2. Relevance of World Bank Group Support

Highlights

- World Bank Group support to financial inclusion grew by 20 percent over the last six years, barely keeping pace with the growth of the MFI industry, which grew by 80 percent. Still, the fact that IFC supports MFIs that jointly issue 39 percent of the global micro loan volume underscores IFC's leadership role.
- Despite the growth and relative reach of the World Bank Group, its support to financial inclusion is small, given the large number of unbanked and the micro credit gap. This requires a strategic allocation of resources, shifting its scarce resources where they are needed the most and where they have the highest impact.
- The World Bank Group's allocation of its resources devoted to advancing financial inclusion is strategically aligned with countries' needs; that is, they primarily reach countries with low inclusion rates where markets actually reach the poor. This is particularly true for World Bank lending, IFC advisory, and AAA.
- IFC's investments also reach countries with very low inclusion rates – which is remarkable, as these markets are often served by MFIs that rely on subsidies.
- At the country level, World Bank Group support for financial inclusion was relevant in as much as it addressed a clear development priority.
- The most common constraint that Bank Group strategies addressed is lack of capacity and financing of financial institutions along with financial infrastructure (credit reporting) and regulations. Consumer protection and financial literacy were, however, almost never addressed, despite their importance for the poor.
- The focus of the Bank Group's inclusive finance support has been on credit and gradually embraced other services, a promising trend given their importance for the poor.

2.1 **This chapter analyzes the extent to which the World Bank Group's support for financial inclusion has been relevant in the context of its strategic framework and country-level priorities.** The intervention logic for World Bank Group support of financial inclusion builds on their potential to address market or government failure, hence allowing an increase in the supply and demand of financial services to low-income households and micro enterprises at a lower, or at least affordable cost and adequate quality. However, local circumstances vary. Geographic dimensions, population density, the extent of "social cohesion," the progress of banking sector reform and the adequateness of its supervision system – to mention just a few factors – may vary across countries. In other words, each country faces particular constraints and developmental challenges requiring a tailor-made financial inclusion agenda and Bank Group support strategy.

2.2 This chapter presents evidence on (i) how financial inclusion fits into the overall strategic framework of the World Bank Group; (ii) the extent to which the Bank Group interventions matter given the overall magnitude of the issue; (iii) how strategically the Bank Group deployed its resources; and (iii) how the Bank Group addressed development priorities in client countries and identified and constraints to the countries' financial inclusion agenda.

World Bank Group Strategy and its Universal Inclusion Goal 2020

2.3 **The World Bank Group's 2007 Financial Sector Strategy set out an agenda and defined a business model for the Bank Group to engage in financial inclusion.** The strategy noted that the development mission of the World Bank Group "leads it to focus on market and institutional infrastructure"—the legal basis, market standards and systems (including payments). Access to finance "for the underserved" is one of two areas of "special attention through well-defined initiatives." CGAP is identified as leading on microfinance, focusing on "sound policies and best practices" with a "an increasing emphasis on the regulatory and market development implications of the use of modern technologies (e-banking, phone-banking)." The strategy makes note of the need to use more systematic diagnostics, including Financial Sector Assessment Programs (FSAPs), Report on the Observance of Standards and Codes, and IFC microdiagnostics. The plan was to do an FSAP stock taking and to develop a set of "consistent diagnostic-based indicators."

2.4 **The new 2013 Bank Group strategy lays out a role for World Bank Group in financial inclusion.** It mentions the priority of access to finance in poor and fragile and conflict-affected (FCS) countries and states that "new products are likely to emerge to meet the needs of the 2.5 billion people who still do not have access to formal financial services." It recognizes the central role of the private sector in job creation as a means of poverty alleviation. Microenterprises are mentioned only in a box on IFC, noting that IFC's sector focus has shifted to increase the program share of micro, small, and medium-size enterprises (MSMEs). However, financial inclusion is not explicitly mentioned.

2.5 **In addition, IFC has strongly emphasized financial inclusion (which for it includes SMEs) and microfinance.** For example, IFC's 2013-15 Roadmap lists as one of five strategic focus areas: "Developing local financial markets through institution-building, the use of innovative financial products and mobilization, focusing on micro, small and medium enterprises." Its Development Goal 3a is "Increase access to financial services for micro/individual clients." In declaring IFC's goals, it emphasizes its "strong focus" on MSMEs and its continued "lead in innovation in microfinance" including in technology, products, and policy "to help financial intermediaries reach a greater number of people in a more cost-effective way by effectively combining Investment Services and Advisory Services." In the

2013-15 Roadmap, IFC replaced its development goal of "helping MSMEs increase their revenues" (an outcome or even an impact) and focused on an existing Development Goal: "increase access to financial services for SMEs clients and micro/individual clients." A major reason was its difficulty in measuring MSME revenues. IFC plans to continue to increase financial inclusion within the context of the World Bank Group approach to responsible financial inclusion through a range of investment, advisory, and Treasury activities, a leading role in the G20 Global Partnership for Financial Inclusion, and leveraging its client network for financial inclusion. IFC's advice and investment in this area often go hand- in-hand. MIGA's strategy does not enunciate any goals regarding financial inclusion or microfinance, although some of its guarantees have facilitated institutions that provide microfinance among their services.

2.6 **To accelerate and increase effectiveness of reforms and country-led actions on financial inclusion, the World Bank Group launched the Financial Inclusion Support Framework (FISF) in April 2013.** At least 50 countries have set financial inclusion targets and/or made commitments to improve financial inclusion, although far fewer countries have a fully developed FISF yet. This framework is intended to support these countries both in creating the needed enabling environment through policy and regulatory reforms and in building financial infrastructure development, as well as through measures aimed at funding the expansion of financial services by catalyzing private sector finance, know-how and innovation. Country selection for Bank Group engagement is accordingly based on country commitment, dedicated capacity, and the availability of a lead counterpart and the potential for impact.

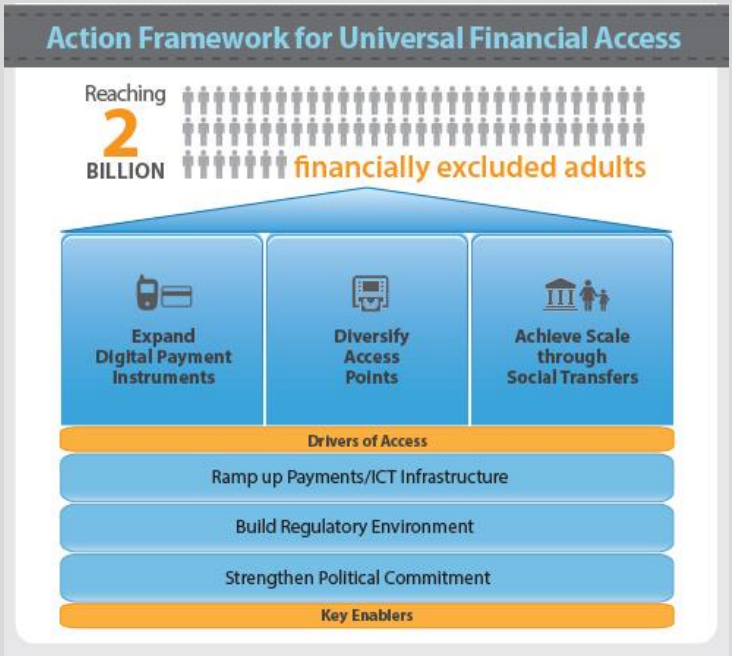
2.7 **Finally, World Bank President Kim lifted financial inclusion to the highest strategic relevance** in October 2013 by declaring the World Bank Group's commitment to achieving universal access to financial services by 2020. The emphasis of this commitment appears to be on extending access to low-income workers and poor families. For details on how the Bank Group plans to achieve the 2020 goal, see Box 2.1.

Box 2.1. World Bank Group's Universal Financial Access Goal is Directly Relevant to its Financial Inclusion Agenda

Consistent with President Kim's commitment to Universal Financial Access by 2020, the World Bank Group's approach centers on financial access through transaction accounts. These include not only bank-held accounts but also e-money accounts held with banks or other authorized and/or regulated service providers including non-banks, which can be used to make and receive payments, and to store value. Beyond providing access by introducing these transaction accounts, the Bank Group focuses on expanding access points, and driving scale and viability through high-volume government programs, such as social transfers, into those transaction accounts. Transaction or deposit accounts are seen by the World Bank Group as the stepping stone to full financial inclusion, that is, providing a pathway to a broader range of financial services. Advisory services and analytical work is currently being programmed to monitor the transition from access to usage and more broad-based inclusion in client countries.

The Bank Group is focusing its efforts – with development and private sector partners - on 25 countries where 73 percent of all financially excluded people live. India and China have the largest share of unbanked people. Together they account for some 32 percent of them. The rest of the top-priority countries include: Bangladesh, Brazil, Colombia, DRC, Egypt, Ethiopia, Indonesia, Kenya, Mexico, Morocco, Mozambique, Myanmar, Nigeria, Pakistan, Peru, Philippines, Rwanda, South Africa, Vietnam, Tanzania, Turkey, Yemen, Zambia. The Bank Group is working with these countries to strengthen the key building blocks needed to achieve the access goal, including, political and stakeholder commitment, enabling legal and regulatory environment, and bolstering payment systems and ICT infrastructure.

Figure: World Bank Group Action Framework for Universal Financial Access



Source: http://www.worldbank.org/en/topic/financialinclusion/brief/achieving-universal-financial-access-by-2020

2.8 **The Bank Group's public commitment to a specific measurable goal contributed to sustaining and expanding international dialogue to reach consensus and advance the financial inclusion agenda.** President Kim's public commitment to universal financial access helped to motivate a high level and visible policy dialogue, including with other UN agencies, foundations, multilateral development banks, dignitaries and experts. As a spin-off, these fora triggered further declarations and commitments; for example by national governments to meet their financial inclusion targets and by foundations, banks, policy makers and financial inclusion alliances to contribute to the global agenda, as was the case at the 2015 World Bank Group/IMF Spring Meetings.[22] This is further supported by the Bank Group's convening power and engagements in partnership and standard setting bodies, discussed in greater detail in Chapter 3.

