STRATEGIC DIRECTIONS
2008–2013

Building Local Financial Systems That Work for the Poor:

Equity and Efficiency

Contents

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Executive Summary

The overarching goal of CGAP is to help build financial systems that work for the poor, with a particular emphasis on building domestic, deposit-driven markets. The special focus of CGAP for the next five years is on ensuring that those local financial markets are <u>*equitable*</u> *and* <u>*efficient*</u> *and that finance for the poor is fully integrated into mainstream markets. By equitable we mean ensuring that the increasing commercial focus of microfinance, or "access to finance," does not leave some poor people, regions, or countries behind; that subsidies are equitably allocated; that loan and other service costs, terms, and practices are competitive, ethical, and transparent; and that sound business practices are respected. By efficiency we mean helping to make local financial systems operate more efficiently. At the institutional level, this means improving institutional effectiveness and performance and lowering transaction costs for clients through technology, streamlined operations, and enhanced competition. By efficiency, we also mean effective financing by international and domestic funders, including the rapidly growing community of microfinance investors. Sound and deep market infrastructure, good information, and policies that stimulate access while protecting clients are critical to efficient and equitable domestic financial markets.*

1. Introduction

The new CGAP strategy is shaped by extensive consultations with CGAP members in the field and in headquarters and with all types of institutions that provide financial services for the poor, including microfinance institutions (MFIs), banks, MFI networks, governments, and other stakeholders in the microfinance industry—over 1200 people in total. Inputs include the following:

- A scenario-building exercise that analyzed five global forces impacting the future of financial services
- A global client survey
- An independent external mid-term evaluation of CGAP III
- A virtual conference on the future of microfinance and the role CGAP should play
- Focus groups with microfinance practitioners, donors, investors, and policymakers in Italy, Mali, Poland, Senegal, and South Africa
- Conference calls with CGAP constituencies

This paper sets out the broad strategic directions and organizational options for CGAP starting in July 2008. The strategic directions and roles described are intended to serve as a general compass for the next five years, but the fundamental priorities of CGAP's work will remain steady. In the next five years, CGAP will consolidate and reinforce what has been accomplished in CGAP III, and push this work deeper in each area of our work—on financial service providers, the financial market infrastructure, government policy, and the effectiveness of funding.

1A. Background: CGAP I, II, and III

Compelled by the potential of microfinance to reduce poverty on a sustainable basis, nine leading donors and practitioners formed CGAP in 1995 to develop and share best practices, set standards, and develop technical tools and models. Over time, CGAP has become a recognized resource for the industry, providing services and information to a wide array of actors engaged in building inclusive financial systems. Its mandate was renewed in 1998 and in 2003 for a second and third phase (CGAP II and III). Its membership has grown to 32 agencies, including bi- and multilateral development agencies, private foundations, and international financial institutions.

Since its inception, CGAP has played a pivotal role in developing a common language for the microfinance industry, catalyzing the movement toward good practice performance standards and building consensus among its many and varied stakeholders. Box 1 summarizes some of the main findings from a recent intensive independent evaluation of CGAP conducted by Klaus Maurer, Sarah Forster, and Michael Mithika. One input to this evaluation was an extensive client survey. The survey results were very positive regarding CGAP's impact on the field of microfinance and, notably, showed that the "more familiar people were with CGAP's work, the stronger their positive views of its role and its contributions to microfinance."

Box 1. Selected Findings from the Evaluation of Phase III:
CGAP's Relevance, Effectiveness, and Value for Money Invested

Relevance

Of those responding to the broad-based survey, 85 percent agree that CGAP contributions are very important to the success of microfinance globally.

Although more sources of information are available now than when CGAP was first formed, survey respondents think CGAP has more legitimacy and is more readily heard than other sources.

Effectiveness

Team has made clear progress in promoting greater institutional diversity in microfinance. But CGAP has done little work so far on financial cooperatives and state banks, which deserve more attention.

Clear progress on promoting pro-poor financial services, but now needs to focus on communicating findings so they get translated into practice.

Excellent work on transparency. "CGAP can lay claim to having contributed to improved quality and increased quantity of information available today from different microfinance actors."

Well on track to achieving expected policy and legal frameworks outputs. Attribution for policy changes is difficult to measure, but there is an increasing number of examples where CGAP interventions have had a decisive effect on policy makers.

"Aid effectiveness is an area where CGAP has a clear mandate, an absolute advantage, and has made some very good progress."

"CGAP's training and capacity-building initiative has been a great success."

Strong and effective communications capability, highly rated by all stakeholders. "CGAP publications and knowledge products are considered among the most important and influential sources in …microfinance."

"The CGAP Operational Team has produced high-quality outputs during Phase III. With a few exceptions, the team is on track to produce almost all outputs.

Accountability

"CGAP has adequate governance and management systems that are transparent and thorough in providing information about the program." Measurement of outputs is well developed, but more work is needed on tracking contribution to longer term outcomes and objectives.

Value for Money

A cost-effective and competitive organization. …confident that CGAP represents value for money and it compares favorably with other organizations with similar activities and mission."

"Overall, CGAP is a powerful and pivotal force in the field, [and it plays] a critical role in helping others to build inclusive financial systems. It produces high-quality, high-value work that is universally respected. CGAP provides good value for money and has earned a highly coveted brand. It has long moved from being a 'program' to being an organization of central importance to helping achieve the vision of 'access for all' in terms of financial services."

1B. The Role of Microfinance in Poverty Reduction

At the core of microfinance is a fundamental belief that access to financial services protects and empowers the poor by mitigating them from risks and giving them choices. Financial services help the poor cope with a common feature of their lives: vulnerability. Whether they save or borrow, evidence shows that when poor people have access to financial services in the absence of emergency conditions, they choose to invest their savings or loans in a wide range of assets. These "assets" can be sending children to school, buying better medicines and more nutritious food, fixing a leaky roof, meeting social and cultural obligations like paying for weddings and funerals, as well as building income-generating potential by investing in their enterprises.

The multiple roles of financial services for the poor parallel the multiple dimensions of poverty captured in the Millennium Development Goals (MDGs) (see box below). The MDGs have galvanized the development community around measurable and concrete indicators of poverty reduction.

Financial services put power into the hands of the poor to pursue their own strategies for building human, physical, economic and social capital to escape poverty. And because microfinance services can be delivered sustainably within relatively short periods of time, benefits can be delivered on a permanent basis, well beyond the duration of donor or government programs that rely on continuous subsidies.

How Does Microfinance Contribute to the Millennium Development Goals (MDGs)?

A review of microfinance literature points to several specific conclusions about the impact of microfinance on poverty reduction and several other MDGs:

Eradicate extreme poverty and hunger. Extensive evidence demonstrates that microfinance helps reduce poverty through increases in income, allowing the poor to build assets and reduce their vulnerability.

Achieve universal education. Households that have access to microfinance spend more on education than non-client households. Improvements in school attendance and the provision of educational materials are widely reported in microfinance households. Participation in credit and savings programs has enabled many families to send several children at a time to school, and has reduced drop-out rates in higher primary grades.

Promote gender equality and women's empowerment. Microfinance clients are overwhelmingly female. Microfinance has been widely credited for empowering women by increasing their contribution to household income, the value of their assets, and control over decisions that affect their lives.

Reduce child mortality, improve maternal health, and combat disease. Microfinance contributes to improved nutrition, housing, and health, especially among women clients.

Far from being a narrowly defined, specialized field occupying a small corner of development thinking and practice, microfinance is an important foundation for poverty alleviation and the wider development agenda. It supports other development efforts and can make a significant difference in the way poor people address those development problems on their own terms.

