

FocusNote

NO. 39

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FINANCIAL INCLUSION 2015: FOUR SCENARIOS FOR THE FUTURE OF MICROFINANCE



The authors of this Focus Note are Elizabeth Littlefield, CEO, CGAP; Brigit Helms, sector leader, International Finance Corporation; and David Porteous, consultant.

The authors wish to thank Samer A. Badawi, communication officer, CGAP, and Jasmina Glisovic-Mezières, microfinance analyst, CGAP, for their extensive work on the scenario-building project.

“How can the international community—public and private—contribute to the greatest possible increase in financial service access for underserved people?”

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Setting the Stage

The last two decades have witnessed a powerful opening up of the world of microfinance. Beginning in the early 1990s, the development community came to realize that microcredit providers could recover loans to poor and low-income people and cover their costs, and thus reach large numbers of people. At that time, donors and microfinance providers alike focused primarily on a single product (credit) for a particular client group (microentrepreneurs). Microcredit was delivered mainly by specialized microfinance institutions (MFIs), most of which were nongovernmental organizations.

Over time, the notion of microcredit broadened first from microcredit into microfinance then into the concept of building entire financial systems that serve their poor and low-income populations—financial systems that are “inclusive.” This new, more ambitious and complex vision has captured the attention of governments, international financial institutions, philanthropists, social investors, mainstream bankers, and even some royalty and celebrities.

We now understand that poor and low-income people can fruitfully use and pay for a range of financial services. Financial services for the poor are delivered by banks and other retail organizations as well as NGOs. A few years ago, CGAP research identified well over 750 million savings and loan accounts in institutions that cater to the lower economic strata; 74 percent of these were in state-owned savings, development, and postal banks.¹ A second study by Peachey and Roe identified over 1.4 billion accessible (low average balance, low-cost) accounts in developing and transition economies.²

¹ Christen, Rosenberg, and Jayadeva, “Financial Institutions with a ‘Double Bottom Line’.”

² Peachey and Roe, “Access to Finance: What Does It Mean and How Do Savings Banks Foster Access,” January 2006.

CGAP Building financial systems for the poor



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We know that microfinance can be robustly profitable. A 38-country analysis found that MFIs with publicly available performance information were more profitable on average than the commercial banks in those same countries.³ We know that when the model is right, microfinance grows fast: over the last decade, borrowers from MFIs worldwide have grown by 13–15 percent a year, implying a doubling of outreach every 7 years.⁴ On the other hand, these growth rates pale when compared to the growth of mobile phone subscribers, which has averaged almost 60 percent per year from 1999 to 2004. Sub-Saharan Africa's mobile market has grown 82 percent per year.⁵

Despite the improvements in financial access, two-thirds of the world's adults still do not have a basic bank account.⁶ Access to a bank account is only one dimension of financial inclusion, but it is an important one. A basic bank account is the entry point that allows customers to save money outside the household, make loan or premium payments, or transfer funds within their country or across borders. More than 80 percent of households have bank accounts in high-income countries, compared to well below 20 percent in low-income countries. In countries like Bangladesh or Sudan, that number hovers just above zero.

The Scenarios: What Do the Next 10 Years Hold?

The drive for financial inclusion remains strong. But is it strong enough to be irreversible? Will today's focus on microfinance fade away, or will it gather enough momentum to reach most of the billions who still do not have access to financial services? One thing is clear: over future decades the growth and diversification of financial services for the poor will depend increasingly on what happens in the mainstream financial sector, not just in isolated niche institutions. When global financial markets thrive and diversify, poor consumers could be drawn in as never before. But when those markets sneeze, finance for low-income people may catch a cold.

The factors influencing inclusive finance are more complex than ever before and no one has a crystal

ball that can predict the future. But organizations often use scenario planning as a means to develop strategies and plan for the long term. Scenarios are structured thought experiments that prepare for different potential outcomes. By isolating key forces or trends that affect all possible developments, including those that might derail the storyline and take it off course altogether, scenarios create plausible narratives about the future, based on the trends of today. Scenarios are not predictions; they are stories about different possible futures. A good scenario is one that is believable and encourages the organization to think about how it might respond.

Not All Developing Countries Are Alike

Building global scenarios for financial inclusion is a challenge. Countries differ enormously in terms of their current circumstances and prospects for the future. For scenario purposes, CGAP divided developing and transition countries into two groups:

- Large, emerging market countries that have experienced rapid growth and financial systems development, consisting mainly of the *BRICs*—Brazil, Russia, India, and China. (Some people might include South Africa or Kazakhstan in this category, and remove Russia as a special case in terms of financial access.)
- Low-income countries (*LICs*) that often have weak economic growth, deep poverty, and unstable governments. Several subcategories of LICs are also relevant for the exercise, for instance LICs with populist governments (such as those currently emerging in some Latin American

³ CGAP and the Microfinance Information eXchange (MIX) compared 2001–2004 profitability for 1799 commercial banks reported in Bank Scope and 344 MFIs that reported to the MicroBanking Bulletin or that published rating reports. Average return on assets was 2.8 percent for the MFIs and 1.5 percent for the commercial banks. The returns of the MFIs were adjusted to remove the effects of subsidies they received.

⁴ CGAP/MIX analysis of data from the MIX and the Microcredit Summit.

⁵ ITU, "The un-wired continent: Africa's mobile success story."

⁶ CGAP estimates based on several documents, including Peachey and Roe, "Access to Finance: What Does It Mean and How Do Savings Banks Foster Access?" January 2006 and Beck, Demirguc-Kunt, Peria, "Reaching out: Access to and use of banking services across countries," 2005.

countries) and LICs with that are fragile or failed states (e.g., Sudan, Bangladesh, Afghanistan).

BRICs are attracting increased attention because they are big and growing fast. Their sheer size is overwhelming: more than 40 percent of the world's people live in the BRICs, including more than 37 percent in India and China alone.⁷ They are already among the largest 10 economies measured by purchasing power parity,⁸ and they hold more than 30 percent of the world's foreign exchange reserves.⁹ As Figure 1 shows, the BRICs are forecast to overtake the G6 industrialized countries over the next 40–50 years in terms of the size of their economies.

If one or more of the BRICs were to become unstable and falter, global growth prospects would be seriously compromised. Should the BRICs succeed as they hope in obtaining more influence in global structures such as the United Nations, the International Monetary Fund, and the World Trade Organization, global prospects could also evolve differently.

In the BRICs, the influence of developed country capital, structures, standards, and advice is declining. China's program with the World Bank is called a "Country Partnership Agreement" rather than the Bank's more traditional "Country Assistance Strategy." India's and Brazil's strategies for poor people's financial access are homegrown, not derived from developed country counsel.

What happens in the BRICs will affect the LICs as well. LICs seeking economic growth and political influence increasingly follow the lead of the BRICs. BRIC models for economic growth are compelling, as is their emerging role as donors in their own right. China is giving \$600 million in aid to Cambodia and investing over \$1 billion in Africa; Russia is joining donor groups to provide grants to Africa.¹⁰ In January 2006, South Africa was one of the first countries visited by newly elected populist Bolivian President Evo Morales. He reportedly sought advice on achieving national reconciliation with growth and development.¹¹

⁷ Source: World Development Indicators.