2.9 **Despite the Bank Group's public commitment to the Universal Access Goal 2020, there appears to be little guidance on how to operationalize this goal for Bank Group staff.** Although the above-mentioned FISF delineates some principles of actions and key building blocks of World Bank Group support, it remains to be seen how this goal will be translated into practice. Such guidance may also define the relative emphasis placed on access to a *range* of financial services and *usage* thereof, that is, actual financial inclusion, versus access to basic transaction services, such as receiving government payments electronically.

2.10 **A focus of "driving up access numbers" runs the risk of ignoring that there is yet limited evidence that demonstrates that the provision of access to financial services leads necessarily to financial inclusion of the poor.** Conceptually, the link between access and inclusion (active use) of financial services is clear, but empirically, nonutilization rates in some schemes raise questions. A lot depends on the quality, design and utility of this initial access.

2.11 Studies reveal the pros and cons of policy options that are aimed at providing the poor with access to financial services in a fast manner. For example, the promotion of access through government-supported programs to digitalize cash payments via mobile phones or no-frill accounts for a large share of the population may not necessarily lead to inclusion. In Niger cash transfer via the mobile phone proved that such payment systems could be low-cost ways to deliver cash transfers. Moreover, households receiving mobile transfers had higher diet diversity and children consumed more meals per day, attributed to increased time saving as well as increased intra-household bargaining power for women (Aker and others 2013). However, a later study by the same authors cautions that "[although} these results are promising, they suggest that electronic transfers may not lead to improved financial inclusion for all households or in all contexts, as proponents might suggest. Unlike the mobile money "revolution" in Kenya, mobile money registration and usage has not grown substantially in other parts of sub-Saharan Africa, including Niger." (Aker and other 2014, page 29).

2.12 Another example that is frequently quoted in this context is mPesa in Kenya. Jack and

Suri (2014) found that mPesa users weathered shocks better than those not using that technology. Despite this encouraging findings, the mPesa model stands out in as much as the mobile network operator, Safaricom, had a quasi-monopolistic coverage of Kenya and agents were contracted based on exclusivity agreements, i.e. they were not allowed to disperse cash for potentially competing service providers. The replicability of mPesa to date has proved limited.

2.13 India with its massive rollout of the *Pradhan Mantri Jan Dhan Yojani* scheme offers additional cautions – the World Bank finds that 72 percent of accounts opened under the scheme have zero balances (implying dormancy). On a broader basis, the latest Findex data point equally at low usage of accounts, despite strong growth in access to them. Globally, 460 million people have dormant accounts, that is, they have not made a single transaction during the last year (Demirguc-Kunt, Klapper, Singer and Oudheusden 2015). Dormancy and low usage are particularly strong in low income and lower middle income countries and indicate that "there are millions of accounts, including new ones, that are essentially dormant, and many more that are used for one or a narrow range of purposes"(Kelly and Rhyne 2015, page 19). All of these cases exemplify that the link between access and inclusion cannot be assumed – it rather relies on the quality, design and utility of the initial access and a set of assumptions.

2.14 **Already the historic approach of trying to lift the poor out of poverty through micro credit built on a set of assumptions – but these proved overly optimistic.** The first "wave" of financial inclusion provided the poor with credit, assuming they would invest these funds in productive assets, eventually lifting them out of poverty. However, this model did not work as intended for most. As the preceding literature review showed, the key assumptions that were thought to make this model work, did not materialize. This could be attributed to several explanations – for example, that access to finance was not the binding constraint to start with, or loan recipients did not invest in productive assets, but used this funds to smooth consumption and manage their day-to-day finances; or recipients lacked the entrepreneurial skills required. Only a very small fraction of recipients were able to develop their microenterprises and thus escape poverty.

2.15 **One could argue that the international development community, including the World Bank Group, has learned from the experience with micro credit and has turned now to payment systems and savings.** However, also the approach of enabling access of the poor to financial services through digital payment systems also relies on a set of assumptions. These assumptions include (i) sufficient mobile phone network coverage, and if not present, the availability of funds to conduct the needed upfront investment; (ii) the availability of agents to allow users to cash in and out because in their local economies cash still prevails; (iii) the required literacy to use mobile phones and associated accounts; and/or (iv) the needs of the poor to use the devices beyond the initial government-mandated cash transfers. As Aker and others (2014, page 29) put it in the context of their analysis of cashless transfers in

Niger: "This suggests that substantial investment to register clients and agents would be required to establish mobile payment systems. In addition, while program recipient households in our study used mobile money to receive their transfer, they did not use it to receive remittances or to save, two important aspects of financial inclusion. This is potentially related to the limited m-money agent network in the country, a common issue in other West African countries. Like many field experiments, the generalizability of our results may be limited." Equally, an approach of digitalizing P2P and G2P payments or mass roll-outs of no-frill accounts rely on a set of assumptions, similar to those above: (i) the availability of these systems, (ii) customer-centric design of these accounts so they are being used beyond the initial transaction they were set up for and – most importantly – sustainability. While in some cases digitalizing payments may be self-financing due to efficiency increases and savings from reduced leakage of funds, sustainability needs to be examined carefully.

2.16 **Even assuming access does lead to inclusion, the question remains to what extent the poor actually benefit.** The conclusion of the above presented IEG-commissioned literature review is that micro credit was not transformational in lifting people out of poverty; yet payments, savings and insurance tend to have a higher potential to help the poor manage their day-to-day finance. To some extent these latter services can also lead to investments in education and health care and to business expansion. At least, they provide choices that poor people did not have before.[23] The rather limited evidence on benefits points to the importance of continuous monitoring and evaluation of World Bank Group interventions in financial inclusion to ensure support activities actually benefit the poor – an issue that Chapter 4 will analyze in greater depth.

2.17 **The current World Bank Group's strategy of focusing on 25 priority countries may have to be adjusted going forward as the remaining population of excluded will increasingly be broadly distributed among many countries.** The World Bank Group's plan implies a focus on 25 "priority countries," based on the rationale that about 73 percent of the unbanked live in these countries. Concentrating on these countries may result in efficient resource allocation as a large number of unbanked potentially benefit through a limited number of interventions in a few countries; however, it is likely not only to pose questions of equity, but also leaves unaddressed the excluded in other countries. Although China and India may continue to show substantial progress in including people, the still-excluded will come from many countries in all regions. "It will hence be important that support for efforts to advance inclusion engage with smaller countries that are not in the spotlight", Kelly and Rhyne (2015, p. 15) conclude. In addition, as initiatives reach the more proximate populations, many of the remaining excluded poor will live in rural areas, requiring further adaptation of the approach.

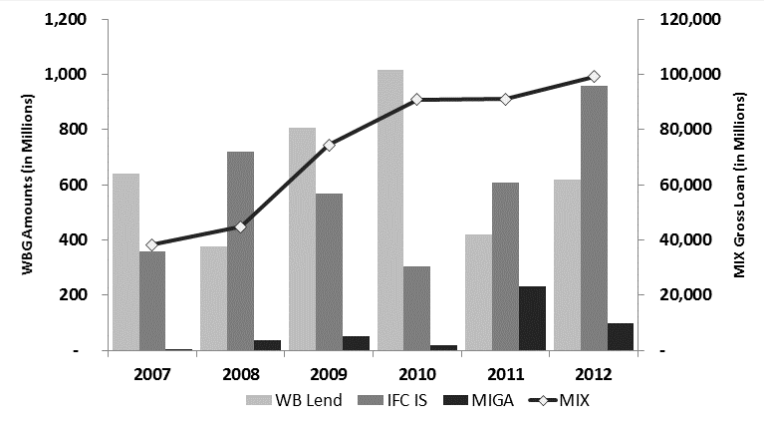
2.18 **Last, the question remains as to whether the Universal Access Goal is achievable by 2020 at all.** Recent extrapolations from current trends concluded that by 2020 just over one

billion people will be unbanked, taking population growth into consideration (Kelly and Rhyne 2015). Will the World Bank Group's support boost access to such an extent that these one billion will still be reached? Have the "low hanging fruits already been harvested" as large countries have implemented government-mandated mass rolls outs? Will it there be more costly to reach this "last billion" of unbanked? **Summing up, the current Bank Group strategy raises a set of questions.** It is important going forward to provide a minimum of guidance in setting out the envisaged future state of financial inclusion; the expected benefits for the poor based on evidence; the focal areas of engagement -- in particular guidance to find the right balance between focusing on "headline numbers" by pushing for access versus enabling inclusion; and a roadmap describing how the actual Universal Access Goal would be achieved, given the World Bank Group experience in scaling up the relevant approaches. The World Bank Group's leadership will be important, given that financial inclusion is high on the global development agenda.

Given the Magnitude of the Financial Inclusion Gap – Does the Role of the World Bank Group matter?

2.19 **The microfinance industry grew rapidly – and with it World Bank Group Support.** The MFI industry grew significantly in terms of numbers of players and – associated with this – also the issuance of loan volume over the last six years (Figure 2.1). Based on MIX data, there were a total of 1,650 MFIs in 2012. This was well above the original three that reported in 1995 and significantly more than the 526 reporting in 2007, the start of the evaluation period. In terms of volume, the gross issuance of loans by MIX reporting MFIs increased by 80 percent, from a three-year-average FY7-09 of $52 billion to $94 billion during FY10-12. Bank Group support grew as well, albeit only by 20 percent, from $1.19 billion to $1.42 billion.

Figure 2.1. The Parallel Growth of the Microfinance Industry and World Bank Group Support to Financial Inclusion

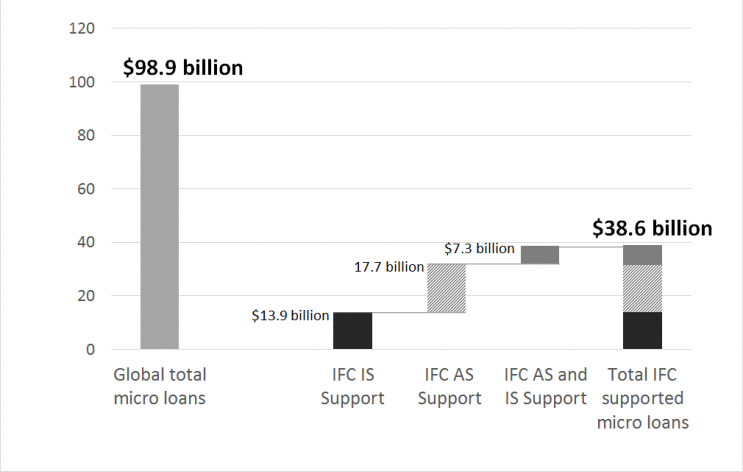


Sources: MIX and IEG.

