularly updated, but not comprehensive; 3 = Credit-reporting systems store information that is comprehensive, regularly updated and accessed by providers.

2. Privacy protection for both borrowers and lenders:

a) Are privacy rights respected?

Scoring: 0 = Credit-reporting systems do not actively protect privacy rights; 1 = Credit-reporting systems have rules in place to protect privacy rights for EITHER borrowers or lenders, but these rules are not well enforced; 2 = Credit-reporting systems have rules in place to protect privacy rights for BOTH borrowers and lenders, but these rules are not well enforced; 3 = Credit-reporting systems have rules in place to protect privacy rights for both borrowers and lenders and these rules are well enforced.

b) Can individuals access their records and are they able to correct any errors?

Scoring: 0 = Individuals cannot access their records or correct any errors; 1 = Individuals may access their records, but may not correct any errors; 2 = Individuals may access their records, but the error-correction process is difficult OR expensive; 3 = Individuals may access their records and the error-correction process is easy and inexpensive.

11. Market-conduct rules

1. Existence of a framework and institutional capacity to protect the financial consumer:

a) Are there a framework and a specialized capacity in place for financial-consumer protection?

Scoring: 0 = No consumer-rights framework is in place; 1 = Consumer-rights framework exists, but no specialized capacity is in place; 2 = Consumer rights framework exists and some specialized capacity is in place; 3 = Consumer-rights framework exists and specialized capacity is in place.

2. Existence and content of disclosure rules:

a) Does the regulator collect information about pricing and make relevant information easily accessible to consumers for comparison purposes?

Scoring: 0 = The regulator does not collect information OR information collected is not easily accessible; 1 = The regulator collects information that is easily accessible, BUT it is either incomplete or difficult to understand; 2 =The regulator collects information that is easily accessible, complete and easy to understand.

b) Are there clear rules that require providers of financial services to disclose information about the overall cost of the products and consumers' rights and obligations?

Scoring: 0 = Disclosure rules exist EITHER for some products OR apply to some providers; 1 = Disclosure rules exist for all products AND providers; 2 = Disclosure rules exist for all products AND providers AND they are comprehensive.

3. Existence of fair-treatment rules:

a) Are there clear rules requiring non-discrimination in financial-service provision in terms of gender, race, religion, caste, ethnicity, etc.?

Scoring: 0 = There are no clear rules; 1 = = There are clear rules, but compliance is low; 2 = There are clear rules and compliance is high.

b) Are there clear rules set by the regulator aimed at preventing aggressive sales and unreasonable collection practices?

Scoring: 0 = There are no clear rules set by the regulator; 1 = There are clear rules set by the regulator, but compliance is low; 2 = There are clear rules set by the regulator and compliance is high.

12. Grievance redress and operation of dispute-resolution mechanisms

1. Internal complaint mechanisms:

a) Are there clear rules in place requiring financial-services providers to set up internal mechanisms to deal with consumer complaints?

Scoring: 0 = There are no clear rules; 1 = There are clear rules, but compliance is low; 2 = There are clear rules and compliance is high.

2. Existence and effectiveness of a third-party-redress entity:

a) Is there a third-party entity empowered with oversight where consumers can seek redress, and is it effective?

Scoring: 0 = No third-party entity exists; 1 = Third-party entity exists, but redress is ineffective; 2 = Third-party entity exists and redress is somewhat effective; 3 = Third-party entity exists and redress is effective.

ADJUSTMENT FACTOR: *STABILITY*

1. General political stability:

a) To what extent are political institutions sufficiently stable to support the needs of businesses and investors?

Scoring: 0 = Very unstable, and 100 = Very stable

2. Shocks and restrictive policies impacting financial inclusion:

a) To what extent have any shocks or restrictive policies affected market development?

Scoring: 0 = There have been shocks or restrictive policies that have affected the market; 1 = There have been shocks or restrictive policies that have had a broad, negative impact in the market; 2 = There have been shocks or restrictive policies that have had a limited, negative impact in the market (either geographically or on a specific type of institutions); 3 = There have been no shocks or restrictive policies affecting market development.

Regional representation

This index builds on earlier studies of Latin America and the Caribbean; as a result, countries from that region are numerically over-represented in the global *Microscope* study (21 of 55 countries). Countries in other regions were then selected on the basis of the importance of their existing microfinance segments or the potential for future market development. For the 2015 edition, we still have a total of 55 countries, but have added Russia, Ethiopia, South Africa and Jordan, and have removed Azerbaijan, Armenia, Georgia and Yemen. The study, therefore, provides differing levels of geographic coverage: 21 countries from Latin America and the Caribbean, 13 countries from Sub-Saharan Africa, 12 from Asia, four from the Middle East and North Africa, and five from Eastern Europe and Central Asia. These differences in coverage impact regional conclusions and should be considered carefully when evaluating index results beyond individual country scores.

Normalization and weights

Once the raw scores are assigned, each score is then normalized to a 0–100 range and then aggregated across categories. Normalization rebases the raw indicator data to a common unit, to make them comparable, so that they can be aggregated. The data in the *Microscope* are already in a fixed range, for example, 0–100, 0–4, so they have been transformed using the min/max of the fixed range. For example, if the indicator is in a 0–100 range, a raw data value of 0 gives a score of 0, and a raw data value of 100 gives a score of 100. If the indicator is in a 0–4 range, a raw data value of 0 gives a score of 0, and a raw data value of 4 gives a score of 100.