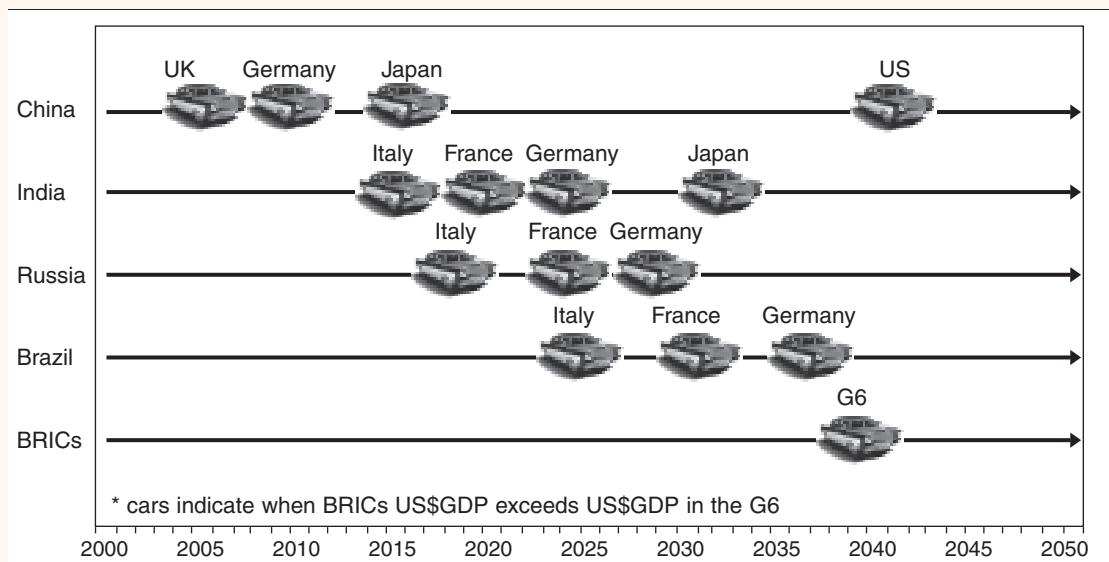
⁸ Source: World Development Indicators.

⁹ The Business Online, "Jobs Threat as Europe Falls Down League Table," December 4, 2005.

¹⁰ BBC, China Gives Cambodia \$600m in Aid, April 2006, <http://news.bbc.co.uk/2/hi/asia-pacific/4890400.stm>; China's accumulated direct investment in the African continent reached \$1.18 billion by the end of 2005, with Chinese investments scattered in 49 African countries, Chinese Government's Official Web Portal: http://www.gov.cn/mic/2006-06/15/content_311626.htm. As an example of Russia's re-entry into international aid, it has recently joined other donors by contributing US\$30 million to Global Village Energy Partnership to scale up its work in sub-Saharan Africa Global Village Energy Partnership, June 2006, <http://www.gvep.org/content/general/detail/13013>.

¹¹ Katzenellenbogen, Bolivian Leader Seeks SA advice on change, *Business Day*, January 2006.

Figure 1 BRICs Overtaking the G6



Source: Goldman Sachs, Global Economics Paper No. 99, Dreaming with BRICs: The Path to 2050

Seismic Shifts in Demography Affect All Countries

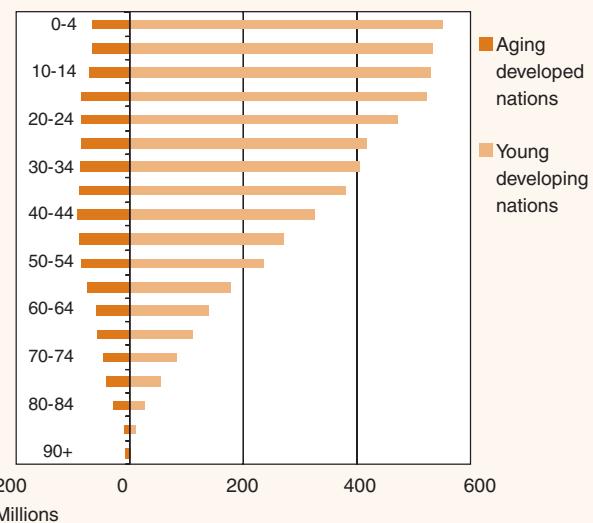
The growing pressure that demographics will place on cities, labor markets, and immigration patterns will probably be the single most important trend affecting access to finance—along with everything else—over the next several years. The client base for financial services globally will be:

- *Younger:* 2.5 billion of today's world population is children and teenagers who will become adults during the next decade or two (see Figure 2). Meanwhile, aging in the developed world will compel greater reliance on imported labor from developing countries. This bifurcation between the rapidly growing South and the shrinking North is starkly illustrated by population projections for Yemen and Russia—assuming little emigration, the former will have more people than the latter by 2050.¹²
- *More urban:* By 2009, urban dwellers will become the majority of the world's population. UN Habitat estimates that developing countries will add 2 billion new residents to urban areas in the next 25 years.¹³ Of the world's fastest growing major cities, 98 percent are located in low- and middle-income countries.¹⁴
- *More connected and informed:* As the result of communications technology, people in developing countries are more connected to each other and to the world than ever before. This can make them more reachable and informed consumers of financial services; but also more easily influenced by others and by status and branding considerations.

These factors are, in general, positive for access for financial services. It costs less to reach people with financial services when they reside in more densely populated urban areas and are more “connected.” Young people are more likely than their parents to be earlier adopters of new technologies that financial institutions will use to deliver services more widely.

However, youth unemployment in most regions of the developing world is already a problem, and will likely become more acute. For instance, the Middle East will need to double the number of jobs available

Figure 2 The Demographic Divide



Source: United Nations, Population Division: World Population Prospects: The 2004 Revision Population Database.

to accommodate jobseekers arriving on the market in the next 20 years.¹⁵ Will the new generation seek different ways of earning a living than their parents? Will self-employment be less or more attractive to them compared to a job? What about the new HIV-AIDS orphans who need to be “breadwinners” at a very young age? Can new financial products be developed to meet the needs of this burgeoning mass of un- and underemployed youth? Are existing microfinance methodologies (such as village or group lending) appropriate for younger clientele who are first-time entrepreneurs? Does this mean that microfinance will be increasingly urban based? What are the implications for microfinance in rural areas?