2.20 **IFC was able to support a significant portion of the MFI industry with its investments and advisory services.** IFC supports MFIs through investments in form of debt or equity, through advisory services to advise, for example, on risk management, market segmentation, upscaling or downscaling, and so forth, or through a combination of both. IFC's investments support MFIs that jointly issue $13.9 billion of micro loans; in addition, IFC advisory supports MFIs that jointly issue an additional $17.7 billion and the combination of both (IFC investment and advisory) supports MFIs responsible for an additional $ 7.3 billion. In total IFC-supported MFIs issued about $38.6 billion of microloan or about 39 percent of the MFI industry (Figure 2.2). This is a considerable "reach," demonstrating a clear leadership role of IFC, jointly with KfW, in funding and advising MFIs.

2.21 **An important note on attribution though:** supporting an MFI through an investment or advice may not necessarily indicate that IFC was responsible for the entire loan volume (or even the major share of the loan volume) that this MFI subsequently issues possible. Hence, the $38.6 billion are not due to IFC's interventions, but IFC played a role in the institutions that issued them.

Figure 2.2. Micro Loans Globally versus Micro Loans issued by IFC-Supported MFIs

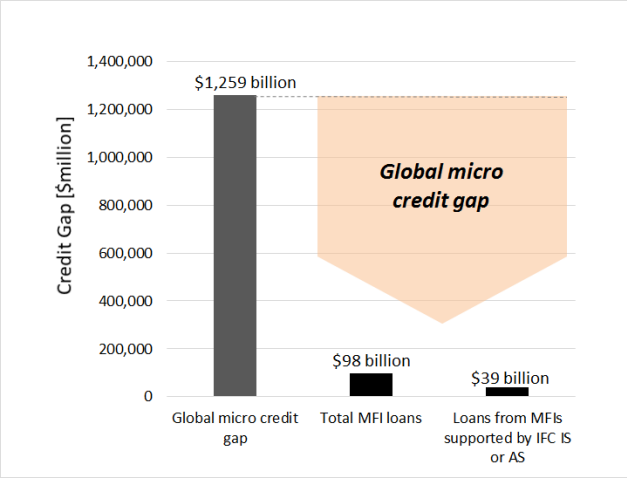


Sources: MIX and IEG.

2.22 **Despite the growth of Bank Group support to financial inclusion and IFC's reach of MFIs, the Bank Group support is dwarfed by the magnitude of the yet-to-be accomplished agenda.** Globally, as of 2011, 2.5 billion people were unbanked of which the World Bank Group is likely to have reached about one to two percent directly. Most of the 2.5 billion unbanked live in developing countries amounting for about 59 percent of adults. Of these, the Bank Group's IFC has reached about 25 million through deposit accounts and about 23 million through micro loans, issued by MFIs that IFC supported.

2.23 **Despite this growth, the entire MFI industry still only reaches about 20 percent of its potential market among the 2.5 billion unbanked and is meeting only eight percent of the IFC-estimated $1.3 trillion microloan credit gap.** Collectively, all MIX reporting MFIs reach about 72 million of clients—a tiny fraction compared to 2.5 billion of unbanked. Collectively these MFIs issue a gross loan volume of $98 billion[24]—again a small fraction of the actual credit gap: IFC and McKinsey estimated the global credit gap for microenterprises to amount to $1,259 billion.[25] Of the total loan amount issued, the share of microloans that was issues by IFC supported MFIs amount to $38.6 billion or eight percent (Figure 2.3). In a similar vein, the global MFI industry is estimated at about $60-100 billion, of which IFC accounts for about $3 billion of cumulative investments and $1.45 billion in currently outstanding commitments. Hence, despite the fact the Bank Group support grew in line with the MFI industry, it appears rather small overall.

Figure 2.3. Global Micro Credit Gap versus Microloan Industry versus IFC Supported Microloans



Source: IFC 2012.

2.24 **In summary, the volume of Bank Group support is small given the large number of unbanked and the demand for microfinance—calling for a selective and strategic engagement.** Regardless of which measure one takes, Bank Group support appears small compared to the industry size, even though? IFC is among the top lenders in this sector.[26] Bank Group support appears even smaller when compared to the demand, that is, the number of unbanked and the microcredit gap. This indicates that Bank Group support cannot fix the problem through its volume (and it may not even be desirable), but rather by establishing the foundation for better functioning markets, creating new MFI markets (for example, through greenfield operations) or expanding them. This requires a strategic allocation of resources, shifting its scarce resources where they are needed the most and where they can be expected to have the highest impact either in terms of creating new markets or scaling up existing

markets.

2.25 **But World Bank Group support extends beyond funding of MFIs.** The Bank Group is active "upstream," that is, in creating an enabling environment for financial inclusion. A full 30 percent of Bank Group activities aim to create the enabling environment for financial inclusion, by assisting countries in diagnosing financial inclusion constraints and developing national financial inclusion strategies and policies (12 percent), adequate legislation and regulation (14 percent) and the needed financial infrastructure (10 percent), such as payment systems and credit registers or bureaus. Such activities are typically supported by either World Bank and, to a limited extent, also by IFC advisory services. In addition, the convening power and thought leadership, although difficult to capture in a formal program, are another relevant aspect of World Bank Group engagement (Chapter 3).

2.26 The following sections therefore assess to what extent World Bank Group resources have been allocated in a strategic manner, including upstream and downstream work. It will then analyze in how far the Bank Group's agenda has reflected the needs of the poor, that is, has responded to their specific constraints; followed by an assessment of Bank Group's capability to address specific country needs.

The World Bank Group's Strategic Resources Deployment to Financial Inclusion

2.27 **Given its limited resources, the World Bank Group has to allocate them where they are needed the most** and are likely to result in a high development impact. One way of measuring the need for such support is by looking at country characteristics with regard to financial inclusion, that is, its "financial inclusiveness." Four types of measures have been chosen by IEG as proxies of a country's financial inclusiveness and hence as an indication for its relative need for financial inclusion support. Each of these measures can be measured objectively using Findex and MIX data. See Table 2.1 for details.

i. Prevalence and share of the unbanked relative to the country's population
ii. Capacity of the MFI market to reach the poor, that is, its "depth
iii. Funding gap for microloans relative to the country's GDP
iv. Penetration of the MFI market relative to the size of the country.

2.28 **Based on these inclusiveness measures, the universe of client countries was analyzed and divided into quartiles.** Such a division yielded four discrete categories depending on the level of inclusion, that is, "lowest," "low," "middle," and "high" inclusion countries. [27] For example, according to graph (i) in Figure 2.4, about one quarter or 24 percent of all client countries fall into the category of "lowest" inclusion when using the measure "Number of people who do not hold an account according to Findex in a given country."

Comparing these 24 percent to the 49 percent of World Bank Group support (in terms of number of projects) provided to this category of countries indicates, that the Bank Group strongly support these "lowest" inclusion countries. The relative resources allocation in terms of number of World Bank Group financial inclusion projects is (with 49 percent of its portfolio) significantly higher for these lowest inclusion countries than for any other category. As only 24 percent of countries fall into this category, the allocation is disproportionally high – which illustrate the strong emphasis on "lowest" inclusion countries.

Table 2.1. Financial Inclusiveness Measures

Measure	Numerical Value	Comment
Prevalence and share of the unbanked	• Prevalence in terms of the absolute number of people who do not hold an account according to Findex in a given country • Share of people who do not hold an account according to Findex over entire population • Share of people who do not hold an account at the bottom of the pyramid (BoP, lower 40 percent) over entire copulation	The first measure (number of unbanked) emphasis relative strong larger countries, for example, India and China. The third measure involving the number of unbanked at the BoP reflects better the target population of this evaluation.
Capacity to reaching the poor, that is, "depth" of MFI market	• Average loan size according to MIX data in client country, GNI	The average loan size is quoted in the literature a proxy for the extent of which an MFI markets actually reaches the poor, assuming that smaller loan size indicate better reach of the poor.
Funding Gap	• $ billions of funding gap of very small, micro and informal enterprises in the respective client country, according to IFC / McKinsey (IFC 2010)	Relies of IFC's own calculation and has not been subject to IEG validation, even though the data model has been assessed for its soundness.
Penetration of the MFI market	• Aggregated gross loan volume [$ billions] of MIX-reporting MFIs in the respective client country/GDP • Share [percent] of borrowers according to MIX data/total population of client country	Both measures indicate in how far the MFI markets has developed; one caveat, however, need to be noted: MIX data may not be entirely representative of the entire MFI market

Sources: IEG, Findex, MIX, and IFC 2010.
Note: BOP = bottom of the pyramid.

2.29 **To assess how far the relative share of Bank Group's volume was adequate for the country, the gross loan portfolio of the country's MFI industry was taken as a benchmark.** In total, 1,650 MFIs report to MIX; MIX data provide a detailed breakdown of the respective MFI industry per country. The volume ($ billions) of gross loans outstanding in a respective country can be taken as an indication for the size of the MFI industry in that country and hence its status of development. Comparing the relative share (in percent) of World Bank Group allocation of volume towards a specific category of countries with the gross loan volume of the MFI industry provides an indication of appropriateness. For example,

according to graph (i) in Figure 2.4, all MFIs together hold 43 percent of the gross loan volume in the "lowest" inclusion countries. These are countries where only 0.4 – 15 percent of the population are banked. The World Bank Group allocated a full 72 percent of its volume there. This indicates that the Bank Group gears volume disproportionally toward these lowest inclusion countries.

2.30 **Overall, World Bank Group support targets countries most in need of its support, that is, "low-inclusion countries."** Looking across *all* different "financial inclusiveness" measures presented in Table 2.1, World Bank Group has synchronized its financial inclusion support with country needs; or in other words, the Bank Group has geared its support toward countries that (i) have a high number of unbanked and also relatively high shares of unbanked, including when looking at the bottom of the pyramid; (ii) suffer from the highest microloan credit gaps; (iii) have a relatively low MFI market penetration, that is, countries where the MFI market is as yet relatively underdeveloped and small compared to the countries' GDP and population size; and (iv) where the MFI industry caters to the poor, that is, where the average loan size is relatively small.