Assigning weights to categories and indicators is a final and critical step in the construction of the index. In a benchmarking model such as the Microscope, weights are assigned to categories and/or indicators to reflect different assumptions about their relative importance. There are various methods that can be used to determine these weights.

There are 12 Financial Inclusion Indicators relating to different regulations and business activities conducive to financial inclusion. Each Financial Inclusion Indicator is composed of between one and three sub-indicators, and *all 12 indicators are weighted equally*, or 8.33% each (100%/12).

The sub-indicators are weighted individually, depending on their overall importance to the Financial Inclusion Indicator. These weights were determined by a consensus between the project team, clients and industry experts. The sub-indicators are composed of between one and four

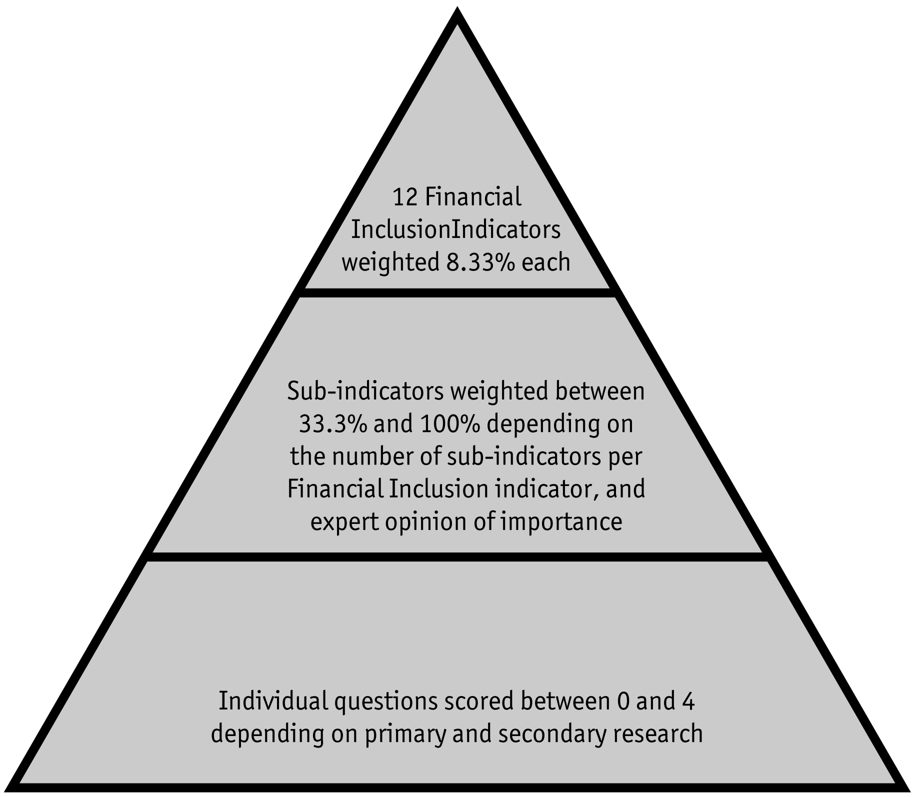

Figure 2. **Indicators pyramid**

Source: Global Microscope 2015.

Table 2
Indicator and Sub-indicator Weights

Indicator	Sub-indicator	Question
1. Government support for financial inclusion Considers a country's formal commitment and actions towards achieving financial inclusion. *Weight: 1/12= 8.33%*	1. Existence and implementation of a strategy *Weight: 66.7%*	1. Is there a documented strategy on financial inclusion?
	2. Collection of data *Weight: 33.3%*	1. Does the government collect customer-level data that help understanding of low-income populations' demand of financial services?
2. Regulatory and supervisory capacity for financial inclusion Considers whether regulatory institutions possess an adequate capacity, independence and readiness for the regulation and supervision of products and services related to financial inclusion. *Weight: 1/12= 8.33%*	1. Technical capacity to supervise *Weight: 100%*	1. Is there a specialised and adequate capacity in place in the regulatory agency?
		2. Is the financial regulator politically independent?
3. Prudential regulation Considers how conducive the financial regulation is to allowing the entrance and operation of institutions that offer savings and credit products *Weight: 1/12= 8.33%*	1. Appropriate entry and licensing requirements *Weight: 50%*	1. Are minimum capital requirements appropriate to allow new entrants and ensure the safe provision of financial services? 2. Are there any impediments imposed on foreign funding or through ownership restrictions?
	2. Ease of operation *Weight: 50%*	1. Are capital-adequacy standards appropriate to ensure both financial stability and the operation of a variety of providers? 2. Are reporting requirements reasonable in light of the specific nature of the services provided?
4. Regulation and supervision of credit portfolios Considers whether regulations and supervision in the country are conducive to the responsible provision of credit *Weight: 1/12= 8.33%*	1. Interest Rates *Weight: 33.3%*	1. If there are interest-rate caps; if so, do they distort the market?
	2. Risk management of credit portfolios *Weight: 33.3%*	1. Does the regulator actively supervise the status of overindebtedness for credit portfolios? 2. Is there a differentiated risk-management framework for consumer-credit portfolios? Does the regulator supervise the status of consumer-credit portfolios?
	3. Risk-management framework for microcredit portfolios *Weight: 33.3%*	1. Is there a differentiated and comprehensive risk-management framework for microcredit?
5. Regulation and supervision of deposit-taking activities	1. Ease of offering savings products by regulated institutions *Weight: 50%*	1. Are account-opening requirements for savings products proportionate?