In BRIC countries, attention will increasingly turn to the large and growing middle class. As Figure 3 illustrates, the fabled “pyramid” is really shaped more like a tall diamond—in India at least—with a newly bulging middle class and a relatively slim “stem” of very poor people. Of course, the projected 37 million poor households in India still represent an enormous number of people who will need access to finance and other services. Other

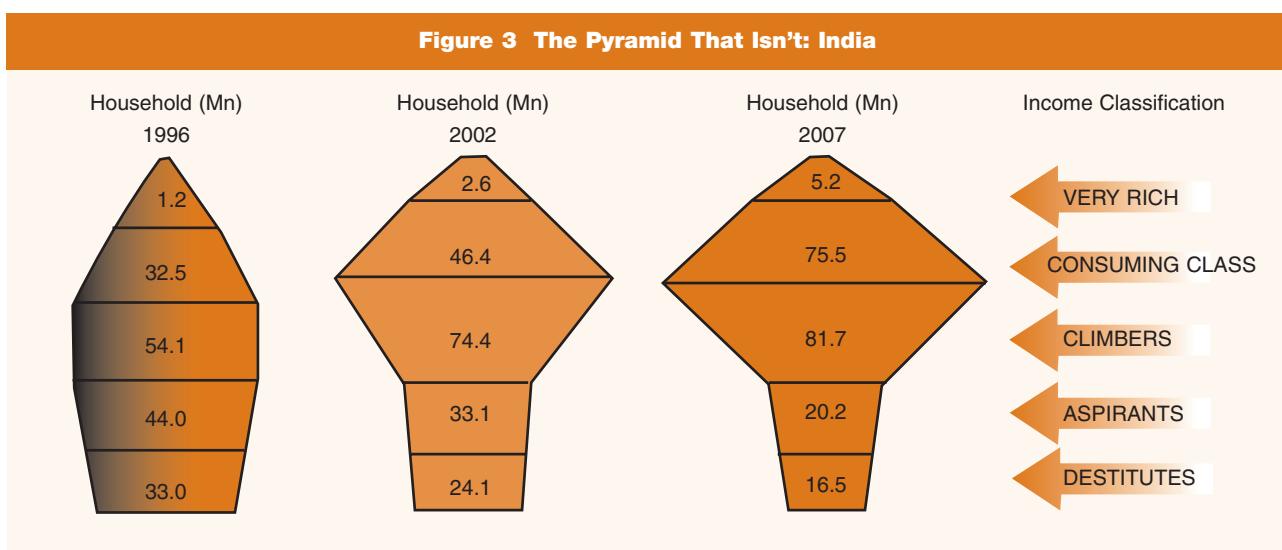
¹² Demeny, *Population Policy Dilemmas in Europe at the Dawn of the Twenty-First Century*, page 8.

¹³ UN Habitat, *Urban Millennium Partnership: Localizing MDGs Meeting the Challenge of MDGs in Cities*, page 3.

¹⁴ World Resources Institute, 2006.

¹⁵ World Bank, MENA Brief, “Development Challenges.”

Figure 3 The Pyramid That Isn't: India



Source: Sinha et al. (2005) Ogilvy and Mather India.

BRICs have similar socioeconomic distributions, although LICs do look more like pyramids. As the BRIC economies flourish and financial inclusion improves, the question is whether the people in those stems of the diamonds will benefit or be left behind.

The aging of developed nations guarantees a continuing stream of migrants from the South taking jobs in the north, especially in service industries. For instance, every day more than 3,100 Filipinos leave their country, and more than 1 in 10 Filipinos work abroad, leading President Arroyo to call them “our greatest export.”¹⁶ Remittances flows will probably continue to expand, strengthening the business case for linking them to retail payment systems.

However, if these workers are barred from legalization (as is threatened in many northern countries today), then they also may be denied access to formal financial services, including cheaper, safer remittances. In this case, the ranks of the financially excluded are certain to grow within developed countries.

These seismic shifts in demographics will affect all countries differently. For the purposes of this paper, however, the authors have chosen not to weave these demographic forces into the scenarios that are developed about the future for financial inclusion. Leaving aside the demographic forces allows for more focus in the scenarios on forces specific to financial access and on forces that the international comments can influence.

Four Trends and Their Uncertain Implications

After the demographic analysis, we focused on four trends that could help or hurt financial access: wireless technology, activist governments, new international actors, and international regulation. For each of these, we developed extreme scenarios, one positive and one negative, and looked at the implications for the international community promoting financial access.

1. Wireless Technology: Connecting or Dividing

Over the next decade, the most significant technological change that could open up access to finance for large numbers of excluded people is pervasive extension of wireless access, even in poorer countries. Wireless technology could radically reduce transaction costs and create anytime, anywhere access, even for very poor and remote clients.

The International Telecommunication Union (ITU) estimates that just over half of people in LICs are already within range of a wireless service.¹⁷ The ITU’s “Connect the World” initiative proposes to raise coverage to 100 percent by 2015. Such widespread access will change not only information flows but also financial service delivery. In the coming wireless world, corner grocers, petrol

¹⁶ Paddock, “The Overseas Class,” *Los Angeles Times*, April 20, 2006.

¹⁷ ITU, www.itu.int.

stations, and lottery outlets with cell phones can become delivery points/channels for financial and other services. Private and public banks in Brazil established nearly 60,000 such points since 2000, when one-quarter of Brazil's 5,800 municipalities lacked any access to formal financial services. Today, these points offer formal banking services in every municipality in the country.

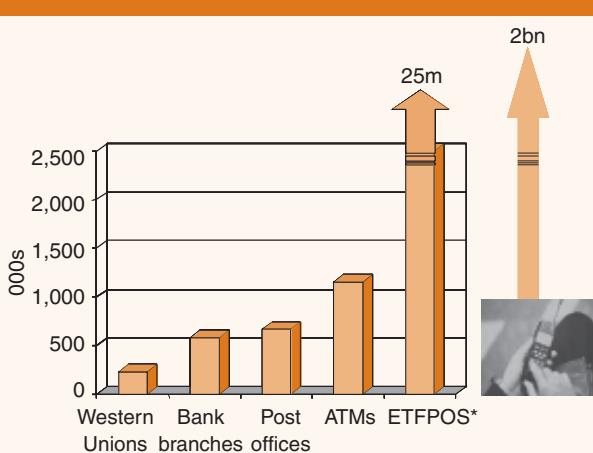
As seen in Figure 4, the 2 billionth cell phone has now hit the market. It took 12 years to reach the first billion, but only two-and-a-half years to reach the second. And 82 percent of the second billion went to developing countries both in BRICs and LICs.¹⁸ The 2 billion cell phones in the world today vastly outnumber the estimated 25 million point of sale (POS) devices linked to the major credit card associations. These POS devices, in turn, dwarf the number of more traditional points of contact for those using financial services (bank branches, ATMs, postal and Western Union outlets.). These cell phones and POSs may hold the key to bringing access to financial services into poor people's neighborhoods—and pockets.

Whereas the overwhelming majority of the traditional access points and POS devices are in developed countries today, developing coun-

tries already account for half of all cell phone users. Cell phone use in Africa is growing faster than any other region and jumped from 63 million users two years ago to about 152 million today. The Democratic Republic of Congo, for example, has 3.2 million cell phone customers and just 20,000 conventional land lines. At least 8,000 new mobile phone customers sign up each day, and the number of users has increased more than tenfold in the last five years.¹⁹ With more than 1,000 new customers added every minute, about 59 percent of users are in developing countries, making cell phones the first telecommunications industry in history to have more users there than in the developed world. Subscriber numbers there are growing rapidly, though it is uncertain how long this pace of growth will continue. The ultimate penetration levels will depend on cost to the subscribers and revenue possibilities for the networks. The cost of a new entry-level handset is approaching €20 and is projected to decline further, while second-hand phones cost even less. Revenues are linked to the volume of transactions (including financial transactions) that can be delivered through the mobile phone network. In the Philippines, South Africa, and Kenya, experiments using cell phones for financial transactions among previously excluded populations are already showing positive results.²⁰ WIZZIT, a division of the South African Bank of Athens, offers basic cell phone and card-based current accounts in tribal and rural areas as far as 100 kilometers from the nearest bank branch. Rather than the fixed monthly fee that most South African banks charge, WIZZIT charges only a low sign-up fee and transaction fees.