2.31 **Figure 2.4 shows the distribution of World Bank Group support** in relation to the above define measures, that is, the prevalence of the unbanked at the country level, the capacity of the MFI market to reach the poor, and the size of the funding gap for microloans (relative to the country's GDP); for sake of simplicity the charts visualizing the fourth measure, that is the penetration of the MFI market relative to the size of the country, is not displayed, but exhibit a similar pattern of World Bank Group support.

i. *Prevalence of the unbanked relative to the country's population.* World Bank Group's portfolio is strongly geared towards lowest and low inclusion countries. While about half of the countries of countries belong to the category of lowest and low inclusion countries (25 and 28 percent, respectively), full 70 percent of Bank Group interventions take place in these two categories of countries. In volume the emphasis is even stronger: 83 percent of World Bank Group volume ($) flows there (Figure 2.3a).
ii. *Capacity of the MFI market to reach the poor, that is, its "depth.* Equally pronounced as above, World Bank Group support reaches countries where MFI markets are likely to work for the poor, as evidenced by the average loan size of the respective MFIs. About half of the countries fall into the categories having the "smallest" and "small" loans while 60 percent of interventions and 80 percent of Bank Group volume flows into these countries (Figure 2.3b).
iii. *Funding gap for microloans relative to the country's GDP.* With regard to the size of the micro loan funding gap, Bank Group support is somewhat in sync, but it does not emphasis those countries with the relative largest funding gap. As can be seen in

Figure 2.3c interventions and associated volume ($) is somewhat more evenly spread across all four categories

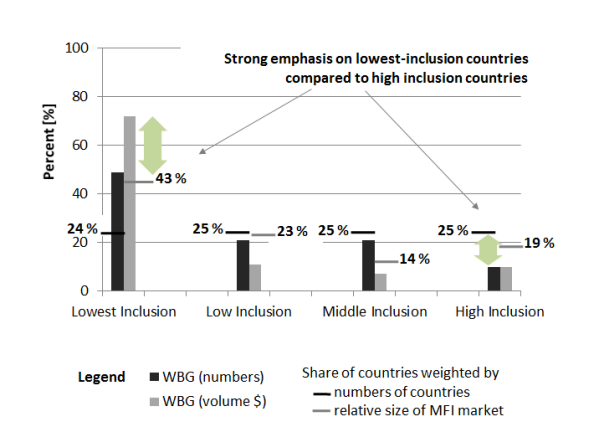
2.32 **Looking at the relative emphasis of the various World Bank Group institutions and instruments reveals that World Bank lending, IFC advisory and AAA have the strongest focus on reaching the lowest and low inclusion countries.** Taking again the share of the unbanked in client countries as a measure, World Bank lending over-emphasis countries with the lowest inclusion rates: 67 percent of its interventions take place in this category of countries which represent 57 percent of countries. For IFC advisory, 61 percent of their projects take place in this category; and 60 percent of AAA work takes place in these countries. The resources allotted to the other categories that is, low, middle and higher inclusion countries, is generally commensurate with their prevalence. Figure 2.5 shows the strategic resources allocation of World Bank lending and IFC advisory services.

2.33 **The allocation of IFC investments generally is commensurate with country needs – and when looking at volume invested, IFC exhibits even a strong emphasis on countries with the lowest inclusion rate.** Fifty-six percent of IFC investments take place in lowest inclusion countries, commensurate with the relative share of 57 percent of these lowest inclusion countries (Figure 2.6). The demand-driven nature of IFC's business helps explain this pattern; that is, it cannot create investment itself, but needs sponsors to go along with. With regard to investment volume ($), however, IFC does emphasize the lowest inclusion countries. IFC provides more funds to lowest inclusion countries than the MFI market itself does: 46 percent of IFC investments ($) flow into lowest inclusion countries while about 42 percent of the gross loans of the MIX MFI market are issued in these countries.

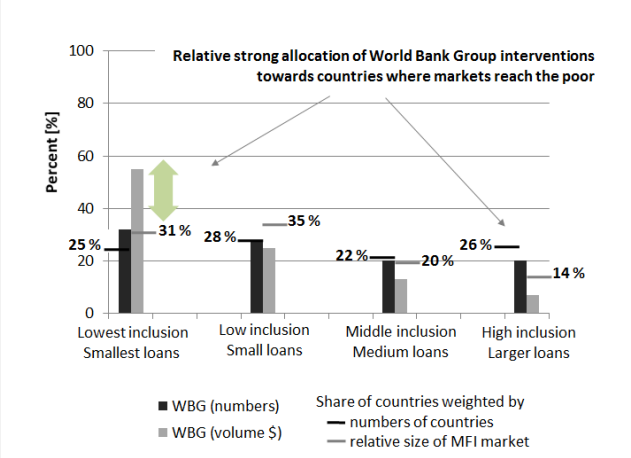
2.34 **IFC investments can be considered pioneering as they occur in countries where otherwise commercially oriented financial services providers shy away.** While IFC's investment allocation is only about 4 percent above of the MIX volume, it needs to be noted that the MIX market data contain a high number of MFIs that are not aiming at full financial self-sustainability. A fair share of the MFI markets is composed of NGOs with 31 percent of the total market; banks only make up 10 percent of the MFI market.[28]

Figure 2.4. Client Countries' Financial Inclusiveness and World Bank Group Support

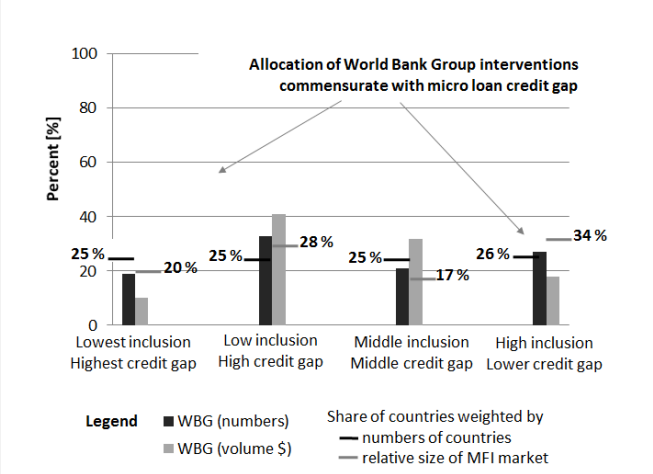
(i) Countries Grouped by Prevalence of Unbanked versus World Bank Group Support[a]



(ii) Countries Grouped by Extent to which MFI Markets reach the Poor (average loan size) versus World Bank Group Support[a]



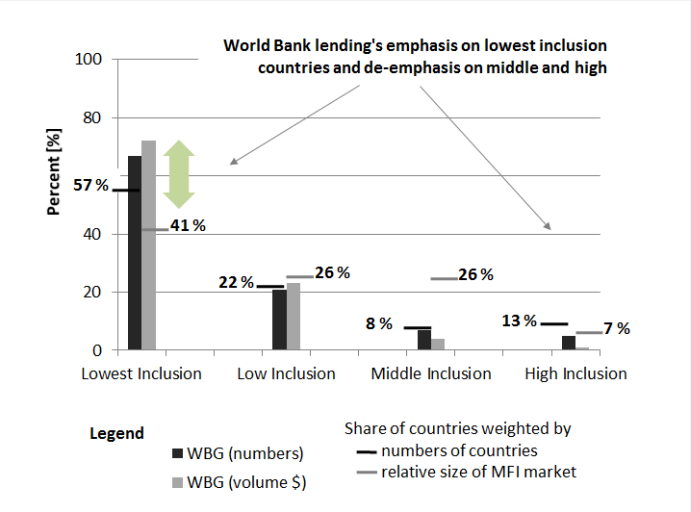
(iii) Countries Grouped by their Funding Gap of Microloans versus World Bank Group Support[a]



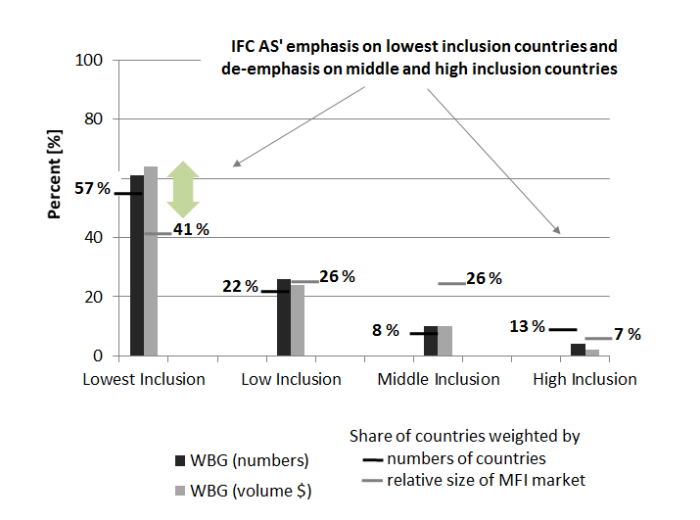
Sources: Findex, MIX and IEG. WBG = World Bank Group.
[a.] Data on country level inclusiveness were transformed using the natural log.

Figure 2.5. World Bank Lending and IFC Advisory versus Client Countries' Financial Inclusiveness

(a) World Bank Lending across lowest, low, middle and high inclusion countries



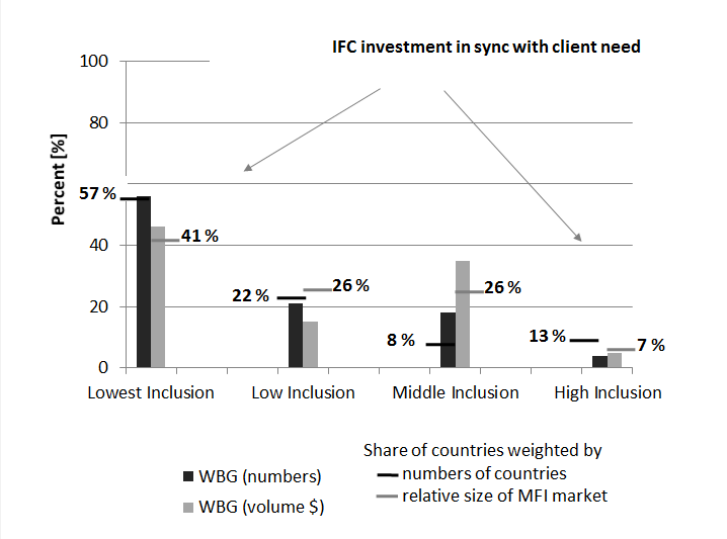
(b) IFC advisory services (AS) across lowest, low, middle and high inclusion countries



Sources: Findex, MIX and IEG.
Note: WBG = World Bank Group.