Table 2 continued

Indicator	Sub-indicator	Question
Considers how conducive the regulation for deposit-taking is (the assessment focuses on commercial banks and non-bank financial institutions.) *Weight: 1/12= 8.33%*		2. Are there any interest-rate restrictions that generate market distortions?
	2. Existence of an in-depth deposit-insurance coverage *Weight: 50%*	1. Is deposit insurance applicable to all institutions authorised to take deposits and with the same conditions?
6. Regulation of insurance targeting low-income populations* Considers the existence of regulation and promotion of insurance to low-income populations by the regulator and/or government *Weight: 1/12= 8.33%*	1. Existence of regulation of insurance targeting low-income populations *Weight: 33.3%*	1. Is the regulation comprehensive and has it been implemented?
	2. Delivery channels for insurance targeting low-income populations *Weight: 33.3%*	1. Do regulations facilitate a variety of channels for distribution?
	3. Consumer protection for insurance targeting low-income populations *Weight: 33.3%*	1. Does the regulator monitor key indicators for consumer protection? 2. Are there clear rules that require insurance providers to disclose information about the overall cost of the products and consumers' rights and obligations? 3. Are there any dispute-resolution mechanisms available for insurance targeting low-income customers?
7. Regulation and supervision of branches and agents Considers whether regulation is conducive to the delivery of financial services through physical branches and non-financial banking outlets. *Weight: 1/12= 8.33%*	1. Ease of setting up a branch *Weight: 33.3%*	1. How easy is it for financial-services providers to open a branch or direct-service outlet owned and operated by the financial institution?
	2. Ease of agent operation *Weight: 66.7%*	1. Does the regulation allow a wide range of actors to serve as agents and does it enable all providers of financial services to have agents? 2. Are agents allowed to perform a wide range of activities? 3. Do regulations on agent exclusivity constrain the market? 4. Do financial institutions retain responsibility for the actions of their agents?
8. Requirements for non-regulated lenders Considers whether the legal framework is conducive to the entrance and functioning of specialized institutions not prudentially regulated by the	1. Information reporting and operational guidelines *Weight: 100%*	1. Are reporting requirements reasonable? 2. Do these providers comply with accounting transparency standards?

Table 2 continued

Indicator	Sub-indicator	Question
financial regulator. (NGOs, non-regulated co-operatives, retail lenders and other providers of credit) *Weight: 1/12= 8.33%*		
9. Electronic payments Considers the regulation and infrastructure that facilitates electronic transactions to the low-income population. *Weight: 1/12= 8.33%*	1. Available infrastructure for financial inclusion *Weight: 50%*	1. Does the payment infrastructure serve the needs of the low-income population?
	2. Digital financial services *Weight: 50%*	1. Are regulations on e-money or similar digital financial services adequate and are not constraining the market?
10. Credit-reporting systems Considers the effectiveness and reliability of credit-reporting systems for the provision of credit *Weight: 1/12= 8.33%*	1. Comprehensiveness of information *Weight: 50%*	1. Is the information stored by credit-reporting systems comprehensive, regularly updated and accessed by providers?
	2. Privacy protection for both borrowers and lenders *Weight: 50.0%*	1. Are privacy rights respected?
		2. Can individuals access their records and are they able to correct any errors?
11. Market-conduct rules Considers institutional capacity as well as transparency, disclosure and fair treatment, with the aim of protecting financial-services consumers that use products and financial services *Weight: 1/12= 8.33%*	1. Existence of a framework and institutional capacity to protect the financial consumer *Weight: 33.3%*	1. Are there a framework and a specialised capacity in place for financial-consumer protection?
	2. Existence and content of disclosure rules *Weight: 33.3%*	1. Does the regulator collect information about pricing and make relevant information easily accessible to consumers for comparison purposes? 2. Are there clear rules that require providers of financial services to disclose information about the overall cost of the products and consumers' rights and obligations?
	3. Existence of fair-treatment rules *Weight: 33.3%*	1. Are there clear rules requiring non-discrimination in financial services provision in terms of gender, race, religion, cast, ethnicity, etc.? 2. Are there clear rules set by the regulator aimed at preventing aggressive sales and unreasonable collection practices?
12. Grievance redress and operation of dispute-resolution mechanisms Considers availability of dispute-resolution mechanisms, client awareness of the grievance	1. Internal complaint mechanisms *Weight: 50%*	1. Are there clear rules in place requiring financial-service providers to set up internal mechanisms to deal with consumer complaints?