The use of technology could result in massive, widespread access to financial services among poor, low-income, and remote people. Alternatively, a subset of these same people could be left behind,

Figure 4 Global Electronic Touch Points



*Electronic Funds Transfer POS—the S name for POS machines connected to card networks

Sources: Western Union offices: company website; Post offices: UPU Web site (2005); Banks and ATMs: Beck et al., World Bank (2005), EFT POS: estimate from VISA and Mastercard numbers after controlling for overlap

¹⁸ GSM Association. *GSM Hits Two Billion Milestone*.

¹⁹ Washington Post, "In War-Torn Congo, Going Wireless to Reach Home," 9 July 2006.

²⁰ Ivatury, "Using Electronic Payments to Build Inclusive Financial Systems." 2006.

exacerbating the digital divide at a lower level. These two possible future scenarios are fleshed out in the box below.

2: Activist Governments: Friends or Foes?

Most of the microfinance community believe that the government's best role is to create a friendly policy environment for microfinancial services and

not to provide them directly, at least when it comes to credit. However, in the BRICs, but also increasingly in countries with populist governments, governments are getting more involved in delivering financial services to the poor directly. In BRIC countries, large state retail banks and other state credit institutions have long been important providers of financial services, and the governments seem

Unwiring the World: Scenarios for 2015

Scenario 1: Massive Access. Wireless technology revolutionizes the way financial institutions and other businesses offer financial services to low-income people. Hundreds of millions of poor and unbanked clients gain access to cell phones, either by owning their own or using someone else's. This sparks the interest of domestic banks because the costs of executing low-value transactions can be lowered substantially. Because international banks are capturing most of the corporate clientele, domestic banks turn more to retail business. They invest in delivery systems that can reach more people at lower cost, thus improving access for lower-income clients. In BRIC countries, the movement down-market starts with the burgeoning number of lower middle-class consumers. Major mobile phone operators form a new hub that enables international remittances to be securely and cheaply routed to mobile phone numbers. Innovation in handsets and software design spurs rapid customer adoption even among poor and illiterate clients.

Regulators appreciate the potential of technology and especially the combination of cell phones, smart cards, and POS, to extend access. In addition, they see wireless technology as a fast and transparent way to track transactions, making it easier, among other things, to comply with international standards that combat money laundering and the financing of terrorism. They amend regulations that limit banking transactions to conventional bank branches, allowing other infrastructure to do double duty as virtual branches. Once customers can make payments, transfers, cash withdrawals, and deposits outside of conventional branches, banking becomes more convenient and less intimidating for them. User-friendly products, some tailored for illiterate and semi-literate customers, attract many poor clients. The increased volume of remittances and internal transfers stimulates demand for other services. Higher volumes and lower costs allow deeper penetration.

In the BRICs, as well as LICs such as Botswana, Kenya, and Namibia, governments opt to make social transfer payments to their "stem" of poor citizens through banks and other financial institutions, using electronic payments and wireless technology.

Once deployed, this wireless backbone can handle huge numbers of transactions, including not only financial services but also other development activities. For instance, cell phones and wireless Internet kiosks transmit basic health education to poor households, market information to remote farmers, and rainfall conditions to holders of weather insurance. Easy access to information makes it far simpler for those in developing countries to tap into global best practices. It also ensures that governments are held more accountable.

Scenario 2: Deeper Digital Divide. Technology is adopted mainly to serve the easier-to-reach, wealthy clients and the substantial middle class in BRIC countries. The high fixed cost of technology infrastructure allows large banks to push out small players. The large banks find other opportunities more attractive than extending the lower income frontier of the retail market, thus leaving most of the poor outside the system and worsening the digital divide.

As financial institutions move toward automated processes, clients interact more with machines than with people. Poor people who do not fit lenders' automated profiles lose out on the benefits of conventional microfinance, including the personal relationships with loan officers that make uncollateralized, unscored credit possible, and interaction with other poor clients, which builds confidence and empowerment, especially for women.

Governments in developing countries are concerned that increasing numbers of financial transactions, including deposit collection, occur outside of the banking sector, beyond their limited capacity to supervise. In reaction, they tighten financial regulations, prohibiting banking services via cell phones and other electronic means outside of bank branches. Governments also clamp down on nonbanks, such as telecommunications companies, offering card and cell phone-based payments/banking services.

The trend away from legalizing immigration in Europe and the United States blocks access to bank accounts and possibly even easy cell phone subscriptions for immigrants in the North. This makes it harder to send funds safely and cheaply back home to family members.

The traditional donor community and other international actors supporting microfinance assume that technology can solve the access problem commercially: they think most of the job is done. They lose interest in financial inclusion. Most poor people are left behind, and entire LICs as well. This shift in interest leaves countries like Sudan and Zambia with limited support for building financial access, even while they remain on the fringes of the wireless revolution.

poised to use their own retail institutions as vehicles to achieve greater inclusion.

In populist Latin American countries, new state credit programs are springing up, reflecting frustration with persistent poverty levels and with the pace, price, and geographic coverage of private sector financial service delivery. For instance, the Venezuelan government recently announced that it will invest \$223 million to create 800 new community microbanks.²¹ Subsidized state credit could drive many private MFIs out of business and destroy the general repayment culture (many borrowers see government loans as social and political transfers and do not feel compelled to repay them). The potential damage from these populist approaches in Latin America is particularly worrisome because a number of countries in the region have large, sustainable private microfinance sectors.

The pendulum seems to be swinging back from widespread privatization and liberalization toward more state control—and possibly even nationalization in some cases. In between, there are several other options: requiring institutions to lend to priority social sectors (India, Colombia); requiring financial institutions to serve the communities from which they receive deposits (as with the U.S. Community Reinvestment Act); linking government contracts to banks' social performance (South Africa); creating fiscal incentives to invest in priority sectors (as has been done in the Netherlands); or fostering moral suasion for banks

to commit to access targets (South Africa's Financial Sector Charter).

Basic principles of good lending for poor and low-income clients are increasingly well known and accepted.²² As states exercise more control over retail financial services, some may heed the accumulated lessons of microfinance experience. Armed with good practice guidance, governments could potentially provide these services directly and do a good job. On the other hand, governments may continue naturally to succumb to the significant social and political pressure to deliver subsidized, uncollectible loans.

3. New International Players: Dealing with Popularity

International actors such as donors, technical assistance providers, and microfinance networks have played an important role in the growth of microfinance to date. While modern microcredit was developed by local social entrepreneurs in countries from Bangladesh to Bolivia, international agencies supported many of these entrepreneurs as they developed their models and enabled them to scale up successful ones. Going forward, however, the influence of the international community is

²¹ See 9 March 2006 article available via www.bnamicolas.com.