Figure 2.6. IFC Investment versus Client Countries' Financial Inclusiveness

IFC IS across lowest, low, middle and high inclusion countries



Sources: Findex, MIX and IEG.

2.35 In contrast to banks, NGOs tend to receive subsidies through below-market priced funding and hence easier open shop in areas where start-up costs are relatively high. Hence, having 56 percent of IFC investment and 46 percent of its volume ($) flowing into lowest inclusion countries can be seen as a sign of high relevance of IFC's MFI support.

2.36 **MIGA's resources allocation is difficult to assess due to the low number of financial inclusion guarantee projects.** MIGA has supported 21 financial inclusion projects through guarantees during the evaluation period. Of these, 12 belong to one MIGA project in support of ProCredit. MIGA's guarantees reach lowest inclusion countries to some extent, but to a lesser extent than the World Bank and IFC projects. By contrast, MIGA's guarantees are quite frequent in middle inclusion countries, in particular when looking at guarantee volume: 43 percent of its gross issuances are in middle inclusion countries, even though these countries only absorb 26 percent of the MFI market globally. In terms of number of projects the emphasis on middle inclusion countries is similar, with 19 percent of MIGA projects in these category of countries even though this category only comprises 8 percent of countries globally.

2.37 **In conclusion, the World Bank Group's allocation of resources devoted to advancing financial inclusion are strategically well aligned with countries' needs, that is, they reach primarily countries with very low inclusion rates.** Although World Bank lending, IFC advisory, and AAA strongly emphasis the lowest inclusion countries – indicating a high level of relevance. IFC's investments are also well in sync with client countries' needs, but exhibits less of an overemphasis on lowest inclusion countries. Given that these markets are

typically dominated by NGOs, IFC's presence in these countries is pioneering as IFC aims at establishing self-sustaining microfinance providers.

2.38 Following the analysis of strategic resources allocation, the next few paragraphs will analyze the extent to which governments have identified financial inclusion as a priority and how well the World Bank Group has responded to their needs. Subsequently, the next section will also take a look at the beneficiaries and assess the needs for financial services of low-income households and microenterprises, the focus of this evaluation.

Addressing Country Priorities and Financial Inclusion Constraints

COUNTRY-LEVEL PRIORITIES AND CONSTRAINTS

2.39 **Financial inclusion was identified by most countries strategies as a priority, albeit not explicitly.** Across all 15 countries analyzed in depth, financial inclusion is mentioned as a priority in the respective country strategy documents during the evaluation period. However, the term "financial inclusion" was hardly used in the country strategy documents; instead, "access to finance," or support to "rural finance" were some of the terms used, implicitly emphasizing the financial inclusion aspect of the financial sector interventions.

2.40 **While a prominent issue throughout, only about half of the countries described financial inclusion as a "binding constraint" to growth or poverty reduction in general**. About half of the 15 countries evaluated mentioned financial exclusion or the "lack of access to finance" as a binding constraint to growth and poverty reduction (Ghana, Indonesia, Kenya, Pakistan, and Tanzania), and out of these five, four explicitly mentioned "lack of access to finance" as a binding constraint to at least growth and poverty reduction (and also include investment climate and doing business). For Indonesia the CAS FY09-12 specifically states that "inadequate access to financial services for SMEs and poorer households" was a major obstacle to improve investment climate. Limited access to finance is seen as an obstacle to poverty and growth by way of it being linked to the strategies and core engagements supporting investment climate. Similarly in Pakistan, where financial exclusion, or the lack of access to finance, is identified as a constraint to growth and private sector development. Likewise, for Ghana financial exclusion is explicitly described as a constraint to growth and MSME development, but not to poverty reduction. However, given the country's growing inequality, promoting broad based growth will be closely linked with poverty reduction, in particular when discussing constraints to broad based growth in rural areas (where poverty and inequality are more prevalent).

2.41 **The overall timing of country-level support was generally in sync with global trends.** The general timeline around which financial inclusion emerged as an issue in the country documents is between 2000 and 2007. The emergence of financial inclusion in country

strategies hence roughly coincides with the general global trend. This finding from the country case studies is further corroborated by portfolio data: as we have seen above, the growth of Bank Group support was largely synchronized with the overall growth of the MFI industry over the last ten years.

2.42 **The Bank Group's support to financial inclusion broadened over the last ten years, in parallel to the global perception that financial inclusion is a multi-faceted endeavor.** Throughout the [15] case studies World Bank Group had a significant emphasis on microfinance during early 2000's, which implies an emphasis upon financial inclusion in the countries in question. However, towards 2010, the focus on financial inclusion evolved to include also other themes like financial literacy, consumer protection and financial infrastructure interventions.

2.43 **Typically financial inclusion was pursued under the "Growth Pillar".** Across all country cases, except for Indonesia, every country has had financial inclusion listed under pillars for growth in the country strategy documents. Financial inclusion had been under different pillars for different time periods, roughly between 2000 and 2014. The shift in financial inclusion being under different pillars also reflects upon the transition in the World Bank Group's approach towards this area for different country contexts. Countries like Azerbaijan, Kyrgyzstan, and Tanzania maintained financial inclusion under their growth pillars throughout the different CAS periods spanning years 2003 to 2015. China, India, and Pakistan showed a shift from the growth pillar to "inclusion" or "inclusive development" pillar for their respective country strategies. For Ghana, financial inclusion was listed under the growth pillar in FY04-08 period, shifting to 'private sector competitiveness' for the FY08-12 CAS. Finally, country strategies of Kenya and Mexico showed a transition from poverty reduction from 2004, to "growth" around 2010 for the incorporation of financial inclusion.

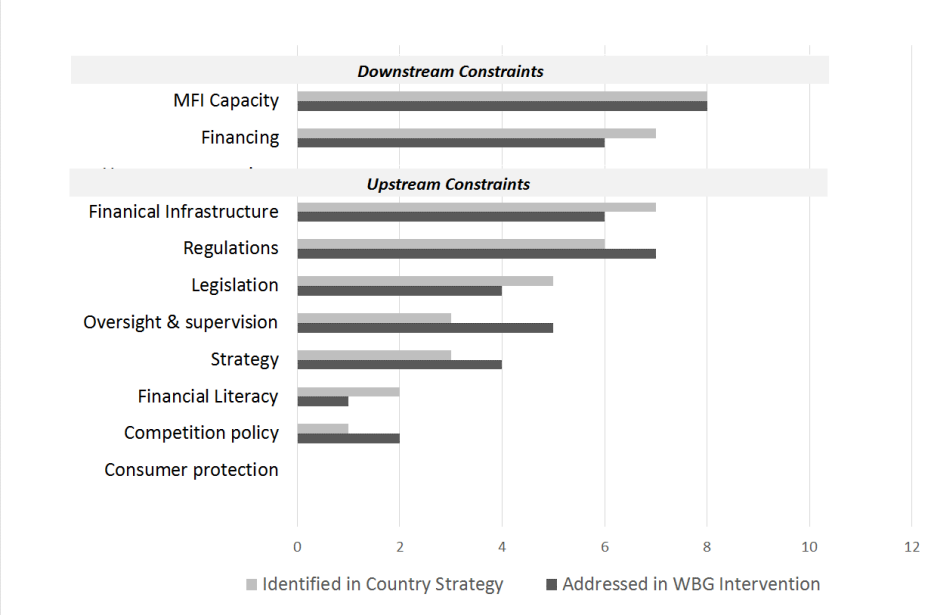
2.44 **Country-specific constraints may impede the implementation of a country's financial inclusion agenda**. Identifying financial inclusion as a priority is an important expression of country commitment, but in itself it is not enough. For a country-specific financial inclusion agenda to take root, a set of preconditions needs to be met. This include an adequate regulatory and supervisory regime of both deposit and non-deposit taking institutions, consumer protection laws of particular importance as the poor generally lack higher education, sector management capacity and capacity at the MFI level; all of these should be embedded in a country's financial inclusion strategy.

2.45 **The most common constraints identified in World Bank Group strategies were the lack of capacity at the level of the financial institution, that is, lack of MFI capacity, and lack of finance.** These constraints were identified in eight countries and refer to capacity to adapt to regulatory changes, to develop MFI strategies, and to engage in product development, technological upgrading or risk management. The Bank Group responded in

most cases with adequate interventions to mitigate this downstream constraint – in both cases led by IFC, indicating the relevant role of advisory services and investments.

2.46 **The second most common constraints were lack of financial infrastructure and regulatory deficiencies.** Both of these constraints are "upstream" constraint as they relate to the enabling environment, identified in 7 and 6 of [15] case study countries, respectively. For both constraints, the World Bank put measures in place to mitigate them (Figure 2.7).

Figure 2.7. Financial Inclusion Constraints in Country Strategies



Sources: Country Assistance / Partnership Strategies, IEG.
Note: N=15 countries. Downstream = measures directed toward MFIs; upstream = measures aimed at improving the policy framework.

2.47 **Credit reporting, an important component of a country's financial infrastructure, was increasingly addressed as a constraint after the 2008 global economic crisis.** A general trend observed is that the country strategy documents emphasize MFI capacity constraints during the early 2000s (mostly 2002-08). However, after the 2008 crisis, financial infrastructure (pertaining to capturing and reporting credit information) has increasingly been identified as a significant constraint to financial inclusion, and to the improvement of financial sector in general. This increased attention to credit reporting is possibly an outcome of the financial crisis, following which the Bank Groups interventions, focused on more expansive and accurate credit reporting. Further example from country cases are presented in Box 2.2.