Table 2 continued

Indicator	Sub-indicator	Question
processes and ease of access. *Weight: 1/12= 8.33%*		
	2. Existence and effectiveness of a third party-redress entity *Weight: 50%*	1. Is there a third-party entity empowered with oversight where consumers can seek redress, and is it effective?
A. Stability (Adjustment Factor) Considers political tensions or other significant changes that affect the achievement of financial inclusion.	1. General Political Stability *Weight: 33.3%*	To what extent are political institutions sufficiently stable to support the needs of businesses and investors?
	2. Shocks and restrictive policies impacting financial inclusion *Weight: 66.7%*	To what extent have any shocks or restrictive policies affected market development?

**For the purposes of this study, "insurance to low-income population", "micro-insurance" and "inclusive insurance" are considered to refer to the same concept.*

Source: Global Microscope 2015.

questions, which are scored according to thorough secondary research and expert interviews.

The scores for each question are aggregated to the sub-indicator level, where the individual weights are applied, and then the sub-indicators are aggregated to determine the final score.

For example, Financial Inclusion Indicator 1: Government support for financial inclusion is composed of two sub-indicators: sub-indicator 1.1 Existence and implementation of a strategy, and sub-indicator 1.2 Collection of data. Experts agreed that the Existence and implementation of a strategy (sub-indicator 1.1) is of greater importance to financial inclusion than Collection of data (sub-indicator 1.2), so sub-indicator 1.1 is weighted 66.67%, compared to 33.33% for sub-indicator 1.2.

Similar to previous years, the 2015 Microscope contains an adjustment factor, based on the stability score (the 13th indicator). After the country's total raw score is determined (through tallying and weighting of sub-indicator and indicator scores), the adjustment factor is applied, adjusting each country's total raw score downwards to account for any political instability and shocks/restrictive policies that may impact or challenge the environment for financial inclusion.

The adjustment factor is a percentage reduction applied to the raw country score, up to a maximum of 25% (that is, countries can lose up to 25% of their raw country score through this adjustment factor). The adjustment factor is calculated based on the country's stability indicator score, which, in turn, is a combination of two sub-indicators (general political stability, and restrictive policies or other shocks to the market) aggregated to generate a score of 0–100. The adjustment factor is calculated using the following formula:

Adjustment factor = (100 — stability score) × × 0.25,

where:

Stability score = 0.33 × (normalized political stability score) + 0.67 × (normalized restrictive policy score).

The country score follows this formula:

Country score = Raw country score × [(100 – – adjustment factor)/100].

Example for a country "Y":

Raw country score = 40.8.

Stability score = 37.2.

Adjustment factor = (100 – 37.2) × 0.25 = 15.7.

Country score = 40.8 × [(100 – 15.7)/100] = = 40.8 × 0.843 = 34.4.

Moving in the right direction, though slowly

The 2015 Microscope Index shows a number of improvements in the last year (see table 1), including an increase in the average score of the top ten in the study, from 67 in 2014 to 69 in 2015. One of the most positive developments is at the bottom of the rankings. In 2014, five countries received overall scores of 25 or less.

Table 3

Microscope 2015 overall scores and rankings

Rank/55			Score/100	Δ
Average			48	+2
1	←→	Peru	90	+3
2	←→	Colombia	86	+1
3	←→	Philippines	81	+2
4	▲1	India	71	+10
5	▲2	Pakistan	64	+6
6	▼2	Chile	62	−4
6	▲3	Tanzania	62	+6
8	▼1	Bolivia	60	+2
8	▼3	Mexico	60	−1
10	▲8	Ghana	58	+7
11	←→	Indonesia	56	+1
11	←→	Kenya	56	+1
11	▲3	Uruguay	56	+3
14	▼5	Cambodia	55	−1
14	▲3	Morocco	55	+3
16	▼5	Rwanda	54	−1
17	▼3	Brazil	53	0
17	▲1	Nicaragua	53	+2
19	▼5	Paraguay	52	−1
20	▲3	Bosnia and Herzegovina	51	+3
20	▲3	Dominican Republic	51	+3
20	▲3	Ecuador	51	+3
23	▲8	Mozambique	50	+6
23	▲5	Turkey	50	+4
23	▼3	Uganda	50	0
26	▼3	El Salvador	49	+1
26	▼3	Thailand	49	+1
28	▲1	Mongolia	48	+3
28	▼8	Nigeria	48	−2
30	▲3	Kyrgyz Republic	47	+4
31	←→	Panama	46	+2
31	←→	South Africa	46	n/a
33	←→	Jamaica	45	+2

Table 3 continued

Rank/55			Score/100	Δ
33	n/a	Russia	45	n/a
35	▼2	Senegal	44	+1
36	▲6	China	42	+6
36	▲5	Costa Rica	42	+5
36	▲8	Honduras	42	+7
36	▲12	Trinidad and Tobago	42	+9
40	▲2	Argentina	39	+3
40	▼11	Bangladesh	39	−6
40	▼4	Guatemala	39	0
40	▲7	Nepal	39	+5
44	▼6	Tajikistan	38	0
45	▼1	Cameroon	35	0
46	▼10	Vietnam	34	−5
47	▼3	Sri Lanka	33	−2
48	n/a	Ethiopia	32	n/a
48	n/a	Jordan	32	n/a
50	▼1	Venezuela	31	+3
51	▲2	Egypt	29	+8
51	▼1	Lebanon	29	+2
53	▼1	Madagascar	27	+4
54	▼3	Dem. Rep. of Congo	26	+1
55	←→	Haiti	24	+8

Normalised score 0–100, where 100 = best

"←→" No change in rank

"▲" denotes a change

Source: Global Microscope 2015.