1C. CGAP Vision of Phase III

In Phase III, CGAP sought to achieve its vision through a strategy of promoting *diversity* of products and delivery channels along with *integration* with mainstream financial markets. The vision envisaged an ever wider range of financial services, delivered through a variety of convenient mechanisms by different types of institutions—non-governmental (NGO) MFIs, savings and credit cooperatives, commercial banks, postal banks, consumer credit companies, insurance companies, and non-financial providers.

The vision saw commercial banks and, ultimately, non-financial infrastructure, such as lottery outlets, gas stations, and post offices, also becoming increasingly important as financial infrastructure that provides services to the poor. Because this architecture already exists in many poor neighborhoods, exploiting it would enable financial services to be delivered to poorer and more remote clients than costly dedicated branch infrastructure would allow. The vision predicted that competition and integration with mainstream markets would improve transparency and performance of financial service providers as well as client choice and value for money. Advances in technology would lead to reduced transaction costs, enabling volumes to grow and outreach to expand and deepen.

2. Current State of Microfinance: Progress Made Against CGAP Vision

While this vision seemed radical to many at the time, great strides have been made, thanks to the work of many, in achieving this vision over the past five years.

2A. Accomplishments

- Microfinance has become **increasingly integrated in the formal financial system**, as more commercial banks and retail institutions take up microfinance as a business line. New types of service providers are entering the market in many countries, including existing providers like telecommunications networks, retail outlets, and credit card companies. Some are reaching very poor clients. Another dimension of integration is MFIs collecting deposits and tapping into domestic and international capital markets to raise the financing necessary to fuel their growth. Microfinance is now widely viewed as an integral part of mainstream financial sectors.
- Traditional **MFIs have matured** in the last five years. There are five times as many profitable MFIs today as there were four years ago. New institutions are breaking even in two years on average, much faster than their predecessors. Several hundred have reached a take-off point and are growing rapidly. The strongest financial cooperatives also compare favorably to other financial institutions on efficiency, product range, and growth.
- Whatever the legal form of the provider, the need for **commercial practices has become widely recognized** as a condition for massive and sustainable access to an array of demand-driven microfinance products. There is important evidence that commercially focused organizations can indeed reach the poor profitably, though most profit-maximizing commercial institutions do not reach very deep.
- **New funders, such as private philanthropists and socially responsible investors,** have entered the field with large funding programs planned. Over 78 funds, with more than $2

billion outstanding investments, have been created to invest in microfinance (including 30 in the last two years). IFIs have stepped up their investments too, with portfolios doubling annually. Grant money from new philanthropists may dwarf public donors soon.

- More institutions are offering a **wider range of financial services**, such as flexible deposit services, insurance services, and money transfers, although narrow micro*credit* continues to dominate in many countries.
- The business **model for financial service delivery is "disaggregating"** as new partnerships among MFIs, banks, and, more recently, telecommunications and card companies allow each actor to carry out the role in service delivery most suited to its comparative advantage. For example, such contractual arrangements enable the MFI, self-help group, or other agent to focus on client interaction, while a bank provides the back office services and a telecom provides transaction processing.
- Experiments with **technology-driven delivery models** are spreading rapidly, promising to reduce costs and thus extend outreach to poorer and more remote clients. Although not yet proven, there is evidence that, with the right value proposition, product design, and marketing, client adoption is possible.
- The widespread **use of non-financial architecture (like petrol stations)**, called branchless banking, offers the hope of exponential growth and outreach to more remote areas, provided the regulatory environment adapts to allow this to happen.
- An increasing number of market players recognize the value of transparency in the sector. The industry has become more professional, with more and more financial service providers adhering to **performance and disclosure** standards developed by CGAP and others. Compliance is now driven by investor and market expectations.
- The need for transparency about the poverty levels reached, client impact, and the **social performance of institutions is gaining support**. New socially responsible investors have joined traditional donors and a growing number of practitioners in calling for better measurement tools. Consensus is building that this transparency work must address consumer protection issues, such as product terms and conditions and business practices.
- Many traditional donors have recognized **that the quality of aid is usually more important than the quantity** and that their funding can sometimes hinder rather than help the development of sustainable microfinance. Some CGAP members have engaged in serious change processes to improve their effectiveness.
- **Microfinance is high on many governments' agendas.** Their heightened interest has both up and downsides. A more widespread understanding of what it takes to build sustainable access, more enabling legal and regulatory frameworks, and a greater focus on consumer protection and education are welcome. The re-introduction of low interest rate caps and the creation of government-sponsored direct lending institutions in some countries are troubling developments.

Microfinance has burst forth from its place as a curious niche within the development community to center stage. It is now viewed as a key component of financial-sector development and an attractive investment for socially motivated investors. What the CGAP III vision did not anticipate was the level of enthusiasm among the general public generated by the UN Year of

Microcredit and the Nobel Prize awarded to Mohammed Yunus and Grameen Bank. Politicians and policymakers, private and public donors, philanthropists, investors, the media, and the general public around the world have developed interests and views about microfinance. This increased public interest benefits our mission in many ways and is challenging in others.

2B. Remaining Challenges, Gaps, and Constraints

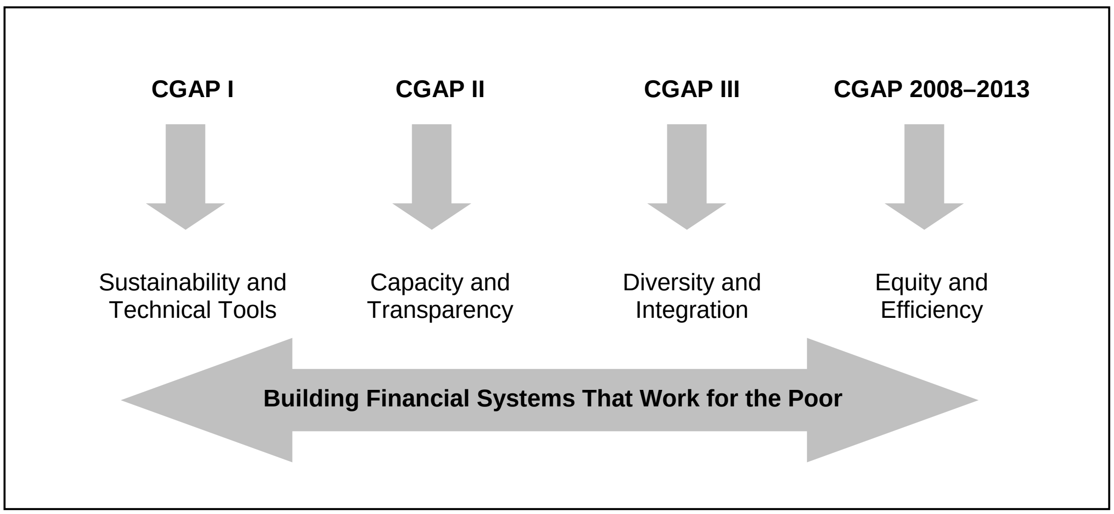
For all of these accomplishments, the gains are still fragile, and significant gaps and constraints remain. Stakeholders identified the following as the greatest challenges to achieving widespread access to finance.