Box 2.2. Constraints to Financial Inclusion – Country Examples

MFI capacity was a leading constraint in **Kenya**. The lack of capacity points towards a profound lack of capacity of institutions when it comes to adapting to regulatory changes in order to gain access to finance through commercial banks; this suggests a need for informal institutions to "graduate" to formal status in order to achieve financial inclusion objectives. Another key area of lack of MFI capacity in Kenya was risk management.

In **Pakistan**, the identified capacity constraints indicated a lack of adequate products and services, technology, and staff trainings. Inadequate coverage through private credit registries hindered the process of acquiring credit information in Pakistan and therefore the provision of credit and other financial services for the already underserved segments.

Constraints pertaining to MFIs capacity in **Tanzania** were associated with the lack of financial products (including loans and deposits), outreach to the target beneficiaries (in line with financial inclusion objectives of outstanding loan portfolios), inadequate staff skill of banking regulators who would contribute to regulatory oversight and payment systems, and general FI/MFIs constraints.

Source: IEG country case studies.

2.48 **The Bank Group was consistent in identifying constraint and subsequently also addressing them.** Across most countries, once constraints were identified in a country strategy, they were also addressed though Bank Group interventions, which indicates an internal consistency of Bank Group country level engagement.

2.49 **Consumer protection and financial literacy were rarely identified as a constraint – despite their importance in regard to the poor.** Financial literacy was only identified in two countries and followed up on in one; while the lack of financial literacy has been identified as a significant barrier on the demand side, fighting the lack of financial literacy through development interventions poses a challenges (Box 2.3). In light of this, financial literacy interventions are likely to remain a matter of trial and error. Consumer protection did not at all appear on the radar screen of constraints. This may relate to the fact that financial inclusion was initially more concerned with the provision of microcredit, paying less attention to the enabling environment in which this happened. However, the notion of financial inclusion changed, at least after a series of repayment crises 2008 and 2009 in Bosnia and Herzegovina, Morocco, and Nicaragua and 2010 in India (Andhra Pradesh), which underscored the need for consumer abuse by service providers to be checked and consumers be educated. The latter would help, *inter alia,* keeping over-indebtedness at reasonable levels, an issue discussed in the next section.

Box 2.3. The Challenge of Fighting Financial Literacy

Lack of knowledge is an important barrier is the. There have been attempts at increasing financial literacy, most of them with frustratingly limited results. The outreach effort by Cole, Sampson and Zia (2011) discussed above also involved a free two hour financial education program. Unlike the subsidy to open an account, financial education had no effect on the likelihood to open an account. A similar study in western India finds that financial literacy courses for female micro-entrepreneurs had no impact on their savings behavior (Field and others 2010). Bruhn, Ibarra, and McKenzie (2014) analyze attendance and effects of a large-scale financial education program in Mexico City and find that monetary incentives is what is most likely to convince individuals to attend.

Attending training results in a 9 percentage point increase in financial knowledge, and a 9 percentage point increase in some self-reported measures of saving, but in no impact on borrowing behavior. Overall, the authors conclude, however, that most individuals make the right benefit-cost choice when deciding not to attend. On a more positive note, Berg and Zia (2013) find that including examples of responsible and irresponsible financial behavior in soap operas in South Africa can improve financial behavior of viewers, including lower incidence of overindebtedness and gambling. Bruhn et al (2013) report the results of a comprehensive financial education program spanning six states, 868 schools, and approximately 20,000 high school students in Brazil through an RCT. The program increased students' financial knowledge, led to a modest increase in saving for purchases, a better likelihood of financial planning, and greater participation in household financial decisions by students. The authors also find significant "trickle-up" impacts on parents' behavior.

In summary, the studies on financial literacy show a very limited effect of such attempts on financial behavior, including savings behavior. There seems more promise in fine-tuning financial literacy attempts to teachable moments, that is, trying to reach out to individuals when they are in the process of making financial decisions. Similarly, reaching out to younger population segments, who are easier to influence seems promising.

Source: Beck 2015.

AVOIDING OVER-INDEBTEDNESS

2.50 **Too much credit can also be a bad thing.** Knowing how much credit a country's MFI clientele can absorb is critical for microfinance policy makers and practitioners. Improving access to financial services while ensuring that its clients remain protected from the risks related to over-borrowing is essential (PlaNet Rating 2013). For the poor, overindebtedness can result in an unsustainable spiral of repayment, with consequent damage to investment in their microbusinesses or to household consumption and welfare, as presented in the literature review in Chapter 1. It is hence essential to understand to what extent client countries have reached levels of market saturation – and are hence at risk of overindebtedness – and as to whether World Bank Group takes this market saturation into consideration in its strategic resources allocation.

2.51 **Overindebtedness of microfinance clients is perceived as a risk facing the industry** (Centre for the Study of Financial Innovation 2014). Accordingly, overindebtedness is widely seen to be symptomatic of wider problems in the industry: surplus lending capacity, a lack of professionalism within MFIs, and an emphasis on growth and profit at the expense of

prudence. Overindebtedness is linked to a range of risk factors, including credit risk; the (in)ability of microfinance providers to manage the lending process; the lack of credit information of MFI clients; the level of competition, in particular the rapid growth in lending capacity created by abundant funding and new entrants; potential weaknesses in consumer protection regulations and political interferences. The fact that consumer protection is rarely identified as a constraint, as pointed out above, is hence particularly worrisome.

2.52 **Taking the Microfinance Index for Market Outreach and Saturation (MIMOSA) score, about 18 percent of countries warrant a careful evaluation of potential overindebtedness**. This MIMOSA score ranks countries from 1 to 5. A score of 1, implies significant under-development of formal credit use; markets scoring 2 or 3 generally show a normal level of development in the use of formal credit; and countries scoring 4 or 5 are either approaching their credit capacity threshold or have crossed it altogether, and thus require a strong emphasis on preventing over-indebtedness (PlaNet Rating 2013). About 6 percent of countries are at risk of overindebtedness (that is, are rated 5) and about 13 percent warrant a detailed analysis of market stability factors – including evaluation of levels of over-indebtedness (that is, are rated 4).

2.53 **The lack of safeguards against multiple borrowing and lack of credit information played a major role in one of the most prominent cases of overindebtedness, the Andhra Pradesh microfinance crisis** (Box 2.4). Similar reports have also been published on Tanzania where prevalence of multiple borrowing was very high, underscoring the need for efficient credit information systems.[29]

2.54 **Broadly speaking, World Bank Group strategic resource allocation to client countries reflects market saturation.** Taking the MIMOSA as an indicator, World Bank Group's activities are commensurate with level of saturation. Countries at risk of overindebtedness receive relative limited finance from the World Bank Group, commensurate with their limited ability to absorb more credit volume. Countries rated 5 on the MIMOSA score receive commensurate support in numbers of projects: jointly such countries represent seven percent of all countries , but receive 9 percent of all Bank Group support; however, only four percent of IFC's investments and three percent of World Bank's finance flow into these countries, reflecting well these countries' limited credit capacity. Only AAA work can be found more often in countries at risk, that is, those rated 5. Thirteen percent of all financial inclusion AAA work can be found in these countries even though they represent only seven percent of all countries. This indicates that the Bank Group—intentionally or unintentionally—provides the support these countries needs rather than flooding them with funding which they could not absorb safely.

Box 2.4. The Andhra Pradesh Microfinance Crisis and Crisis Response

The AP crisis. By 2010, two major systems of finance for poor people coexisted in Andhra Pradesh -- there were roughly 6 million borrowers from microfinance programs and 19 million borrowers through a linkage program for rural self-help groups that channeled commercial bank finance. In late 2010, Andhra Pradesh state authorities reacted to claimed abuses and breakneck growth of the microfinance industry, which included over-lending, inadequate consumer information and protection and abusive collection practices. While abuses clearly occurred, the degree to which abusive practices were widespread and the connection of such practices to an alleged 72 suicides remains hotly debated. The crackdown took the form of state legislation that was so restrictive that no microfinance institution found it possible to operate or to collect most out-standing loans. The ordinance and regulations eliminated MFIs as competition to the self-help group (SHG) system as a means of providing finance to the poor.

Crisis Response. The Andhra Pradesh microfinance crisis, deeply shocked the microfinance industry and India's central bank – the Reserve Bank of India (RBI), stimulating both to remedial action. The RBI took several key steps to address the liquidity crisis in the microfinance sector, including encouraging banks and development finance institutions to re-start lending to MFIs, and granting certain relaxations with regard to the restructuring of bank loans to MFIs. The RBI also set up the Malegam Subcommittee, whose report in January 2011, formed the basis for subsequent RBI regulations of non-bank financial companies (NBFC) MFIs, including limits on interest rates, margins, fees, and loan tenors, as well as capital adequacy and provisioning requirements, the mandating the establishment of credit bureaus and the monitoring of MFIs conduct.
The microfinance industry strengthened its nascent professional association for NBFIs, MFIN, into a viable self-regulatory body recognized by RBI. Through the Microfinance Institutions Network (MFIN), NBFIs introduced a code of conduct for all NBFCs, and a credit information scheme (now adopted by multiple private credit bureaus) covering all NBFC loans. RBI, after initially introducing a fairly strict set of regulations for NBFCs to restore faith in the industry, has recently begun vetting drafts of more viable long-term regulations and has introduced regulations allowing for small banks which can take deposits and payments banks as new instruments for financial services. The World Bank Group, which had been working to support the development of MFIs and encourage responsible finance, provided significant formal and informal support.

Source: IEG country case studies.