Four of these countries are covered again in this year's Index. Of these, three (Democratic Republic of Congo, Egypt and Madagascar) have moved above 25 points. The other, Haiti, nearly made it, with one of the biggest gains in the last year: it rose from 16 to 24 points. These improvements indicate that some basic elements of policy essential to promoting financial inclusion are now widespread, and that efforts to raise awareness and measure progress are more relevant with time.

Although less striking, progress is also visible in most other *Microscope* countries. Of the 51 that are covered in the 2014 and 2015 indices (country composition has changed in the last year), 37 saw an improvement in their overall scores from last year, while only nine experienced a decline.

Bangladesh, which slipped the most this year (six points), dropped mostly in the score for *Government Support for Financial Inclusion*, scoring poorly in the *Government's Collection of Customer*

Data from *Financial Institutions* sub-indicator, which was redefined in 2015. The declines also require a caveat. In some cases, they reflect deterioration in policy; a tightening of interest-rate caps, for example, contributes to **Vietnam's** decline of five points. In other cases, lower scores reflect reassessment in the light of our ongoing efforts to obtain more detailed information on how financial inclusion measures are working in practice. This affected **Vietnam**, for example, as a result of new information on regulation of agents.

In other words, one of the key takeaways from the *2015 Microscope* is that there is very little policy slippage around financial inclusion; new policies are being adopted and existing ones further implemented. The real concern in this year's report is how limited progress has been. Although most countries saw higher scores than in 2014, on average the increase was **only two points out of 100**. Moreover, the overall average is just **48** out of 100. Put another way, only 22 out of 55 *Microscope* countries are more than halfway towards a robust and functioning policy environment that fully promotes all aspects of financial inclusion, and just three are more than three-quarters of the way along that journey.

These figures have changed little since last year. Although, as discussed below, some countries are seeing important progress, worldwide financial inclusion is experiencing what could best be described as a *slight positive drift*.

Looking at the big picture

Given the diverse and complex elements that contribute to financial inclusion, it might be tempting for governments with limited resources to focus narrowly on specific areas. The Index results suggest that this is the wrong approach. The countries seeing the fastest increases in their scores, and those which are at the top of the Index, are more likely to be pursuing a comprehensive strategy, or at least programmes and laws that tackle simultaneously multiple, often interlinked, barriers to inclusion. High scores for *market-conduct rules* were mostly correlated with a high overall score and, although the correlation was not high, it was statistically significant.

The results of such an approach can be seen rapidly. **India** saw the biggest increase of any country in its score this year (10 points), which largely reflected a substantial drive to make banking more accessible to the entire population.

This included the issuing in July 2014 of guidelines for creating specialized *Payment Banks and Small Finance Banks* specifically aimed at the poor, and the in-principle approval of 11 of the former (as of August 2015) and 10 of the latter (as of September 2015). A month later, the Indian government, in conjunction with the banking industry, launched a programme to provide a basic bank account for every household, which included access to financial education, credit and insurance. By January 2015, nearly 100% of households had such a facility, although active use of the new accounts has been limited so far, with most accounts remaining dormant. Penetration of financial services in rural areas also remains low.

Two more of the top gainers over the past year — **Haiti** and **Egypt** (both up eight points) — took measures that covered an even wider range of financial inclusion issues. Haiti's new financial inclusion strategy, drawn up with the help of the World Bank and not yet fully implemented, has brought improvements across various areas of the Index. The most obvious was the *Government Support for Financial Inclusion* indicator.

Elsewhere, the knowledge obtained from the policy-creation process drove gains in *Regulatory and Supervision Capacity* and the creation of a Credit Bureau in October 2014 also led to improvements in the *Credit Reporting Systems* indicator. **Egypt**, meanwhile, improved its score in seven out of 12 Index indicators, largely because of *Law 141 of 2014* and its implementation. Although this does not represent a formal financial inclusion strategy, it is the country's first legislation that addresses microfinance.

In addition to gains over the short term, Index results also indicate that comprehensive, national financial inclusion *strategies* drive long-term results. Of the six countries that get top scores for implementing such a strategy (Colombia, India, Pakistan, Philippines, Rwanda, Tanzania), five finish in the top seven places overall in the Index (Rwanda being the exception). In other words, strength in this sub-indicator drives results across the board. **Peru** seems to be an anomaly, ranking first overall but scoring only 2 out of 3 for this indicator.

It may, however, be the exception that proves the rule. In July 2015, rather than continuing to rely on multiple, diverse initiatives, the country published its first *National Strategy of Financial Inclusion*. Full implementation of Peru's strategy would likely tip it into the top scoring range for this Index metric.