- Despite successes in dozens of countries, **many countries have little high-quality financial services** of any kind**.** Product diversity remains limited, especially well-designed deposit products and transaction accounts that could be the gateway product for other services.
- **Capacity at the management and staff level** of microfinance providers remains the principal bottleneck to expansion. Efforts to build capacity are severely constrained by lack of patient funding and adequate mechanisms to address the magnitude of need.
- Despite the increasing engagement of commercial banks and retail institutions, real **competition among retail providers is limited**. Without the pressure of competition, costs to poor clients remain high, pricing opaque, and quality services limited in most markets.
- The **local financial market infrastructure** for microfinance (i.e., local debt and equity markets, payments systems, rating agencies, and credit bureaus) remains underdeveloped in most countries. This thwarts access to finance and the ability of financial institutions to raise capital domestically.
- Service expansion is constrained by **client remoteness and lack of financial education/literacy and credit histories. Expansion and adoption of services are also limited by clients' own perceptions of their eligibility.**
- **Government policies and regulation continue to hinder** the development of microfinance in many countries. In many markets, subsidized lending by government programs and poorly designed apexes, often funded by donors, continues to undermine the development of sustainable financial services. Where more enabling policies and regulation have been adopted, capacity to implement them effectively is often weak.
- Many donors continue to fund in suboptimal ways (e.g., wrong instruments, poor geographic distribution, disbursement pressure) and can even undermine markets. The rapid and large-scale entry of new investors has raised **questions about the role of subsidy** and the optimal interaction between public-purpose and commercial actors. Institutional incentives of donors and investors alike too often lead to competition rather than complementary work.
- Despite important advances, **further methodological refinements and real incentives for social performance management** are needed for its widespread adoption. The intersection of social and financial goals will raise increasingly complex issues about balancing the "double bottom line" in microfinance.

3. CGAP Vision for the Next Five Years

The vision for the future of CGAP builds on the vision of CGAP III. It aims to help build efficient local financial markets that are integrated into the mainstream financial system and that serve all the unbanked, including very poor and harder-to-reach clients with ever more innovative, convenient, and affordable financial services. These clients will be valued participants in their countries' financial systems. A wide array of financial service providers will harness lessons learned and innovations of recent years to continuously improve services and lower costs to compete for clients. These financial service providers will be sound and transparent, and they will fund growth primarily through local deposits. Ever more enlightened policy making will support the long-term development of efficient, competitive, and inclusive local capital markets. Donors and investors will contribute to expanding access to finance based on their respective comparative advantages. More effective aid mechanisms will efficiently and equitably allocate subsidies, measure performance, complement commercial actors, and be accountable to their end clients. In short, all actors will be focused on *responsible finance*, with the well being and needs of clients at the center of strategy and operations.

4. Overall Objective and Focus: Equity and Efficiency



Thus, CGAP's overarching objective remains helping to build financial systems that work for the poor, with a particular emphasis on building local, deposit-driven markets. The focus of CGAP for at least the next five years is on ensuring that those local financial markets are *equitable* and *efficient* and that finance for the poor is fully integrated into mainstream markets. By *equitable* we mean to ensure that the increasing commercial focus of microfinance, or "access to finance," does not leave some poor people, regions, or countries behind; that subsidies are equitably allocated; that loan and other service costs are competitive, ethical, and transparent; and that sound business practices are respected. We aim to ensure that financial service access contributes to reducing poverty. By *efficiency* we mean helping to make local financial systems operate more efficiently. At the institutional level, this means lowering transaction costs for clients through technology, streamlined operations, and enhanced competition. By efficiency, we also mean effective aid delivery and investment mechanisms by international and domestic funders. Sound and deep market infrastructure, good information, and policies that stimulate access while protecting clients are critical to efficient and equitable domestic financial markets.

5. CGAP Roles

The CGAP mid-term evaluation cited several "first generation" or inherent comparative advantages with which CGAP was born. It then listed several "second generation" comparative advantages CGAP had *earned*.

CGAP Comparative Advantages*

First Generation

- Convening power
- Credibility
- Global perspective
- Link to World Bank

Second Generation

- Credibility/brand
- Ability to attract high-quality staff
- Communications ability
- Freedom to say what we want
- Objectivity/neutrality
- Respect of the World Bank

*As cited by evaluators

CGAP aims to leverage its distinct comparative advantages to help build local financial systems that work for the poor. Comparative advantage shapes roles. CGAP's advantages and roles have evolved over time: CGAP has been a funder, a developer of technical tools, a trainer, and a technical assistance provider. It has strived to be an objective convening platform on the one hand and, on the other, a body relied upon to develop standards and guidelines and take a strong stand on issues.

The client survey and the virtual conference on the future of CGAP overwhelmingly agree on CGAP's role as a knowledge resource center for the industry. CGAP is also widely perceived as a standard setter for microfinance, a global network for microfinance, and a think tank/research institute. The role for CGAP most often elected by respondents was "providing services that help advance the cause of universal access to financial services."

The next phase of CGAP's work will focus on three roles that emerge from our distinct comparative advantage: (1) developing standards and providing advocacy and advisory services around those standards; (2) providing objective, high-quality market intelligence complemented by sector data and analytics; and (3) supporting experimental new approaches, delivery channels, and product designs.

An important value that cuts across each of these roles is our aim to be an informed, credible and objective industry organization able to raise controversial issues and advocate for difficult change and reform. We seek to be open to all views, and free to take unpopular positions. We seek to stimulate and facilitate industry debate. CGAP aims to leverage the first- and second-generation comparative advantage it has earned as an asset to further our mission.

With the rapid growth, commercialization, and high profile microfinance has gained, we will commit to asking the tough questions and helping to bring deep issues into the light. We will invite discussion around the intersection of social and commercial aims, and the trade-offs in balancing the double bottom lines of microfinance. We will explore, provide data, and engage with industry critics on the limits to what microfinance can achieve and the extent to which it can benefit very poor and disadvantaged people. We will examine the risks and advantages of the burgeoning cross-border funds. In short, we will invest some of the social capital CGAP has earned, and the objectivity our structure permits, into confronting even the most controversial issues in the business of providing financial services to the poor.

Building on our current work, CGAP will carry out these roles in four key areas of work, or client groups: financial service providers, financial market infrastructure, governments, and funders, including investors. A matrix in the Annex illustrates the types of roles we undertake in various aspects of work. The three roles are exemplified in the narrative immediately following while the representative areas of work for CGAP that emerge from these roles are described in the Annex.

5A. Standards, Advocacy, and Short-term Advisory Services

CGAP's consensus guidelines and standards, developed in partnership with its member funders and others, are a core contribution to the development of microfinance. They include financial disclosure standards, rating standards, regulation and supervision guidelines, and good practice guidelines for funders. New standards and benchmarking initiatives, such as the Quality of Aid Management for Microfinance Index and the Microfinance Investment Fund performance benchmarks, are underway.

Going forward, CGAP will continue to develop and disseminate guidelines and standards, with an emphasis on our key themes of equity and efficiency. CGAP's standard-setting role will continue, but with more of a focus on promoting good behavior among institutions and their responsibilities toward clients. These may include standards around disclosure of loan costs and terms, financial performance of deposit-taking institutions, and perhaps consumer protection principles and codes of conduct governing business practices. Each of these standard-setting initiatives will be developed in partnership with governments, investors, and other relevant actors.

We also aim to develop templates or frameworks others can use to carry out research, data collection, or analysis in different areas (e.g., country-level effectiveness and accountability review and the branchless banking policy diagnostic templates that will enable funders or others to carry out such analysis directly). Our hope is that, by developing and sharing such templates or standards, we can encourage learning and inter-organizational collaborations and an ever growing database of comparable data contributed by different parties on a common framework.

CGAP's advocacy and advisory work—with funders, governments, and financial institutions—will be limited to short-term engagements, generally in connection with these standards, guidelines, and templates or where significant demonstration effect can be attained. CGAP will continue to link such work with longer term advisory work and implementation carried out by others.