²² See "Building Inclusive Financial Systems: Donor Guidelines on Good Practice Microfinance," CGAP 2004.

Activist Governments: Scenarios for 2015

Scenario 1: Successful State Involvement. A few governments take an informed, long-term approach to the use of their massive state bank infrastructure to offer sustainable financial services. They follow examples such as Bank Rakyat Indonesia, a state bank that successfully built firewalls between politics and the technical business of banking, resulting in sustainable provision of more than 31 million savings accounts and 3.2 million small loans outstanding at present.* Based on sound practices and fuelled by massive injections of start-up capital, access skyrockets. Loan repayment is high, and state banks become profitable.

BRIC and other governments channel social transfer payments to the poor through state and other commercial banks, enabling many people to have bank accounts for the first time. Governments professionalize their state savings banks, which become better at collecting, protecting, and investing poor people's savings.

Other governments successfully motivate private banks, for instance by entering into public/private compacts to extend access. They also encourage developments like credit bureaus that enable the poor to develop credit histories transferable from one provider to another. They work together with banks to develop common financial architecture like interoperable ATMs and POS machines and cell phone-based transaction networks that reduce costs and increase mobility of poor people's money.

The few success stories where governments in both BRICs and LICs have really insulated credit from politics and replaced traditional approaches with sounder practices draw imitators throughout the developing world.

* Robinson, "Why the Bank Rakyat Indonesia Has the World's Largest Sustainable Microbanking System."

Activist Governments: Scenarios for 2015 (continued)

Scenario 2: Flood, Distortion, and Collapse. BRIC and populist governments reject so-called international “good practice.” They blame the free market orthodoxy emanating from the West, and especially Washington, for deepening poverty and social divides in their countries. These same governments experience immense pressure to deliver resources quickly to poor and remote constituencies. In addition, a number of governments (especially in BRICs and some Middle Eastern countries) are so concerned about the potential impact of youth unemployment that they rush to create unsustainable microcredit schemes as a solution.

As a result, state-owned “Banks for the Poor” crop up in dozens of countries. Interest charged on the loans is far below the cost of delivering them, and borrowers are not compelled to repay them. This kind of unfair competition squeezes out sustainable private MFIs. In BRIC countries, the governments finance these efforts as part of their welfare policy. In LICs, donors grudgingly agree to bankroll these new state players, in fear of being completely left out of the development debate in countries increasingly hostile to free-market ideas.

Some countries reinforce each other’s stances, as happened in 2006 when oil-rich Venezuela donated \$100 million to the Bolivian government for state-run microcredit, threatening to undermine Bolivia’s well-established and viable private MFIs. South-to-South dialogue and technical support hasten the spread of the new state credit initiatives throughout the developing world.

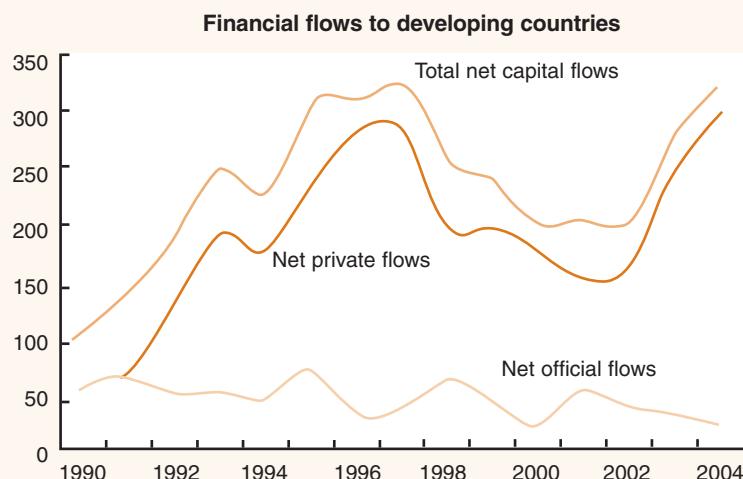
Interest rate ceilings are imposed at levels too low for private microcredit players to survive, and so the subsidized and weak state-run Banks for the Poor are left as the only source of financial services for the poor. Thus poor people have access to their services only as long as the subsidy and political interest lasts.

changing. For one thing, aid flows, except in the poorest countries, are increasingly small relative to private capital flows and even smaller compared with remittances from workers abroad (see Figure 5). In 1988 remittances were less than half of official flows: by 2001 they were more than twice the size of official flows. As the cost of wiring money drops, and the number of migrants increases, remittances are likely to become an even more important source of money for the poor.

The composition of the international donor community is also changing. New actors are emerging

on the scene, both governments and private players. The BRICs and some of the oil-rich Islamic states are playing an increasing role as donors. Fortunes made in business, and especially in technology, are now being deployed to solve some of the problems of development. Warren Buffett’s spectacular \$31 billion contribution makes the annual budget of the Bill and Melinda Gates Foundation (already the largest private foundation in the world) bigger than the GDP of over 40 countries. The annual disbursements of the Gates Foundation and several others in the United States now dwarf the foreign

Figure 5 Traditional Aid Becoming Marginal?



Source: Global Development Finance, 2005

aid budgets of some countries. A key uncertainty will be the extent to which these new funders, many of them enormously successful in making money, will learn from the traditional donors' many years of successes and failures in spending it.

Technology allows even small givers to bypass traditional donor channels and directly reach recipients: In 2004, Oxfam ran a campaign on its Web site that provided an alternative to traditional Christmas presents, offering to send a brood of

chickens to a family in a developing country for 10 pounds (UK), a goat for 24 pounds, mosquito nets for 15 pounds, and a month's food for 25 pounds.²³ Web sites such as kiva.org promise to allow individuals to provide credit to a microentrepreneur in Ouagadougou as easily as they can order flowers for delivery on Mother's Day.

²³ BBC Online, 2004. "Oxfam Offers Chicks for Christmas." 3 October 2004. www.bbcnews.com.

New International Players: Scenarios for 2015

Scenario 1: Making good on the promise. New international funders bring a fresh perspective and support innovations and activities that traditional donors cannot easily handle, such as the application of technology to pro-poor finance. They bring to bear their expertise in business, technology, and governance. Their instruments are flexible, and their approach accelerates innovations that lead to hundreds of millions more people accessing financial services.

The new entrants understand the idea of building, rather than bypassing, domestic funding markets. They structure investments that catalyze rather than displace domestic lenders and investors. The private donors are less swayed by geo-political considerations than the traditional donors have been. They are not as driven by asset-bookkeeping considerations as traditional social investors. They use subsidies to create new IT networks and payment platforms that reduce operating costs and enable new players to enter the market of providing financial services to poor clients.

Against this backdrop, traditional donors seek to innovate and adjust to new roles. They focus on poor people beyond the present reach of microfinance. They experiment with social transfer schemes even in LICs with weak or corrupt governments, transferring grants directly to very poor people via the financial system. They bring formal financial services to the poorest households and link them into the retail payments system. They are run successfully at large scale in a number of LICs.

International activists and celebrities remain engaged and continue to advocate for permanent, long-term access to finance. Instead of simply arguing for more aid, they also take up the subtler yet more powerful cause of making aid more effective.