Lessons from the top of the standings

Three countries form a top group that scores far higher in the Index than all the others: **Peru** (90 points), **Colombia** (86 points) and the **Philippines** (81 points). Several commonalities among them are noteworthy, in that they suggest key approaches to improving financial inclusion.

I. **Commitment matters**: In all three countries, financial inclusion has been on the government's agenda for some time. The central banks of the Philippines and Peru, for example, were among the 17 original participants in the ***Maya Declaration*** in 2011 and, although Colombia took another year to join, its financial inclusion efforts date back to 2006.

II. **Consistency matters**: The most striking similarity in the scores of these three countries is the breadth of their activities. These countries perform well in the areas mentioned at the beginning: *policies and regulations* for a range of financial products and services offered; the *diversity of institutions* providing them; *regulation of delivery methods*; and the *institutional support* that ensures the safe provision of services to low-income populations. **Peru** gets top scores in seven of 12 indicators and scores 75 or above in all of them. **Colombia** earns 100 points for five indicators and also scores 75 or above everywhere, save *Regulatory and Supervisory Capacity for Financial Inclusion*, where it is let down by ongoing political interference with regulators. Similarly, the **Philippines** attains perfect scores in five indicators and falls below 75 only once, because of weaknesses in *Requirements for Non-Regulated Lenders*.

III. **Previous success does not exempt countries from the new challenge of adopting electronic-payment systems**: The one indicator where all three of the leading countries are relatively weak is the *Regulation of Electronic Payments*. Here, each country scores only 75, although this is much higher than the Index average of 55 for this indicator. The issue is not the details of the regulation — ability of the low-income population to use the electronic-payment infrastructure. In particular, electronic-payment systems tend to be expensive and fragmented, with only one of these countries, **Peru**, beginning to take advantage of mobile phones as payment management tools.

The three leaders are not alone in this. Given the wide distribution of mobile phones, the degree of media attention that the use of mobile payments in East Africa has received, and the clear potential of such systems for enhancing financial inclusion, it is surprising how few countries have been able to create reliable *electronic-payment systems* that address the needs of low-income individuals. This is relatively low-hanging fruit, however, which should draw the attention of those active in the field.

Financial inclusion strategies and initiatives on the rise

The 2015 Index has seen substantial progress in the launch of comprehensive financial inclusion strategies, as well as the implementation of existing ones. While Honduras is in the process of adopting a national financial inclusion strategy, Haiti, Indonesia, Peru and Paraguay have already launched such strategies.

In terms of ongoing commitments, in 2015, Bolivia, Colombia, Ecuador, Pakistan and Uruguay have all begun to implement previously adopted legislation and strategies, with the express purpose of increasing access to financial services. Bolivia has made financial inclusion a priority since its current constitution was inaugurated in 2009, and continues to move towards greater inclusion. Colombia's strategy is in the process of being fully implemented. Ecuador is implementing its strategy by initiating payments systems, electronic money, and credit facilities. In Pakistan, the government has a very well documented and articulated strategy, as well as a road map for priority actions and target indicators. The government has already taken steps towards further financial inclusion, having simplified the "Asaan Account", with no minimum balance and a required deposit of only PRs100 (around 95 US cents), although its degree of adoption will be a true test of success.

Implementation will also be the litmus test for the Credit Act, which has just been passed by the National Assembly. Although implementation of both of these initiatives is still in the early stages, the government has shown commitment and targets are expected to be implemented by 2020. The State Bank of Pakistan (SBP, the central bank) is addressing interoperability and money-transfer systems that will facilitate implementation of the requirement that all salaries be paid electronically. In Uruguay, the government passed Law 19 210, the Law on Financial Inclusion, in April 2014. The law details a number of specific steps. The first, which was reducing VAT on all transactions using electronic payments, has been taken.

Rounding out these positive developments, Argentina, Egypt and Nicaragua have shown great promise by adopting legislation that targets aspects of financial inclusion, despite lacking comprehensive national strategies. In April 2015, *Impulso Argentino* (a public-private partnership, or PPP, which promotes inclusive microfinance for small businesses and entrepreneurs), signed anagreement in which the government will provide Ps40m (around US$4.2m) to advance microfinance activities. In June 2015 the *Banco Central de la República Argentina* (BCRA, the Central Bank) and the Ministry of Education signed an institutional co-operation agreement to promote financial literacy nationally. Egypt has no specific strategy for financial inclusion. However, in July 2013, the Central Bank of Egypt joined the *Alliance for Financial Inclusion* (AFI) as a principal member of the AFI network. In November 2014, a presidential decree issued Law no. 141, which is the first law to regulate microfinance services. According to the Egyptian Financial Supervisory Authority (EFSA), a special unit will be established to supervise microfinance activities of civil associations and non-governmental organizations (NGOs).

Furthermore, the EFSA Board of Directors has been tasked with identifying priority areas within the microfinance segment, including licensing requirements, capital adequacy and rules of supervision and control. For Nicaragua, although there is no documented strategy, the country has passed and is implementing a microfinance law, and is honing the regulatory framework for the segment.