5B. Market Intelligence, Data and Analytics

As we learned from the client survey and virtual conference, CGAP is considered by respondents to be the principal resource center for access to finance issues. The data we have developed on financial performance (now via the MIX), information systems, and laws and regulations have been a resource for the field at all levels. More recently, data collected on funding flows in general, and on the portfolios of development finance institutions and microfinance investment vehicles specifically, have stimulated important debates on funding for microfinance.

In the future, given high demand from many new actors in the field, CGAP will invest greater resources in the collection, analysis, and dissemination of data and analytics to the sector at large. As in the past, we will not carry out primary field research. Instead, our focus is on monitoring current trends and analyzing and interpreting their implications. This means collecting and providing data on funding supply, demand, and flows, as well as on client outreach. In this work, we will concentrate on the themes of equity, efficiency, and building local markets.

We will collect more rigorous data on the full cost of loans for poor clients and on financial returns of MFIs and microfinance investment vehicles (MIVs). In our work with governments, we plan to analyze consumer protection frameworks, incentives to financial institutions, and other policy alternatives to direct delivery of financial services for governments seeking to expand access to quality financial services. Connected to this, we intend to collect and analyze hard data on the experience of national wholesale funds and state-owned banks and engage with their government (and donor/investor) sponsors on the key findings pertaining to these important players on the finance scene. In the aid effectiveness arena, we plan to map donor and investor projects in the field, to help arm donor/investor staff with the means to better coordinate their activities. We also aim to investigate ways to measure the social returns of subsidies used for the private sector and explore the optimal roles of public-purpose funding and commercial funding. Finally, we plan to advocate for improved social performance management and better social performance measurement, for instance with the CGAP-supported Progress out of Poverty Index.

5C. Experimentation

A quest for universal access requires supporting experimental models that might push outwards the frontiers that limit us today. This means taking risks and ensuring that both successes and failures are mined for the lessons they offer.

In line with the evaluators’ recommendations, experiments with new approaches will be designed with a greater investment in well-structured learning and dissemination of lessons learned. Partnerships with funders and other organizations with complementary expertise will be essential.

The focus for such experimentation will again be the themes of equity and efficiency. In partnership with funding agencies, MFIs, and technology companies, CGAP will continue supporting experiments in new technologies and other methodologies that help reach poorer and more remote clients. Working with key funders and governments, we also will experiment with joint ventures between providers of financial services; social services; safety nets, such as grants or food security; and livelihoods support. We will explore new approaches to reaching more remote rural areas and vulnerable populations, such as post-conflict populations, nomadic populations, and youth. At the government level, we will encourage experimentation with different public policy approaches, such as regulatory reform to open the way for m-banking and different options to augment consumer protection. In all of these areas, the emphasis will be on learning from other partners and sharing lessons others can take up and implement on a larger scale.

6. How CGAP Works

Going forward, CGAP seeks to continue to engage in more partnerships (especially at the local level), advisory structures, working groups, and joint funding. We aim to reinforce our effectiveness overall through improved monitoring and systems, improved communication systems, and clearer, better articulated roles and expectations with our partners**.**

6A. Communications

At its core, CGAP is a knowledge-based organization that seeks to raise awareness of poor people's need for expanded access to financial services. As the microfinance industry matures and becomes integrated with the broader economy, so too are CGAP's audiences becoming more diverse and complex.

CGAP's strategy for communications and outreach to this increasingly broad audience is more than synthesizing and disseminating microfinance knowledge. It is about impact — making sure knowledge is actually applied. Thus communications mean actively engaging with stakeholders at the field level and elsewhere, and tailoring information for different audiences: technical and political, field and headquarters, and different cultures and orientations. The challenge will be in determining the pressure points where CGAP can best leverage its comparative advantage and have the greatest opportunity for impact.

As CGAP works at the global as well as field and regional levels, our work is as much about learning from the field as it is about serving the field. As recommended in the client survey and the virtual conference, we intend to strengthen our connections to the field through engagement with a wider range of local and regional actors, including microfinance practitioners, networks, governments, parliamentarians, in-country donors and funders, and non-microfinance organizations working on poverty reduction. A stronger connection to the field will also enable CGAP to be more effective at "scanning the horizon" and taking a more pro-active role that seeks to anticipate critical issues and developments, and influence them early on.

As public attention stays focused on the "success" of microfinance, greater efforts will be devoted to communicating more clearly the impact – as well as the limits – of financial services on poverty reduction.

We will also work harder to extract lessons learned from our experiments and to disseminate them in a more timely and user-friendly manner. Recognizing that many of CGAP's innovations are multi-year programs that need time to yield concrete results, such knowledge sharing could take the form of workshops or brief, interim reports.

Finally, CGAP remains the place and means for other organizations and stakeholders to share their high-quality work. The Microfinance Gateway will continue to serve as a platform and resource center for all to present, share, and exchange different viewpoints and perspectives on critical issues.

6B. CGAP Partners

CGAP's business model is unusual in the number and range of collaborations through which we work. The vision, roles, and priority activities of CGAP will require further innovation in the range of partners and the nature of collaborations. For example, the external evaluation, client survey, focus groups, and virtual conference all stressed the importance of decentralization for effective market intelligence and uptake of microfinance knowledge in the field; this could suggest the value of long-term, deeper partnerships with top-flight national and regional organizations. As recommended by the evaluation team and urged by client surveys, CGAP will also continue to experiment with different models of its regional hub structure to enable some representation at the field level, generally in partnership with others.

Partnerships vary in terms of roles, leadership, attribution, and risk. CGAP has established a typology to ensure all parties have a common understanding of roles, responsibilities, and expectations. To make doubly sure that expectations are clear and misunderstandings avoided, CGAP has developed a set of questions that must be addressed, in the form of a memorandum of understanding, at the outset of all new collaborations.

The definitions in the typology below are intended to describe *relationships* between collaborators and not the activities, investments, or projects themselves. Every activity may thus have several different collaboration relationships. For example, investment in a project, such as the Ford-CGAP graduation program, would have a "joint and equal partnership" between Ford and CGAP and a "grant" with the implementers.

Types of CGAP Partnerships

Main categories of partnerships	Description	Examples
1. Grant	CGAP makes a grant to an external organization. CGAP has no executing responsibilities, ownership, or attribution. Subsequent funding is based on agreed minimum performance thresholds; beyond that, CGAP typically has little or no formal influence. (CGAP may retain a board seat and continuing influence in some large grants to "spin-off" organizations.)	Pro-Poor Innovation Challenge grants; Financial Transparency Awards
2. Equal partnership	CGAP and donors or service providers are co-funders, co-organizers, co-authors, or collaborators on a project on a fully equal basis. The partners jointly provide management oversight and funding. Attribution is shared equally among partners.	CGAP/Grameen note on microfinance institutions' capital structures
3. Partnership led by CGAP	CGAP initiates and leads an effort, inviting other partners to join. Partners contribute financial and/or intellectual resources to the activity.	CGAP Africa Advisory Group Consultative Group for MENA; Technical Committee on the Quality of Aid Management Index
4. Partnership led by others	External partners initiate and lead an effort, inviting CGAP to join. CGAP contributes financial and/or intellectual resources to the activity.	CGAP joining DFID's African Enterprise Challenge Fund board; Working Group on Money Transfers
5. Advisory relationship	CGAP works at the request of a donor or other organization. CGAP provides advice, training, or other input to a partner at its request.	Portfolio reviews of the World Bank and UNDP; advice on CIDA credit line review and new policy
6. Contract	CGAP contracts a service provider who provides intellectual, technical, or other services to CGAP. Ownership and control rest only with CGAP.	Contracts with ADA for IS Fund and Rating Fund; contract with consultant to draft credit guarantee focus note

6C. Working Groups and Joint Projects

Working groups. For concrete areas of work requiring further research, advocacy, or experimentation, CGAP's members, in partnership with other microfinance funders and development agencies, may wish to form working groups. Working groups should have a specific goal, a work plan, and assigned human and budgetary resources to make real progress. The specific agenda of working groups may or may not be themes included in CGAP's work plan. Where the agenda is a topic outside of CGAP's priority areas of work, the CGAP operational team will not have a quality assurance role—nor the accompanying accountability—for the products of the working group. However, the team will engage with such groups to the extent feasible and helpful. Any published working group documents, such as proposed

Consensus Guidelines, issued in CGAP's name would be subject to prior approval by CGAP management.