Scenario 2: Backlash. Large volumes of new international funding are generated by over-advertising the benefits of microcredit. The supply exceeds the absorption capacity of local MFIs, encouraging imprudent lending, even attracting irresponsible lenders that take advantage of poor clients. Consumer lending expands rapidly in BRICs and other countries with burgeoning middle classes and young, urban populations. Over-indebtedness becomes a major problem. Most of this lending is done by purely commercial actors, not socially motivated financial institutions. But in the minds of consumers, governments, and activists, the distinctions blur; so that when evidence mounts of over-lending, all credit providers are painted with the same brush.

The new international funders repeat some of the less effective practices of the past, flooding domestic markets with cheap and/or easily accessible foreign funds. The benefits flow mainly to financial institutions that are closest to the funders and the most skilled at accessing these funds. Incentives for mobilizing poor people's savings or otherwise linking to the domestic financial markets are further reduced. Those investors that took on increased risk in hopes of higher returns are surprised when the returns turn out to be much lower than expected. The pressures to take on and deploy excess funding and attention pushes some MFIs into failure.

In places such as Africa, the international community becomes increasingly discouraged because quick wins are scarce, and money is slow to move. In addition, impact remains difficult to prove, disillusioning some newcomers and causing them to shift funding away.

At the same time, the well-publicized plans of new funders with large sums of money cause traditional donors to reduce their focus on the sector or bow out altogether. As they exit the field, large segments of the population are left without service.

The combination of increasing consumer credit, over-indebtedness of people around the world, and disenchantment in the funding community fuels an international mobilization against predatory lending practices. International and local activists decry consumer over-indebtedness and denounce microfinance as anti-poor. They call for a moratorium on consumer debt repayments and a cancellation of debt levels beyond a basic level, akin to the Jubilee Campaign for national debt. This movement further pushes official aid flows away from microfinance. It also spurs national-level initiatives for new laws and regulations to limit abuse. In many countries, rather than protecting consumers, these regulations further restrict access to finance, for instance by imposing interest rate ceilings that make sustainable delivery of microcredit impossible.

Furthermore, national governments may be bypassed, too: Donors have expressed increasing interest in providing cash transfers directly to the very poorest groups. Particularly in countries with weak or corrupt governments, the incentives for donors to go this route will be strong.

International activism on issues of development and global social justice has increased sharply in recent years. The Jubilee Campaign of 2000 successfully mobilized churches and individuals in developed countries to pressure politicians to forgive the debt of highly indebted countries. The Live8 campaigns in 2005 for more aid to Africa motivated millions of individuals to attend concerts and rallies and to send over 26 million cell phone text messages to recruit supporters to the cause. In the UK, private donations to support the Asian tsunami relief effort exceeded the government's initial package within 48 hours.²⁴

Microfinance has generally been regarded as an ally of the development cause, although a few commentators have expressed doubts.²⁵ The new international players could bring the breath of fresh air needed to push financial inclusion to the next level. But the hype and over-selling of microfinance could also lead to overspending, then disenchantment when impact does not meet expectations, and then even to backlash.

4. International Regulation: Safety vs. Access

An increasing number of international financial standards and codes already affect financial systems in developing countries, especially in BRICs and other countries that are better integrated into global trade. These standards are developed by international bodies in which developing countries have little weight. They seldom have access to finance on their minds when developing standards. Measures such as Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) initiatives, certifications by the Office of Foreign Asset Control, and the Basel Capital Accord aim to define a stable architecture for a global financial system. They are ratified at a multilateral level; a country that fails to implement them can be frozen out of important parts of the international financial system. Know-your-customer rules

require financial institutions to collect and report various identifying information for all customers. The expense of complying can make small transactions and accounts unviable, unless they are exempted from the requirement.

Regulation also limits who can provide services. The World Council of Credit Unions has had to shift its business from smaller money transfer operators in developing countries to U.S. operators because the small operators were unable to meet reporting requirements in their countries. In Somalia, the country most dependent on remittances, one million Somalis abroad send US\$1 billion back home every year, equaling two-thirds of GDP and more than 10 times the value of exports in 2004.²⁶ The assets of the largest Somali money transfer company were frozen in late 2001 because of alleged terrorist links. Costs related to licenses, minimum capital, and technology blocked smaller institutions from entering the market and substantially increased the price of remittances to Somalia.

Some of the codes and standards claim to be risk based, which would allow flexibility in how they are applied in local circumstances, so that governments can balance safety and access appropriately. In practice, there is often strong pressure on developing countries to accept and conform to norms that are developed for and applied in the developed countries. Strict application of an inappropriate rules-based approach could exacerbate the divide between formal and informal financial services within developing countries.

The Future Is Here: How Will the International Community Respond?

The scenario exercise began with the driving question, "How can the international community (public and private) contribute toward the greatest possible increase in access to financial services for underserved people and communities by 2015?" So

²⁴ Reynolds, Paul. 2004. "Public Opinion Pushes Governments." BBC Online, December 31, 2004. www.bbcnews.com.

²⁵ See for example, "Hype and Hope: The Worrying State of the Microcredit Movement," Thomas Dichter, SAIIA 9 January 2006.

²⁶ Ismail I. Ahmed, "New Regulations Restrict Somali Remittances," January 2006, p. 5.

International Regulation: Scenarios for 2015

Scenario 1: Achieving Balance. After an initial debate on the tradeoffs between security on the one hand and access (especially in developing country contexts) on the other, an international consensus emerges around the importance of balancing both. The law enforcement orientation of bodies such as the Financial Action Task Force (FATF), which sets AML/CFT standards, is balanced with an agenda that is friendlier to the poor. Some of the new, business-oriented entrants to the field push this agenda. Countries introduce exceptions for small-value accounts and transactions so that financial institutions can afford to work with poor clients.

To comply with FATF know-your-customer standards, more countries establish effective national identity systems, using cards or biometrics. These identity systems become a platform for the development of credit bureaus that give even very poor and remote people the possibility of building a credit record. Credit bureaus also streamline credit decisions by financial institutions, thus lowering costs and attracting more providers into the low end of the market.

Scenario 2: Clampdown. In an increasingly unstable world, AML/CFT rules become even stricter, and more countries come under pressure to implement them. The rules are crafted with reference to their impact on access to finance. Local interpretations of the standards become more rigid as countries wish to be seen as good enforcers. Rigorous documentation, such as proof of residence, required to comply with Know Your Customer rules, effectively block a large proportion of poor people from obtaining bank accounts. Local populations, as well as domestic and international migrant workers, are excluded from any formal financial service.

Small remittance companies catering to the needs of poor immigrants in the North and South are forced out of the market because the banks dealing with them face reporting requirements that are too costly or because lack of information about clients would violate AML/CFT rules. Monopolistic remittance companies and the few banks left in this market force the prices back up to unaffordable levels, leaving poor immigrants and their families with few good options for transferring their very small sums of cash.

At the national level, concern about extortionate lending practices and rising consumer indebtedness (especially in BRIC countries) leads authorities to copy developed-country consumer protection laws. The resulting increase in costs leads banks to abandon the low end of the market. Authorities also worry about what they see as uncontrolled branchless banking, using technology-enabled delivery mechanisms like wireless POS machines in retail shops. They impose limitations that make it more difficult and expensive to serve customers who don't have access to traditional branches.

how should that community respond to the challenges and opportunities of the coming decade? How can we make the positive outcomes more likely and avert the negative ones? The analysis points to some tentative approaches.