Insurance for low-income populations needs far greater attention

For those affected by financial exclusion, low asset levels not only make daily life more difficult, they also make it much harder to deal with economic shocks. Some form of insurance designed for the poor is, therefore, an essential part of full financial inclusion. The 2015 Index accordingly increased the number of sub-indicators covering this field in order to attain a more nuanced understanding of the state of play (see the Methodology in the appendix for full details).

Despite the importance of insurance for low-income populations, the Index shows that it is a very common weakness in national financial inclusion efforts. The average score for *Regulation of Insurance for Low-Income Populations* was just 34 out of 100, by far the lowest for any indicator. Just as striking, 29 of the 55 countries scored only 25 points or less —a markedly greater proportion than for any other indicator — and this was also the sole indicator for which no country scored 100.

The most common issue seems to be lack of focus. Too often, insurance for low-income populations is regulated as part of the mainstream insurance market, but its particular requirements, such as low levels of coverage, as well as a lack of simple policy conditions that can be explained by non-specialist agents and understood easily by purchasers, require more specific frameworks and oversight. Just six countries have implemented such targeted regulations in a comprehensive way. None of those six receive the top score for protecting consumers who buy policies, and 46 countries out of 55 score 50 points or below (out of 100).

Although the numbers are too small to allow definite conclusions to be drawn, the Index data suggest that the widespread failure to regulate adequately this type of insurance is holding back the market. For those countries scoring poorly, there is little statistical correlation between scores for this indicator and the number of people buying insurance. However, once a threshold is reached (around 60 out of 100) higher scores correlate in a statistically significant way with the percentage of people buying coverage. In other words, potential buyers may be put off until the market is deemed safe enough, after which effective regulation and protection makes offering insurance to low-income populations a viable business option.

In too many countries, consumer protection remains a challenge

India's 2010 microfinance crisis, which centered on the province of Andhra Pradesh, was a formative event in the history of financial inclusion, and it showed the central importance of effective consumer protection to the long-term success of the financial inclusion agenda.

Five years on, Index data point to some worrying gaps in such protection. To begin with, measures as a whole are often weak. As of 2015, only eight of the 55 countries, including just one outside of Latin America, provide a comprehensive framework and capacity to protect the financial consumer. There were some, but not many, improvements in this category from 2014 to 2015, with El Salvador, Colombia and the Dominican Republic improving their scores. Most countries stayed the same, with only Tajikistan seeing its score dropping. More worrying still, just eight countries have clear regulations aimed at preventing aggressive sales and unreasonable collection practices, while 20 countries score zero on this sub-indicator, indicating a complete absence of such protection. Four countries showed improvement in this area in 2015, and two saw a drop in their scores.

Concerns also exist around specific areas of activity relevant to financial inclusion. As noted above, no country gets top scores for legal protection for buyers of insurance targeting low-income populations. Similarly, only 14 countries have deposit-insurance schemes that cover, with the same conditions, all institutions allowed to receive funds from savers. Many states have such insurance for banks or other traditional financial institutions, but lower or no coverage at all for accounts at co-operatives or other deposit-taking institutions. Indeed, we downgraded the score of 12 countries for this indicator in this year's Index because a close examination of the regulations revealed such a disparity.

Finally, a danger that threatens both individual borrowers and the segment more widely is lack of attention to over-indebtedness. We changed the relevant indicators in the Index and found that 17 countries were doing this very well, and almost half improved year on year. In terms of regulations for risk management of consumer credit portfolios, only four countries improved and two dropped in score. Scores for the regulation of risk management of microcredit portfolios improved more broadly in 21 countries.

Financial inclusion requires capable customers

The qualitative country analyses included in this report are not only a means of providing important local details; they also help address a limitation inherent in any index such as this one. Indices can include only indicators for which data are available, which means that some factors of potentially great importance to understanding an issue may have to be left out.

For financial inclusion, one such issue is low financial literacy among the poor in many, if not most, developing countries. Measurement of the levels of such literacy is a major gap, although data from a new initiative, Standard & Poor's Ratings Services *Global FinLit Survey* (see: http://www.FinLit.MHFI.com), was being released as this report went to press. Even for developed countries, the OECD is only now undertaking a project to define the term and measure financial literacy.

The lack of hard data does not make the issue any less pressing. Although not asked to comment specifically on the question, the authors of roughly half the country assessments in this publication specifically mention poor financial literacy or the need for financial education as a leading inclusion challenge. This is no anomaly. In a global survey for the World Bank's 2014 *Global Financial Development Report*, 78% of financial-sector practitioners agreed that, "The lack of knowledge about basic financial products and services is a major barrier to financial access among the poor in my country." Nor is this a problem only for poor performers in the Index. The country reports of the top five finishers all note the need for improved financial literacy among the population targeted by financial inclusion efforts.

How to improve such literacy is an open question, with little, if any, good research to point to effective methods[13]. It is, however, an issue

[13] For a summary of what is available, see Margherita Calderone, "The Role of Financial Literacy and of Financial Education Interventions in Developing Countries," Deutsches Institut für Wirtschaftsforschung. Roundup Paper No. 34, 2014.

which those working for financial inclusion will need to address.