Joint funding of projects and initiatives. The full range of funders and other partners are eligible to propose designated funding for projects and initiatives that fit CGAP's strategic priorities and operations. Such projects must support rather than shift CGAP's existing core strategic priorities. Accepting and designing such funding is at the sole discretion of CGAP management. Such funds will not substitute for core sponsorship funding. Though designated funding is often more attractive for funding agencies, and more easily approved, accepting it in lieu of core funding would jeopardize CGAP's financial soundness (by reducing the incentive for core funding), add to administrative costs, and significantly reduce its efficiency and effectiveness.

6D. CGAP Monitoring and Evaluation

Like many development organizations today, CGAP is assessing its monitoring and evaluation system with a view toward strengthening it and being able to come closer to measuring its impact.

A review of CGAP initiatives conducted in fall 2006 revealed three important areas that have also been included as part of the recommendations in the overall evaluation of CGAP III. These include the following:

1. To identify clear output indicators that cross CGAP's thematic areas of work (e.g., technical assistance, research, information dissemination, etc.)
2. To place more emphasis on the collection of citations and other evidence of CGAP's impact
3. To identify a small sample of specific projects within each work area for impact assessments

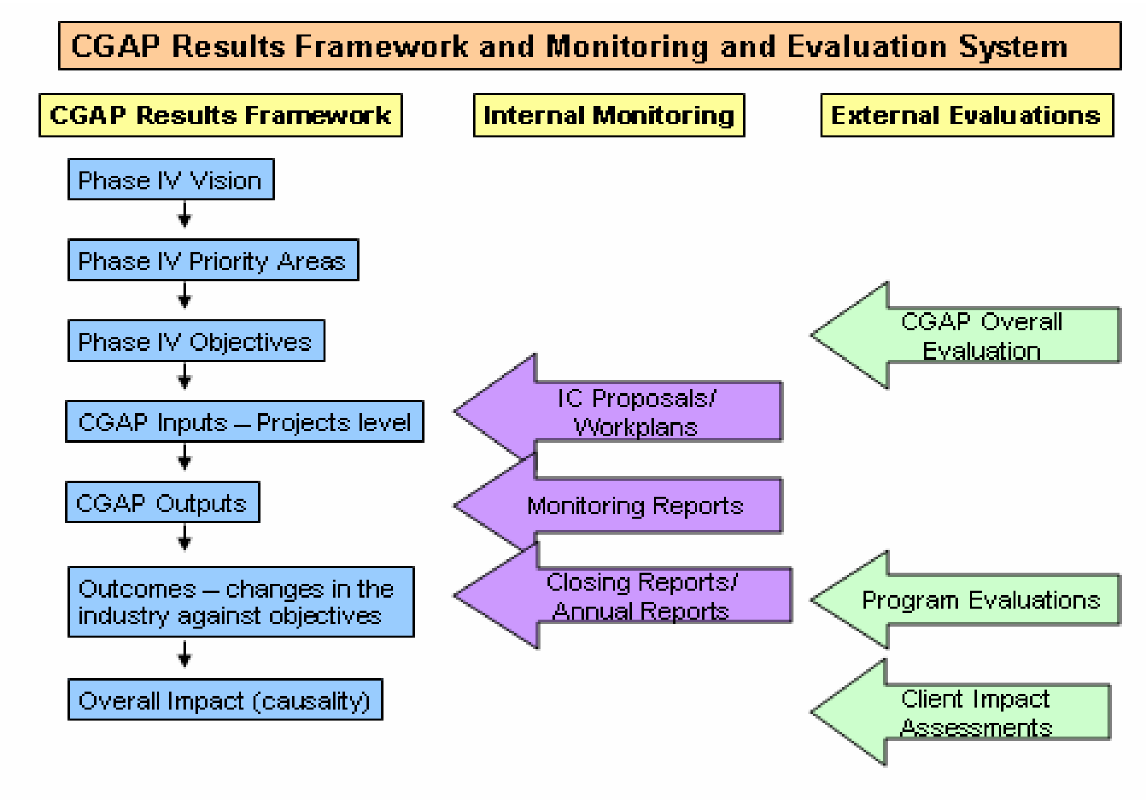
CGAP's overall results framework encompasses the vision, priority areas, and objectives established by the CG. It is at the work plan development and IC proposal level where quantitative and qualitative input, output, and outcome thresholds are established.

Internal monitoring. An effective system of internal project monitoring has been in place for many years now. Performance targets and monitoring indicators are established at the outset of all CGAP projects. Monitoring reports are completed for grants semi-annually and, for internally managed initiatives, annually. At the end of each project, a final closing report is prepared on key accomplishments, failures, and lessons learned for future initiatives. These reports are available to all CGAP members and other interested partners.

External Evaluations. CGAP commissions external evaluations of multiphase investments as a means of measuring outcomes or changes in the industry against the objectives of specific projects. External evaluations have been conducted for the Rating Fund, the Microfinance Gateway, and the Microfinance Information Exchange in recent years. CGAP expects to continue this practice.

Client-level impact assessments will be conducted on various pilot initiatives going forward. The CGAP/Gates Technology Program and the Graduation Pilots have built-in impact assessment components where baseline data and control groups in some instances have been identified at the outset of the activity.

At the institutional level, CGAP operational team performance will be assessed annually by individual work plans and performance targets to be approved by CGAP funders. CGAP will undergo a rigorous external evaluation in June 2012 and will contract a mid-term assessment prior to that. Similar to the evaluations after phases I, II, and III, this will enable funders to determine their interest in funding CGAP going forward.



7. CGAP Membership, Governance, and Funding

The evaluation found that CGAP's work provides an excellent return on investment for funders. By establishing clear criteria for participating in CGAP, continuing to strengthen governance and accountability, and linking participation in governance with a funding strategy, CGAP will maintain this level of return.

The evaluation noted that governance changes introduced in CGAP III were effective, especially those that streamlined the Executive Committee (Excom), broadened its composition to bring in top-flight expertise from the broader field, and strengthened its governance role. These changes have helped make CGAP more responsive to the rapid changes in the field. As both the client survey and the virtual conference noted, it is not only the pace of change that has increased. New actors are entering the field in rapidly increasing numbers. As a result, the evaluation strongly recommended that participation in CGAP's funding and governance be opened to (and limited to) potentially any access-oriented organization serving a public good.

There will be several modest, yet important, changes to CGAP's membership, funding, and governance, all aimed at moving CGAP toward a structure that will be able both to mobilize the funding needed to implement our ambitious strategy and to steward CGAP's resources in the best interest of our fast-changing industry and poor clients.

7A. Membership

The present membership criteria laid out in the Charter have neither been complied with nor enforced. The evaluators recommended that membership criteria be revised and that members hold each other accountable for enforcement. The evaluators also took stock of the importance of untied, core funding to CGAP's success to date and, in particular, to our capacity to identify trends and stay at the forefront of a rapidly developing field.