Technology. How can we accelerate the application of mobile phones and other technology to financial services and increase the chances that poor people benefit from the innovations? In developing countries, large private financial service providers and other private players, such as telecommunications companies, will probably do most of the investing in such technology. These companies already have capital, so what is the role of international funders and especially traditional donors? Their role is to share costs and risks of market development.

Funders can support market research focused on product design and customer adoption at the low end of the retail market. Promoting greater ability for clients to transact at equipment owned by banks other than their own bank (interoperability) and supporting a sound regulatory framework will help.

Deploying new cell phone-based technologies may warrant initial subsidies or social venture capital in the early years, when there is uncertainty over which models will work.

Activist governments. Government involvement in retail credit is likely to increase in many countries. How can we increase the likelihood of positive outcomes and prevent this development from hurting the poor by compromising sustainable service delivery? This question is particularly difficult because the levers of policy influence on national governments are changing. The BRICs will become more independent of the development community in crafting solutions to domestic problems. The more powerful BRICs will exert a more powerful influence on the policies of other developing countries. Service providers from the BRICs will probably be in greater demand as advisors.

Given rising expectations of the BRICs' young citizens and the politically tricky menu of options at these governments' disposal, the tone of discourse from developed country policy advisers will matter even more than before: stridently phrased pro-market

messages may be rejected. A more balanced and nuanced case for encouraging market development, with real models from the developed and developing world, is more likely to be well received.

New international actors. How can we encourage new philanthropists and international activists to learn from experience to date, while we remain open to new insights they bring? Over \$30 million was spent on microfinance conferences alone during 2005; after the hype of recent years, how do we avoid disenchantment and even backlash when progress is slower than advertised?²⁷ How do we channel new enthusiasm for microfinance into building domestic markets rather than retarding their development by substituting for them? How can we avoid supply-driven consumer finance bubbles?

After all this publicity, it is essential to temper expectations about the extent to which microfinance can eliminate poverty or reach the very bottom—destitute households—sustainably. A realistic evidence-based story must be provided. The search for better measures of impact remains an important strategy to prepare for the critiques that will inevitably come and capitalize on the real potential of microfinance.

When aggressive consumer and other retail credit indebts low-income borrowers beyond their ability to repay, the repercussions hurt legitimate financial service providers. Support for the develop-

ment of infrastructure like credit bureaus can help restrain reckless over-lending.

International Regulation. How can we best align the poverty and access agenda with the international security and financial stability agendas, rather than having them continue at odds with one another? International regulatory standards are still set mainly by developed countries.

Traditional bilateral and multilateral donors still have important influence via their home governments on the development of appropriate standards. We need to ensure that the cause of increasing financial access is well represented in the development and application of these frameworks.

CGAP launched this scenario exercise to help it and its partners think about financial access in the light of major global trends. The stories laid out here are just a few of many that could be developed. The future is uncertain, and the scenarios are not predictions, but they suggest some insights into where we can best focus our efforts to help make the positive stories come true and deflect the risks posed by the negative ones.

²⁷ At the request of its Executive Committee, CGAP staff undertook an estimate of the costs of microfinance conferences in the year of microcredit (2005). An approximate tally of travel, hotel and per diem for the 120 conferences organized suggests an expenditure of roughly \$30 million that year excluding staff costs (55,000 staff days).



Annex

CGAP thanks the following individuals for contributing their time and insight to the scenario-building process:

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Notes

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We know that microfinance can be robustly profitable. A 38-country analysis found that MFIs with publicly available performance information were more profitable on average than the commercial banks in those same countries.³ We know that when the model is right, microfinance grows fast: over the last decade, borrowers from MFIs worldwide have grown by 13–15 percent a year, implying a doubling of outreach every 7 years.⁴ On the other hand, these growth rates pale when compared to the growth of mobile phone subscribers, which has averaged almost 60 percent per year from 1999 to 2004. Sub-Saharan Africa's mobile market has grown 82 percent per year.⁵

Despite the improvements in financial access, two-thirds of the world's adults still do not have a basic bank account.⁶ Access to a bank account is only one dimension of financial inclusion, but it is an important one. A basic bank account is the entry point that allows customers to save money outside the household, make loan or premium payments, or transfer funds within their country or across borders. More than 80 percent of households have bank accounts in high-income countries, compared to well below 20 percent in low-income countries. In countries like Bangladesh or Sudan, that number hovers just above zero.

The Scenarios: What Do the Next 10 Years Hold?

The drive for financial inclusion remains strong. But is it strong enough to be irreversible? Will today's focus on microfinance fade away, or will it gather enough momentum to reach most of the billions who still do not have access to financial services? One thing is clear: over future decades the growth and diversification of financial services for the poor will depend increasingly on what happens in the mainstream financial sector, not just in isolated niche institutions. When global financial markets thrive and diversify, poor consumers could be drawn in as never before. But when those markets sneeze, finance for low-income people may catch a cold.

The factors influencing inclusive finance are more complex than ever before and no one has a crystal

ball that can predict the future. But organizations often use scenario planning as a means to develop strategies and plan for the long term. Scenarios are structured thought experiments that prepare for different potential outcomes. By isolating key forces or trends that affect all possible developments, including those that might derail the storyline and take it off course altogether, scenarios create plausible narratives about the future, based on the trends of today. Scenarios are not predictions; they are stories about different possible futures. A good scenario is one that is believable and encourages the organization to think about how it might respond.

Not All Developing Countries Are Alike

Building global scenarios for financial inclusion is a challenge. Countries differ enormously in terms of their current circumstances and prospects for the future. For scenario purposes, CGAP divided developing and transition countries into two groups:

- Large, emerging market countries that have experienced rapid growth and financial systems development, consisting mainly of the *BRICs*—Brazil, Russia, India, and China. (Some people might include South Africa or Kazakhstan in this category, and remove Russia as a special case in terms of financial access.)
- Low-income countries (*LICs*) that often have weak economic growth, deep poverty, and unstable governments. Several subcategories of LICs are also relevant for the exercise, for instance LICs with populist governments (such as those currently emerging in some Latin American

³ CGAP and the Microfinance Information eXchange (MIX) compared 2001–2004 profitability for 1799 commercial banks reported in Bank Scope and 344 MFIs that reported to the MicroBanking Bulletin or that published rating reports. Average return on assets was 2.8 percent for the MFIs and 1.5 percent for the commercial banks. The returns of the MFIs were adjusted to remove the effects of subsidies they received.

⁴ CGAP/MIX analysis of data from the MIX and the Microcredit Summit.

⁵ ITU, "The un-wired continent: Africa's mobile success story."

⁶ CGAP estimates based on several documents, including Peachey and Roe, "Access to Finance: What Does It Mean and How Do Savings Banks Foster Access?" January 2006 and Beck, Demirguc-Kunt, Peria, "Reaching out: Access to and use of banking services across countries," 2005.

countries) and LICs with that are fragile or failed states (e.g., Sudan, Bangladesh, Afghanistan).