PRIORITIES AND CONSTRAINTS OF HOUSEHOLDS AND MICROENTERPRISES

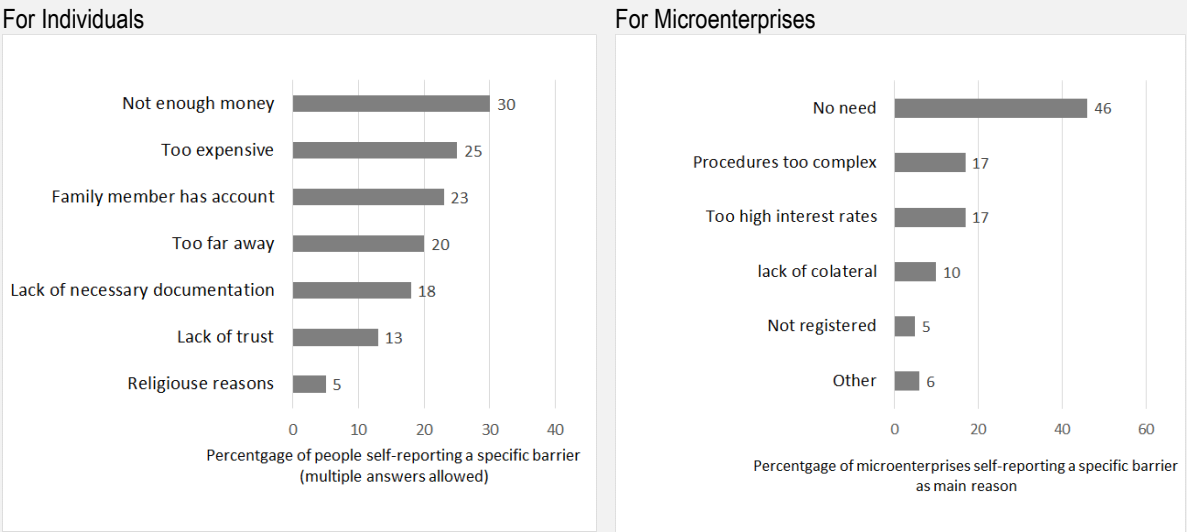
2.55 **To assess to what extent financial inclusion is also a concern for the people in client countries, IEG analyzed the results of a large-scale enterprise survey and Findex data on individual constraints.** The enterprise survey provided access to responses of 4,246 informal enterprises of a survey conducted by the World Bank from 2008-2013. The survey covered 16 countries in Sub-Saharan Africa and Latin America and the Caribbean. Though not representative for the globe, the results are intended to provide a flavor of constraints to financial inclusion among a large sample of microentrepreneurs. Note that firms in the informal sector are on average micro-sized and relatively younger (Farazi 2014); around 80 percent of total micro, small and medium sized enterprises (MSMEs) are informal today IFC (2012).

2.56 **Lack of access to finance is a top priority for microenterprises – underscoring its high importance to client countries' governments.** The enterprise survey asked respondents to evaluate the severity of obstacles that firm faced. The most sever constraints were access to electricity, followed closely by access to finance. Access to land, crime and civil disorder followed as lesser constraints. When it came to identifying their single biggest constraint, more firms identified access to finance, regardless of size of the enterprise. These IEG findings are corroborated also by the literature that indicated that access to finance is the single biggest obstacle (Farazi 2014).

2.57 **High interest rates, collateral requirements and procedural complexity are the key deterrents for microentrepreneurs.** In the overall population of enterprises, 67 percent are "unbanked," that is, have neither a bank account nor a loan from a formal financial institution; while 33 percent were banked. Only 9.8 percent had a loan, although larger firms (above 5 employees) had loans twice as often. Of the 90.1 percent that did not have a loan, 46 percent said they did not need one. The remaining 43.5 percent who indicated they needed a loan, but did not have one, were deterred mainly by high interest rates, collateral requirements and procedural complexity. Complexity of the application being more of a concern than the price and collateral requirement for informal firms can be due to the fact that these firms tend to lack documentation and other required legal papers needed for a loan application.[30]

2.58 **Similar to microenterprises, individuals also quote lack of funds, costs, distance and lack of documents to comply with the procedural requirements as the key factors for not having an account.** Globally, the most frequently cited reason for not having a formal account is lack of money. The next most commonly cited reasons for not having an account are that banks or accounts are too expensive and that another family member already has one. (Demirguc-Kunt and Klapper 2013). Figure 2.8 juxtaposes constraints of individuals and of microenterprises – indicating that both suffer from a set of very similar constraints. This is not surprising as, at the onset of an entrepreneurial activity, there is often little difference between individuals and microenterprises. Assets move back and forth and savings are likely joint; microenterprises frequently try first as individuals to get consumer loans due to lack of collateral or formal credit references.

Figure 2.8. Constraints to Financial Inclusion



Sources: IEG, based on enterprise survey data, Demirguc-Kunt and Klapper 2013, and IEG.

2.59 **Defining target beneficiaries and assessing their specific priorities and constraints is hence important for financial inclusion projects.** Constraints to financial inclusion deserve to be analyzed in detail – and are likely to show the way for policy interventions for the World Bank Group. Given the varying extent to which financial inclusion is a priority and the wide range of reasons why low-income people and microenterprises do not have access to finance, a detailed assessment of the target group's needs and constraints is essential.

2.60 Box 2.5 outlines selected solutions that could help overcome some of these identified constraints and corresponding interventions are likely to contribute to World Bank Groups endeavor in reaching its Universal Access Goal 2020. To assess in how far the World Bank Group has tailored its interventions to the priorities and constraints of the people in client countries, IEG summarizes in the following section to what extent the Bank Group has actually identified specific target groups and assessed their needs.

2.61 **Across the portfolio most projects identified target beneficiaries – albeit most they lacked a definition.** Most project beneficiaries are low-income households and families, microenterprises and very small firms, and those "underserved" by the financial system. In the majority of cases, while these beneficiary types were identified in project documents, they were often not defined. For example in the case of IFC's Investment in Advans Ghana, the MSME sector was described as "mainly informal but includes about 70 percent of the population and contributes about 40 percent of the country's GDP." Nor where beneficiaries defined by IFC's standard definition – as in Kenya's MSME Competitiveness Project, a joint IDA-IFC project that adopted the IFC's Standard Definition and referred to its target group

as including "not only micro (1-9 employees) and small (10-49 employees), but also medium-sized firms, as this segment plays a critical role in employment generation and market linkages (World Bank PAD 2005)." This trend is consistent across the World Bank Group institutions (approximately 7 percent of IFC Investment Services and Advisory Services versus approximately 12 percent of World Bank Lending and AAA).

Box 2.5. Overcoming Constraints – Examples

Overcoming distance through branchless banking. When looking at data on constraints in detail, distance from a bank is a much greater barrier in rural areas. Technological and other innovations that help overcome the barrier of physical distance could potentially increase the share of adults with a formal account by up to 23 percentage points in Sub-Saharan Africa and 14 percentage points in South Asia. At the same time people in Sub-Saharan Africa use mobile phones more often for conducting business than in Latin America and the Caribbean (73 percent versus 42 percent) which points at mobile applications for the provision of financial services as potential solution, at least in SSA, where population density is scarce and usage of mobile phone high. In a similar vein, agent banking models help overcome the high operational costs of traditional banks in sparsely populated areas and hence help provide financial services where distances are a constraint.

Making procedures easier through risk-based KYC requirements. Another example, as we have seen above, is that procedural requirements deter many microentrepreneurs from opening an account; similarly, documentation requirements for opening an account tend to exclude workers in the rural or informal sector more often, as they are less likely to have wage slips or formal proof of residence. In Sub-Saharan Africa documentation requirements potentially reduce the share of adults with an account by up to 23 percentage points. In this context, reviewing a countries KYC requirements will be essential as it would allow introducing a tiered system where KYC requirements are a function of the risks involved that is, allowing for low KYC requirements for low transaction accounts.

Enabling cheap access through no-frill low transaction accounts. One of the most commonly cited reasons for not having an account are that banks or accounts are too expensive. Given that poor people often require accounts for rather simple transactions of low volume, fostering the introduction of cheap no-frill accounts is likely to enable financial inclusion for many poor people – in particular when coupled will risk-based KYC requirements, that is, no-frill accounts that can be opened easier and with reduced documentation requirements as these types of accounts are for low-volume transactions only, hence not the target of anti-money laundry regulations.

Sources: IEG, Demirguc-Kunt and Klapper 2013.

2.62 **In addition, about one-third of projects focus on women and rural areas.** Though women are clients of many of the institutions supported in the Bank Group financial inclusion projects (about 68 percent of MFI clients are women), they are mentioned as project beneficiaries explicitly in approximately 30 percent of projects. This trend holds true across the World Bank lending (35 percent) and IFC Investment and Advisory portfolios (30 and 31 percent, respectively).

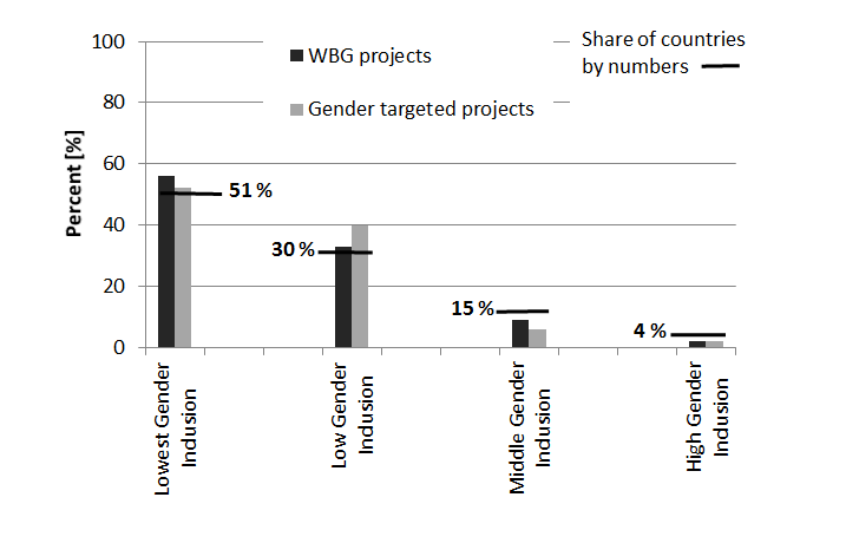
2.63 **Of those projects that mention women beneficiaries, a minority of projects provide an in-depth description of this target population.** An exception to this may be observed in the IFC's Investment and Advisory linked project with Exim Bank Tanzania, where a

definition of "women entrepreneurs" is included in the project's Legal Agreement. Rural beneficiaries are identified in 30 percent of project documents, though the share of rural projects varies across institutions. Projects with rural beneficiaries account for over 40 percent of the World Bank lending portfolio compared to 32 and 30 percent for IFC Investment and Advisory projects, respectively. Interestingly, gender and rural area are targeted in one third of financial inclusion projects in both projects that focus on microenterprises or on households.