Bearing these two ideas in mind, going forward, CGAP members will be required to meet only two criteria: that they be funding organizations that support public goods and that they commit to core funding. Other current membership criteria, such as reporting on microfinance portfolios and complying with CGAP's *Good Practice Guidelines for Funders of Microfinance*, will of course remain important aid effectiveness objectives, and CGAP's members will be strongly encouraged to adhere to them. However, compliance will not be a requirement of membership. Other mechanisms for highlighting and rewarding good practice behavior, such as the Quality of Aid Management for Microfinance Index and the investor benchmarking work, will be explored with *all* development donors and investors.

Current CGAP members who are not in a position to meet membership criteria will become non-voting members effective July 1, 2008. They will not vote on the CG and will not be represented by a constituency or an Excom member. CGAP will continue to collaborate actively with these and other development organizations that do not fund our core budget. Many such actors will be key partners for CGAP's operational work.

7B. Governance

Incentives need to be in place for funders to provide the core resources necessary to deliver results. Hence, only full voting CGAP members — i.e., those funding organizations that fund our core budget — are eligible to elect the Excom and vote on the workplan that deploys their funds and on revisions to CGAP's charter. The Investment Committee (IC) will continue to carry out the World Bank's fiduciary obligations as the trustee of the funding that the members provide

Process for implementing governance transition. As only members of CGAP will participate in the election of Excom members and vote on future workplans and proposed charter revisions, it will be necessary to determine who the members will be with sufficient time prior to the June 30, 2008 (end of CGAP III) to provide for an orderly transition. The deadline for indicating membership commitment will thus be December 31, 2007.

CGAP Executive Committee. Following the successful reform of CGAP's Excom in 2003, the committee consists of 10 members: four elected by constituencies of members whom they represent, four elected as independent industry leaders, one representing the World Bank Group, and the CGAP Executive Director as a nonvoting member. This structure will be retained.

CGAP Investment Committee. The IC is currently comprised of senior officers of the World Bank. Their technical expertise and proximity to CGAP operations enable them to exercise the fiduciary role legally required given CGAP's administration by the World Bank. Two locally-based observers to the IC have been invited to represent the Excom and the CG. Going forward, these Excom and CG member representatives will be full voting members of the Investment Committee. ***CGAP relationship with the World Bank.*** The evaluation report recommended that CGAP remain administratively housed at the World Bank, while continuing to stress its independence. At the same time, it urged CGAP to better leverage the World Bank's credibility, influence with top-level policy makers, and field presence to accomplish a common vision. Going forward, CGAP will endeavor to forge closer ties with World Bank staff and management, particularly on policy issues, regulation and supervision, joint work with standard setting bodies, and Financial Sector Assessment Programs, as well as to be more responsive in providing input to strategic country programs on a full cost-recovery basis.

7C. Budget and Funding

Securing adequate ongoing core funding is the biggest challenge CGAP faces right now. CGAP maintained a strong financial position throughout Phase III, thanks to the support of the majority of its members. Member contributions to CGAP's core budget averaged $12 million per year. Excluding the World Bank funding, core contributions to CGAP over the last four years have averaged $280,000 per year, per paying member. Seven members have not paid in recent years.[1]

[1] Ford Foundation approved a $400,000 core support grant for FY2006/7, but this grant has not yet been disbursed due to issues involving the grant letter. Discussion on how to release the funds are underway.

Total Donor Contributions to CGAP Budget - Phase III

In U.S. dollars (05-10-07)

Core Contributions	FY04	FY05	FY2006	2007	FY2008
World Bank	6,325,000	5,525,000	500,000	500,000	*500,000*
WB Interest Income			4,625,000	4,225,000	*2,150,000*
Argidius Foundation	100,000	100,000	100,000	99,985	
Australia	338,300	338,300	697,550	359,250	
Belgium	377,845	388,725			
Canada	369,058	412,609	428,119	*428,119*	*428,119*
Dell Foundation			100,000	*100,000*	
Denmark	423,986	520,063	476,984	522,362	
European Commission		1,245,215	665,200	*600,000*	*600,000*
European Investment Bank			242,040	256,220	
Finland	293,328	317,512	334,256		
Ford Foundation	200,000	200,000			
France	179,790	198,795	183,750	190,245	*162,500*
Gates Foundation			157,500	*157,500*	*157,500*
Germany	284,150	331,250	317,250	*317,250*	
IFAD					
IFC		300,000	300,000	*300,000*	*300,000*
Italy	635,100	403,050			
Japan	300,000	300,000	300,000		
Luxembourg	434,445	440,241	421,395	464,635	*462,280*
Netherlands	200,000	400,000	400,000	400,000	*400,000*
Norway	476,190	471,143	456,236	*456,236*	*456,236*
Spain		361,830	384,630	*384,630*	*384,630*
Sweden	430,416	389,358	417,944	*417,944*	*417,944*
Switzerland	399,980	400,000	399,975	399,980	*400,000*
United Kingdom	400,000	474,938	474,938	444,625	487,175
United States					
Core	12,167,588	13,518,029	12,382,766	11,023,981	7,306,384
Designated	100,000	1,465,773	1,700,440	7,923,878	7,281,658
Total	12,267,588	14,983,802	14,083,206	18,947,859	14,588,042

Notes:

1. Contributions are based on actuals and formal pledges todate.
2. Designated contributions: FY04 (Ford Foundation); FY05 (Argidius Foundation, EC, IFAD); FY06 (EC, IFAD, Sweden); FY07 (EC, France, Gates, IFAD, Sweden); FY08 (EC, France, Gates, Sweden).
3. Ford Foundation and the US offered additional pledges in Phase III, which have not been received due to WB AML restrictions.

CGAP FIVE-YEAR OUTLOOK Phase IV - Years ending June 30, 2009, June 30, 2010, June 30, 2011, June 30, 2012 and June 30, 2013 Prepared on 5/22/07	Projection *July 2008-June 2009*	Projection *July 2009-June 2010*	Projection *July 2010-June 2011*	Projection *July 2011-June 2012*	Projection *July 2012-June 2013*
Statement of Revenues and Expenses					
Revenues					
Core Contributions from Donors	11,600,000	12,760,000	14,000,000	15,400,000	16,000,000
Designated Contributions from Donors *	7,500,000	7,800,000	7,800,000	7,850,000	7,900,000
Interest Income	1,910,000	2,056,000	2,180,000	2,325,000	2,390,000
Total Revenues (A)	21,010,000	22,616,000	23,980,000	25,575,000	26,290,000
Expenses					
Grants/Initiatives Committed	6,800,000	7,000,000	8,000,000	9,000,000	8,000,000
CGAP/Gates Technology Initiative *	6,500,000	7,775,000	6,800,000	6,850,000	7,900,000
Staff Salaries and Benefits	3,404,427	3,506,560	3,611,757	3,720,109	3,831,713
Office and Occupancy Costs	1,096,225	1,129,112	1,162,985	1,197,875	1,233,811
CGAP Phase III Evaluations	-	-	-	200,000	50,000
CGAP Internships	500,000	525,000	577,500	635,250	698,775
CGAP Travel/Representation and Serv. Providers	560,146	588,153	617,561	648,439	680,861
Communications Activities	1,961,537	2,059,614	2,162,595	2,270,724	2,384,260
CG and ExCom meetings	210,000	224,700	240,429	257,259	275,267
World Bank Administration Fee	565,000	629,000	691,000	762,000	793,000
Total Expenses (B)	21,597,335	23,437,139	23,863,826	25,541,656	25,847,687
Excess of Revenues over Expenses for the year (A)-(B)	(587,335)	(821,139)	116,174	33,344	442,313
Operating Reserves at beginning of the period	8,718,315	8,130,980	7,309,842	7,426,016	7,459,359
Operating Reserves at the end of the period	8,130,980	7,309,842	7,426,016	7,459,359	7,901,672

* Designated contributions assume the BMGF commitment through 2010 and new designations through 2013.