Signs that policy is having the desired effect

The *Microscope* Index is based on measures of policy, regulation, supervision, government capacity, infrastructure and stability — the elements that create the environment for financial inclusion — rather than measures of outcome. This can lead to incongruous results. For example, the three top Index countries — Peru, Colombia and the Philippines — score below others in their region and in their income group on most of the *Global Findex's* measures of inclusion. To look at just one metric, both Peru and Colombia are upper-middle-income countries, in which, on average, 71% of adults have bank accounts. They are also both in Latin America, where 51% of adults have such accounts. For Colombia, however, the equivalent figure is 39% and in Peru, the Index leader, just 29%.

The broad explanation for this apparent disconnect is that, just as it takes time for policy to change, it also takes time for policy, once enacted, to have an effect. Moreover, in some cases, as with insurance targeting low-income populations, as discussed above, a critical mass of regulation may need to exist before markets can grow in a meaningful way. And challenges posed by geography, history and cultural factors are unique in each country. Nevertheless, over time, one would expect that outcome measures of financial inclusion would begin to converge with policy-related ones.

The data suggest that this may be starting to happen, as a number of our Index scores correlate with several relevant Global Findex and IMF indicators. In particular:

1. A higher score on *Regulation and Supervision of Deposit-Taking Activities* is associated with a higher proportion of the adult population having bank accounts;

2. Better results on *Regulation of Electronic Payments* correspond with more of the population having mobile financial accounts;

and

3. The more points a country attain for *Credit Reporting Schemes* the greater the percentage of adults that have borrowed from a financial institution.

In each of these cases, the extent of the suggested effect, the correlation, is modest. However, the likelihood that there is no link at all (the p-value) is also small, indicating that the connections are statistically significant, if still weak. Correlation does not necessarily mean causation, but, in these cases, the posited explanations for the data seem reasonable. It will be worth taking a closer look when the Global Findex's revised figures appear in 2017 to see if advanced policies are having a measurable effect on financial inclusion.

What about Russia?

In 2014 the share of the adult population (15 or over) with an account at a financial institution was 67%, compared with 48% in 2011. Of these, women were slightly above the average, at 70%, while young adults (aged 15–24) were well below the average, at 54%. Of adults belonging to the poorest 40% and adults living in rural areas, 62% and 61%, respectively, had accounts at financial institutions. The landscape of providers consists of three main groups: banks and other credit organizations; non-financial organizations, such as microfinance institutions (MFIs) and credit co-operatives, which can lend, but cannot take deposits or give credit; and payment-service providers, such as money-transfer operators, e-money operators, mobile network operators (MNOs) and payment agents.

The government has been very active in relation to financial inclusion over the last few years, with legislation bringing MFIs and credit co-operatives into the regulatory framework, as well as laws on payment systems and payment agents. Formerly divided between the Central Bank of Russia, the Ministry of Finance and the Federal Service for Financial Markets, most categories are now regulated and supervised by the Central Bank.

This still leaves a large market for agricultural credit co-operatives (ACCs) that are regulated separately and overseen by the Ministry of Agriculture, as well as an unknown number of unregistered non-financial organizations (thought by some to outnumber the MFIs registered under the new law).

There have been several regulatory changes at the beginning of 2015 that have the potential to affect the environment negatively,

Table 4
Russian scores overview

	Score/100		Rank/55	
	2015	**Δ**	**2015**	**Δ**
Microscope 2015 overall score	45	n/a	=33	n/a
1) government support for financial inclusion	61	n/a	=13	n/a
2) regulatory and supervisory capacity for financial inclusion	58	n/a	=10	n/a
3) prudential regulation	25	n/a	=54	n/a
4) regulation and supervision of credit portfolios	67	n/a	=18	n/a
5) regulation and supervision of deposit-taking activities	100	n/a	=1	n/a
6) regulation of insurance for low-income populations	53	n/a	=16	n/a
7) regulation and supervision of branches and agents	58	n/a	=36	n/a
8) requirements for non-regulated lenders	50	n/a	=18	n/a
9) regulation of electronic payments	25	n/a	=41	n/a
10) credit reporting systems	75	n/a	=15	n/a
11) market conduct rules	56	n/a	=17	n/a
12) grievance redress and operation of dispute resolution mechanisms	17	n/a	=44	n/a
A) adjustment factor (stability and policies)	32	n/a	=47	n/a

Source: Global Microscope 2015.

although their impact could be delayed and is likely to be more serious for smaller institutions. New interest-rate caps on consumer loans were temporarily suspended to allow banks and MFIs to reflect their full cost of lending and to secure their continued ability to provide funds. In addition, the minimum capital requirement was raised from 180m to 300m rubles (from around US$2.8m to around US$4.7m), which could lead to the closure of many regional banks. According to the Association of Regional Russian Banks, this would have a negative impact on the segment, as regional banks are often closer to their customers, better suited to regional specifics, and operate in areas where the larger banks do not have a presence.

While there has been significant progress in the regulatory framework for financial inclusion in recent years, there are still many areas for improvement. Not enough is known about demand for particular services among the financially underserved, and, while there has been plenty of innovation in the segment, most people still use traditional channels. This is partly due to infrastructure — with more remote areas and populations not being reached — and partly due to a lack of education and **trust** in financial services.

Clearly, more work can be done!

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