2.64 **A minority of projects identified urban areas as their primary target market, mentioning rural expansion as a future objective.** Although most of the remaining portfolio remains mostly undefined in terms of geographic targeting (by focusing on both urban and rural), a minority of projects identified urban areas as its focal outreach area. These projects, however, often contained language that implied a future move towards rural and more underserved areas. For example, IFC's linked Investment and Advisory project with Tameer Bank in Pakistan identified its target market as "urban, self-employed small businesses with combined aggregate annual household incomes of Rs18,000 ($300 equivalent)"; the institution aimed to expand to peri-urban and rural areas in the future, "if feasible." Similarly, in Tanzania, IFC's linked Investment and Advisory project would begin operations in Dar es Salaam and focus on the urban clientele of MSMEs but aimed to "rapidly" expand its branch network to other cities in Tanzania and to serve rural and semi-rural clients through micro-branches, mobile bank operations, and cooperation with savings and credit cooperatives (SACCOs).

2.65 **Gender was often identified as important project dimension when countries exhibited low inclusion rates for women.** About half of the world's countries have very low financial inclusion rates for women. In these "lowest inclusion" countries 56 percent of World Bank Group projects are located and 52 percent identified gender as dimension. Similar with "low inclusion countries": these capture 30 percent of countries, 33 percent of project and 40 percent of gender-focused projects. This indicate that the focus on gender is well in sync with the needs, that is, where women are mostly excluded. (Figure 2.9). Likewise, rural areas were specified as focal areas when the rural population was largely excluded from financial services. While the data and corresponding figure are not reproduced here, they look similar to the analysis of rural aspects.

Figure 2.9. Identification of Gender Is in Sync with the Gender Gap

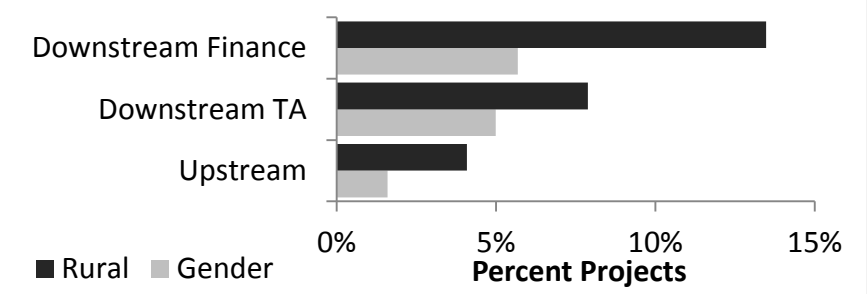


Sources: IEG, based on Findex data.

2.66 **However, financial inclusion projects frequently fail to spell out the constraints specific to these beneficiaries.** Project documents often mention constraints to financial inclusion in client countries but often fail to spell out how these constraints affect the project's beneficiary groups. Figure 2.10 indicates differences between identifying gender- and rural-specific constraints. Rural constraints are presented more often in project documents than gender-specific constraints. Another pattern that can be seen from project data is the fact that downstream finance and downstream technical assistance constraints are more often identified for both the rural and urban sub-sets than are upstream constraints. This is likely because upstream constraints are often seen as "systemic" and thus affect all beneficiaries, both direct and indirect.

2.67 **However, there are cases when these constraints are explicitly defined**, such as in the World Bank's Rural Financial Services project in Ghana, which describes the country's oversight capacity as "overextended," given that the Bank of Ghana has the "statutory mandate to monitor rural bank operations (as is the case for other, mostly urban based, commercial banks). However, this task is made very difficult by the large number, isolation and wide geographic distribution of the 111 rural banks. As a result, poorly performing banks (that actually need) do not often receive the intense supervision required and some banks may not be supervised in a given financial year."(Project Assessment Document Rural Financial Service Project, P069465, May 2000, p. 7-8).

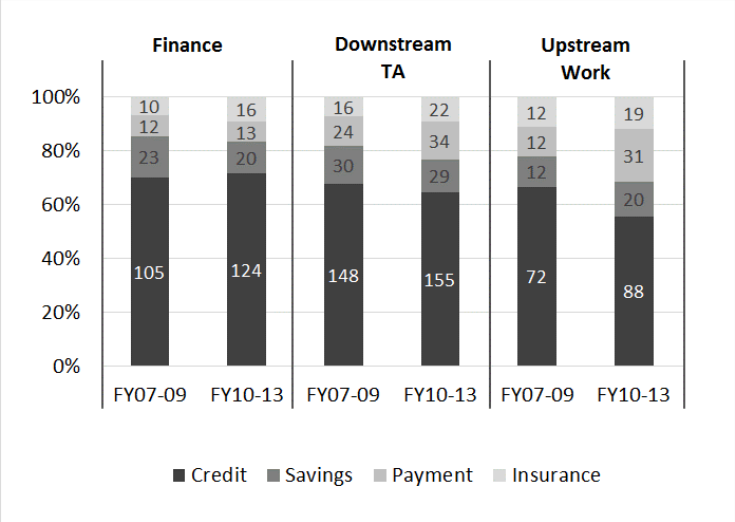
Figure 2.10. Identification of Gender- and Rural-Specific Constraints in Project Documents



Sources: World Bank Group and IEG databases.

2.68 **While in earlier years the Bank Group's inclusive finance support has relied mainly on credit-related interventions, it has gradually embraced other services, such as payments and savings, which are known to have higher potential to improve the lives of the poor.** With a growing realization that poor households and small firms need broader financial services than just credit, the original focus on credit provision during the early days of the financial inclusion agenda gradually gave way to a more comprehensive concept that also included savings, and later payments and insurance. The World Bank Group was no exception to this general trend (Figure 2.11. World Bank Group Support by Type of Financial Services. Across all its instruments, finance, downstream technical assistance and upstream policy support work, credit aspects originally dominate. While downstream technical assistance addressed non-credit aspects slightly more often than finance, during the last three years upstream policy support exhibited gradual shift toward payment systems, insurance and savings.

Figure 2.11. World Bank Group Support by Type of Financial Services



Source: IEG. TA=Technical Assistance

2.69 The focus on credit has simple reasons. Credit is easier to regulate than deposit taking (savings); credit also requires discipline; that is, the client is compelled to repay at regular intervals (while most schemes do not compel savers to make regular deposits). By contrast, mobilizing local client savings is not cheap, because of high mobilization and transaction costs. From an MFI point of view, paradoxically, it may be cheaper to provide poor people with credit than to take care of their savings, and internal incentives may encourage the greater financing required by credit projects. However, an increased mobilization of savings in the local currency would also make MFIs more impervious to foreign exchange fluctuations, reduce their need for hedging, or reduce the foreign exchange risk passed on to customers. Finally, it may also make financial markets less vulnerable, as international funders tend to withdraw funding to frontier markets during crises.

Conclusion

2.70 Financial inclusion has been lifted to the highest strategic importance by President Kim by declaring its commitment to Universal Financial Access by 2020. Over the last six years (FY07-13), World Bank Group support to financial inclusion grew by about 20 percent – however, that was outpaced by the growth of the MFI industry, which grew by 80 percent during the same period. The fact that IFC supported (either though investments or advisory services) MFIs that jointly make up 39 percent of the global micro loan volume demonstrates IFC's leadership role.

2.71 But despite the growth and relative reach of World Bank Group, its support to financial inclusion is small given the large number of unbanked and the micro credit gap. Under these circumstances it is imperative that the World Bank Group strategically allocates is resources, shifting them toward where they are needed the most and where they can be expected to have the highest impact either in terms of creating new markets or scaling up existing markets. While in earlier years the Bank Group's inclusive finance support relied mainly on credit-related interventions, it has gradually embraced other services, such as payments and savings which are known to have higher potential to improve the lives of the poor.

2.72 Globally, the World Bank Group's allocation of resources devoted to advancing financial inclusion are strategically well aligned with countries' needs, that is, they reach primarily countries with low inclusion rates and where markets actually reach the poor. In particular, World Bank lending, IFC advisory and AAA are strongly geared toward the lowest inclusion countries. Also IFC's investments are well in sync with client countries' needs. Given the self-sustaining nature of IFC investments, the presence in lowest and low inclusion countries is remarkable as these countries are typically served by MFIs that rely on subsidies, such as NGOs.

2.73 Overindebtedness of microfinance clients is perceived as a risk facing the industry. But IEG found that, broadly speaking, the allocation of World Bank Group strategic resources to client countries reflects market saturation, improving markets at risk of overindebtedness with AAA work rather than with funding. At the country level, World Bank Group support for financial inclusion was relevant in as much as it addressed a clear development priority. The most common constraint that Bank Group strategies addressed are lack of capacity and financing of financial institutions along with financial infrastructure (credit reporting) and regulations. Other important constraints, such as consumer protection and financial literacy, however, have almost never been addressed.

2.74 Across the portfolio, most projects identified target beneficiaries, such as microenterprises, albeit most lacked a definition of what these projects understand under a microenterprise. This is important as project may end up supporting larger companies under the heading of microfinance. Of those projects that mention women beneficiaries, a minority provide an in-depth description of this target population. However, financial inclusion projects fail to spell out the constraints specific to these beneficiaries.

2.75 The Bank Group's public commitment to a specific measurable goal contributed to sustaining and expanding an international dialogue to reach consensus and advance the financial inclusion agenda. However, despite its public commitment to the Universal Access Goal 2020, there appears to be only limited guidance on how to operationalize this goal. The Bank Group's current approach delineates principles of actions and key building blocks, but it remains to be seen how this goal will be translated into practice. Conceptually, the link between access and inclusion (active use) of financial services is clear, but empirically, nonutilization rates in some schemes raise questions. A lot depends on the quality, design and utility of this initial access. For example, the promotion of access through government-supported programs to digitalize cash payments via mobile phones or to roll out no-frill accounts for a large share of the population, may not necessarily lead to inclusion. High dormancy rates and low usage of newly opened accounts offer additional caution, in particular in countries that implemented mass roll-out programs, but also in low income and lower middle income countries in general. The current World Bank Group's strategy of focusing on 25 priority countries may also have to be adjusted going forward as the remaining excluded will increasingly be broadly distributed among many countries. To what extent and how those who remain excluded by 2020 (according to recent extrapolations about one billion of people) will be integrated in the formal financial system is another question the Bank Group's strategy to financial inclusion leaves unanswered.