Since the beginning of Phase III, the World Bank's funding strategy was to gradually reduce financial contributions over time, because member funding was expected to increase. This has been accomplished, with paying members increasing from 20 at the end of Phase II to 25 in Phase III. The World Bank's share of CGAP's total funding has decreased from 80 percent in CGAP I, to 59 percent in CGAP II, and 25 percent (of contributions to date) in CGAP III.

The World Bank's Development Grant Facility (DGF) commitment to CGAP dropped from $5.5 million to $500,000 per year in FY05 and will stay at that level through FY 08. This was due to a nonrecurring windfall—an accounting determination that $11 million in interest accumulated on earlier contributions ought to be allocated to the CGAP trust fund rather than retained in the World Bank. By the end of 2008, those windfall funds will have been exhausted. Because it is unlikely DGF will increase its annual funding to previous levels, the funding gap will need to be filled by other members. This will require enforcement of funding criteria for sponsorship, increased contributions from existing members, and recruitment of a few new sponsors.

Core sponsor contributions for the next phase of CGAP will average at least $375,000 per year per existing paying member of CGAP to meet our revenue goals for the strategic plan set forth herein. We would expect amounts to vary considerably with each sponsor paying according to its means.

Annex. CGAP 2008–2013: Four Areas of Work, Four Clients

Matrix of Roles and Areas of Work

	Financial Service Providers	Infrastructure/ Markets/ Transparency	Domestic Governments	Funders
Standards/ Short-Term Advisory	E.g., Financial transparency awards	E.g., Financial and social performance standards	E.g., Policy diagnostics for branchless banking	E.g., Investor reporting guidelines, Quality of Aid Index
Market Intel, Analytics & Data	E.g., Deposit mobilization	E.g., Interest rates, loan costs/terms, business practices	E.g., ID and monitor use/performance of policy alternatives to achieve access	E.g., Investor database; Govt funded programs and apexes
Experimentation	E.g., Graduation programs New delivery technologies		E.g., Consumer protection options	

Building on our current work, and in keeping with feedback from the evaluation, client surveys, and members, CGAP will continue to focus on the following four areas of work, or client groups, in its next phase: financial service providers, financial market infrastructure, governments, and funders.

In each of these areas we will seek to consolidate what CGAP has accomplished so far and deepen—rather than broaden and diversify—the work. This means taking our lessons learned from the global to the country level, from headquarters to the field. It means taking high-level advocacy into field-level uptake. It means taking research findings and experiments and extracting more value—sharing knowledge so it may be applied and have real impact. It means a constant drive for innovations that will extend the frontiers of microfinance to those currently left behind. It means focusing on results on the ground.

A. Financial Service Providers: Reducing Costs to Reach Poorer Clients

The focus of CGAP's work with **financial service providers** is to reduce costs and innovate in other ways to reach poorer clients. This will be accomplished through investing and doing advisory work in technology, stimulating competition, advocating a broader range of service, and experimenting with new models to reach poorer clients.

New delivery technologies: Expanding scale, reaching deeper. During CGAP III, an initial focus on strengthening "back end" MIS platforms for banks and MFIs evolved into a more holistic view of what technology can do to reduce transactions costs and increase the reach of financial services for poorer people. This work will continue to expand in our next phase of work. Financed in large part by the Bill and Melinda Gates Foundation, CGAP's Technology

Program aims to break through the frontiers of finance by experimenting with technology approaches, such as mobile phone banking, the use of banking agents, alternative credit scoring methods, and text-free ATMs that illiterate clients can use. We will test new models, including new partnership business models made possible by technology, study barriers to client adoption, and share lessons learned. Going forward, we will focus more on partnering with donors and investors. On the policy front, the program is assessing the challenges and solutions that emerging technologies may create for regulators, with an eye toward balancing innovation with consumer protection. The knowledge gained from this work will be in the public domain to be shared widely so that lessons learned may have real market impact.

Focusing on deposit mobilization. Advocacy on the development of *savings-led* local financial markets is at the heart of CGAP's work going forward. Our belief in the importance of savings, both as a core service to poor clients and as a source of financing, is a key driver of our work in technology, aid effectiveness, and policy. It is also a central theme in our work with financial institutions. CGAP will seek to disseminate the lessons learned from its Savings Initiative in CGAP III, by translating research into concrete action within institutions and policy change with governments and funders. Shedding light on the business case—for different types of providers—to offer small-balance savings products will be particularly important, as will development of tools that go beyond market research and product development to support the full range of operational changes required to succeed. Future work will also explore new business models and alternate institutional arrangements (e.g., linkages between banks and community-level institutions) to extend quality deposit services.

"Graduation" programs to reach poorer people. Pushing the frontiers of microfinance will require clarifying what markets can and cannot do, where commercially driven delivery of financial services stop, and where subsidies must begin.

In a continuing quest to bring poorer clients into the financial system, CGAP and the Ford Foundation launched a series of experiments to help the extremely poor graduate from grant-funded safety net programs, building the assets and skills they need to take advantage of the full potential of microfinance. Depending on the outcome of these experiments, we will seek to build on them, making adjustments to optimize performance and returns on scarce subsidy, and developing more of them in partnership with donors and other implementers. We will continue to experiment with graduation programs and linkages between microfinance and a variety of services, social and market-focused, such as livelihood programs, that can increase outreach to and benefits for poor people.

We also intend to engage in a more substantial learning agenda around those institutions truly reaching extremely poor or vulnerable populations. We will seek to learn in depth how they differ from others—the methods they deploy and the tradeoffs they face. This work will be implemented in particularly close partnership with MFIs, multisector NGOs, and innovative partnerships that have solid experience in developing approaches that enable the very poor to build sustainable livelihoods, incomes, and assets.

B. Financial Market Infrastructure: Generating Reliable, Transparent Information

As an industry organization CGAP has made important contributions to building the **financial market infrastructure**—standards and a body of transparent, high-quality financial information about MFIs. CGAP will deepen its work in transparency by taking it from the institutional level to the client level. This work will center on two interconnected areas. The first is “truth in lending” through clarification and plain-language disclosure of the total costs and other terms and conditions of loans and other products to clients. Second, we intend to focus on disclosure around the poverty levels of clients and the outcomes they experience. What clients are we reaching? How poor are they? Are their levels of incomes, assets, and security increasing? How can we reach—and more important, benefit—poorer clients?

Transparency around financial performance. CGAP’s Financial Statement Disclosure guidelines are established and widely accepted. Compliance is increasingly driven by market expectations. The MIX has become the number one source for data on MFIs, with data on 940 MFIs and 93 funds. (CGAP spun off the MIX during Phase III, but senior CGAP staff remain active in MIX governance.) The Rating Fund has financed 320 MFI ratings and has successfully propelled the microfinance credit rating business. The CGAP Financial Transparency Award has become a major impetus for improvements in financial reporting, with 231 participating MFIs from 46 countries in 2006.

The mechanism for collecting financial information on MFIs is largely in place, so CGAP will focus on promotion and uptake. We will continuing to support and build the MIX, sponsor the annual Financial Transparency Award, and promote transparency through credit ratings and high-quality audit and disclosure standards. We will also help develop new disclosure guidelines for the rapidly expanding universe of new investment funds. These will provide benchmarks on financial return, efficiency, and outreach for the different categories of investment funds.

Transparent disclosure of costs, term and conditions of financial services. In partnership with practitioners and other market players, we propose to undertake research, advocacy, and potentially development of disclosure standards on interest rate levels, total loan costs, and terms of loans and other services. While much attention has been paid to standards for disclosing institutional financial information, interest rates and fees charged to poor clients vary widely and are rarely fully understood by customers. Efficiency has improved in many organizations, but remains poor in many others, with the cost of such inefficiencies borne by poor clients. In organizations that have improved their efficiency, the gains are sometimes passed to clients through lower interest rates and sometimes captured within the organization as returns on assets that are often higher than commercial bank returns. This area of analysis—how different business models and strategies balance the double bottom line—is critical because microfinance is in the spotlight of funders, governments, and the media. It will be a core focus for CGAP going forward.

Transparency around clients reached, benefits, and social performance. We propose to continue our work with key stakeholders, including Ford Foundation, to develop and advocate reporting formats for MFIs that will enable them to track their social performance: from determining the poverty levels of clients to tracking whether clients are improving their economic conditions. We will continue our leadership role as part of the Social Performance Task Force, a group that includes over 100 practitioners, funders, and service providers promoting a double bottom line in the industry (see Box 2).

Box 2. Social Performance: Who are our clients? Does microfinance help? How do we know?

Most MFIs claim to serve the poor and even the poorest. Yet very little rigorous empirical evidence exists to substantiate these claims. The few detailed studies that have been done have found that even amongst the more poverty-focused institutions, many clients are situated above the poverty line and that progress out of poverty from microfinance alone is far from automatic.

Anecdotal evidence and some studies suggest that microfinance has the potential to increase household economic activities, reduce vulnerability, build assets, and even improve economic and social conditions. However these outcomes are not automatic; they may depend on the characteristics of the financial institution and its products and services, as well as the context in which it operates. Proactive and sustained efforts are required to reach the very poor, develop products relevant to them, and create institutional cultures that allow clients to benefit from financial services.

CGAP has been championing social performance in microfinance to provide transparency on this twin issue of who the clients are and what changes they experience. It is therefore supporting the Progress out of Poverty Index. Designed by Mark Schreiner, the tool provides a statistically rigorous, yet simple and inexpensive, way for institutions to determine the poverty levels of clients and the economic improvements in their lives and will be a cornerstone of CGAP's social performance work in Phase IV.

C. Governments: Improving the Policy and Regulatory Environment

There is overwhelming consensus among external stakeholders that improving the **government policy and regulatory environment** should continue to be an important cornerstone of CGAP's work. The CGAP III evaluation noted with approval two important aspects of CGAP's evolution thus far: first, "a shift away from the hands-off stance of the 'Rush to Regulate' era to a more proactive approach to creating a conducive policy environment"; and second, "a shift away from a narrow…focus on regulation and supervision to a broader microfinance policy agenda." This evolution will continue in the next phase of our work, with increased emphasis on the *political economy* of decision making in the policy arena.

A proactive approach to creating a conducive policy environment. Consolidating the gains achieved in CGAP III, we will continue broad dissemination and advocacy of the *Consensus Guidelines: Guiding Principles on Regulation and Supervision of Microfinance* and other messages key to developing a favorable policy environment. The next phase of our work also will mark a concerted move toward more systematic coordination between our short-term policy input and the longer term legal and regulatory reform activities of CGAP sponsors (notably, the World Bank and the regional development banks, but also bilateral donors active in policy and several of the new foundation funders entering the arena).

A broader microfinance policy agenda. Given the now well-established connection between financial access, broad-based growth, and poverty reduction, it is not surprising that government interest in microfinance has increased. The question of which mix of policy choices will best stimulate financial market development that is both inclusive and healthy, however, is far from settled. Governments, especially those of large, resource-rich emerging market countries, will take an increasingly active role in promoting financial access. Popular options include wholesale "apex" funds to provide financial and sometimes technical support to retail providers, carrots and sticks to encourage mainstream banks to go down market, incentives to savers, and direct delivery of financial services by public financial institutions. Awareness about consumer protection and market conduct issues is also on the rise.

Already, this trend takes us well beyond the traditional domain of financial regulation and supervision. Recognizing this, we will join with others to build knowledge on topics such as the successes and failures of direct and indirect government-backed financial service delivery (apexes, state banks, "banks for the poor," etc.); the performance of policy alternatives, such as priority sector lending targets and incentives for community reinvestment; policy prerequisites for technology-enhanced financial service delivery; schemes to promote savings and long-term asset building for poor households; and the whole complex of issues surrounding effective consumer protection and promotion of financial literacy. CGAP will also seek to generate discussion within the industry and with diverse government stakeholders (which include politicians as well as government officials and regulators) about the trade-offs in the various instruments, and which are better-suited to addressing which types of problems in which types of settings. This work will demand a nuanced approach that recognizes the perspectives—political as well as economic—of different players in the policy process.

Emphasis on the political economy of policy reform. Ultimately, policies good and bad are a matter of political decision making. The best of "best practice" messages hold no value if they are not taken on board by policy makers. Thus far, much of the policy work in microfinance has focused on convincing executive branch actors, such as ministries of finance and economy and central banks, to embrace pro-access principles. While this work will continue, CGAP will take stock of the full range of political decision makers and focus increased attention on parliamentarians and interest groups that have their ear.

D. Funders: Optimizing Effectiveness and the Use of Subsidies

The evaluation report noted that CGAP has a "clear mandate, an absolute advantage," in working on aid effectiveness. Moving forward, the challenge will be to harness the lessons from the peer reviews, country-level effectiveness reviews, and other aid effectiveness work conducted since 2002 and apply them to the new, complex, and rapidly changing microfinance funding landscape.

Reaching out to government-financed apexes. CGAP will strive to learn more about, and engage with, apexes. Because these local funders increasingly act as donors, the peer review methodology and other lessons from the aid effectiveness initiative to date could be tapped. Several approaches, in close coordination with CGAP's policy initiative, can be employed, including initiating work with a small group of "champion" apexes and with the funders behind the major apexes (the World Bank, Asian Development Bank, DFID, and IFAD are the largest funders of apexes worldwide). Some apexes are so large that supporting their change processes may be a strategic use of CGAP's short-term advisory services.

Measuring the quality of aid. In the future, CGAP will continue to identify incentives for agencies and investors to improve policies, systems, and procedures for the more effective delivery of financing to microfinance. Examples of this work will include the benchmarking on investment funds and the launch of the Quality of Aid Management for Microfinance Index. Through these initiatives, CGAP hopes to influence the international debate on the quality of financing for microfinance by stressing the importance of quality management systems of agencies and investors.

Monitoring funding flows and exploring optimal roles. CGAP aims to invest in improving coordination and increasing synergies among private markets and between traditional funders and new private funders. In addition, some stakeholders have asked CGAP to help identify the appropriate roles and comparative advantages of different funders. Deepening aid effectiveness will require more systematic monitoring of diverse funding flows—grants and investments, public and private, public-purpose and commercial, domestic and international—into microfinance and their performance.

Providing strategic advisory services. Based on work done so far and in line with the recommendations of its evaluation, CGAP proposes to more systematically define its package of advisory services to investors, donors and IFIs, while retaining the flexibility to respond to ad hoc requests. Some services will have to be adapted and/or repackaged to meet the specific needs of new funders and local funders that, in some cases, are quite different from those of the traditional donors. Offering a predetermined set of services allows CGAP to focus on areas that have proven most important to funders' effectiveness and provides a credible basis to say no to certain requests (e.g., participating in appraisal missions for generic projects). Core areas of services will include strategic planning and advice; systems audit and technical advice; staff development and training; and accountability, transparency and performance monitoring.