BRICs are attracting increased attention because they are big and growing fast. Their sheer size is overwhelming: more than 40 percent of the world's people live in the BRICs, including more than 37 percent in India and China alone.⁷ They are already among the largest 10 economies measured by purchasing power parity,⁸ and they hold more than 30 percent of the world's foreign exchange reserves.⁹ As Figure 1 shows, the BRICs are forecast to overtake the G6 industrialized countries over the next 40–50 years in terms of the size of their economies.

If one or more of the BRICs were to become unstable and falter, global growth prospects would be seriously compromised. Should the BRICs succeed as they hope in obtaining more influence in global structures such as the United Nations, the International Monetary Fund, and the World Trade Organization, global prospects could also evolve differently.

In the BRICs, the influence of developed country capital, structures, standards, and advice is declining. China's program with the World Bank is called a "Country Partnership Agreement" rather than the Bank's more traditional "Country Assistance Strategy." India's and Brazil's strategies for poor people's financial access are homegrown, not derived from developed country counsel.

What happens in the BRICs will affect the LICs as well. LICs seeking economic growth and political influence increasingly follow the lead of the BRICs. BRIC models for economic growth are compelling, as is their emerging role as donors in their own right. China is giving \$600 million in aid to Cambodia and investing over \$1 billion in Africa; Russia is joining donor groups to provide grants to Africa.¹⁰ In January 2006, South Africa was one of the first countries visited by newly elected populist Bolivian President Evo Morales. He reportedly sought advice on achieving national reconciliation with growth and development.¹¹

⁷ Source: World Development Indicators.

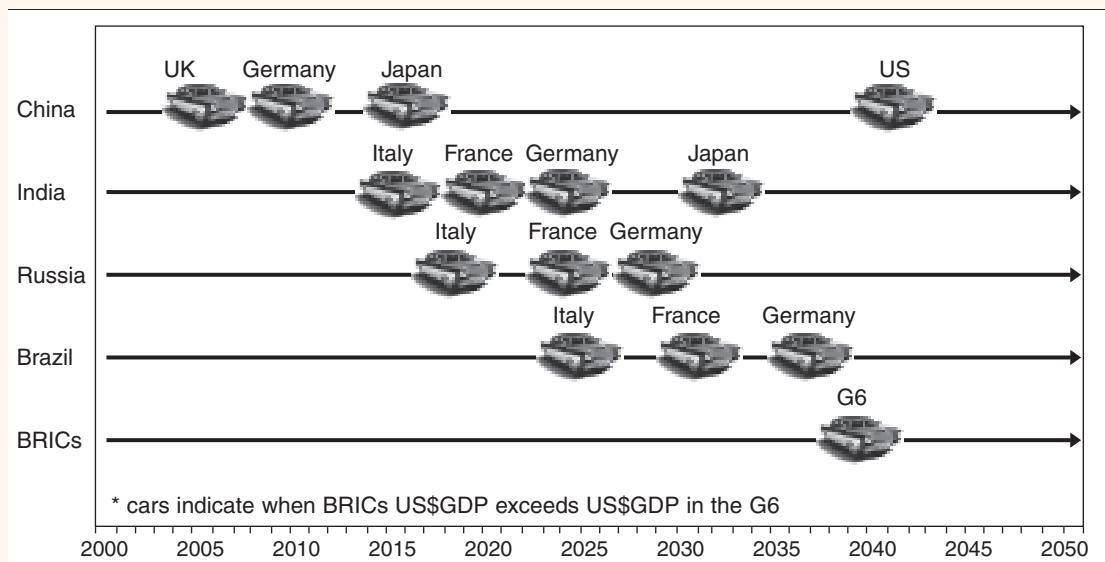
⁸ Source: World Development Indicators.

⁹ The Business Online, "Jobs Threat as Europe Falls Down League Table," December 4, 2005.

¹⁰ BBC, China Gives Cambodia \$600m in Aid, April 2006, <http://news.bbc.co.uk/2/hi/asia-pacific/4890400.stm>; China's accumulated direct investment in the African continent reached \$1.18 billion by the end of 2005, with Chinese investments scattered in 49 African countries, Chinese Government's Official Web Portal: http://www.gov.cn/mics/2006-06/15/content_311626.htm. As an example of Russia's re-entry into international aid, it has recently joined other donors by contributing US\$30 million to Global Village Energy Partnership to scale up its work in sub-Saharan Africa Global Village Energy Partnership, June 2006, <http://www.gvep.org/content/general/detail/13013>.

¹¹ Katzenellenbogen, Bolivian Leader Seeks SA advice on change, *Business Day*, January 2006.

Figure 1 BRICs Overtaking the G6



Source: Goldman Sachs, Global Economics Paper No. 99, Dreaming with BRICs: The Path to 2050

Seismic Shifts in Demography Affect All Countries

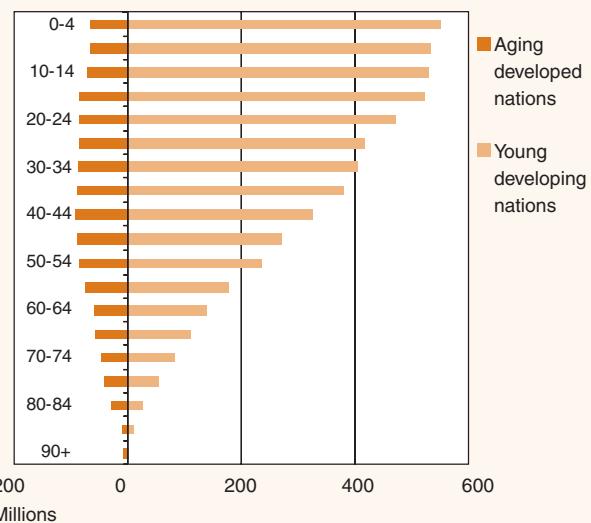
The growing pressure that demographics will place on cities, labor markets, and immigration patterns will probably be the single most important trend affecting access to finance—along with everything else—over the next several years. The client base for financial services globally will be:

- *Younger:* 2.5 billion of today's world population is children and teenagers who will become adults during the next decade or two (see Figure 2). Meanwhile, aging in the developed world will compel greater reliance on imported labor from developing countries. This bifurcation between the rapidly growing South and the shrinking North is starkly illustrated by population projections for Yemen and Russia—assuming little emigration, the former will have more people than the latter by 2050.¹²
- *More urban:* By 2009, urban dwellers will become the majority of the world's population. UN Habitat estimates that developing countries will add 2 billion new residents to urban areas in the next 25 years.¹³ Of the world's fastest growing major cities, 98 percent are located in low- and middle-income countries.¹⁴
- *More connected and informed:* As the result of communications technology, people in developing countries are more connected to each other and to the world than ever before. This can make them more reachable and informed consumers of financial services; but also more easily influenced by others and by status and branding considerations.

These factors are, in general, positive for access for financial services. It costs less to reach people with financial services when they reside in more densely populated urban areas and are more “connected.” Young people are more likely than their parents to be earlier adopters of new technologies that financial institutions will use to deliver services more widely.

However, youth unemployment in most regions of the developing world is already a problem, and will likely become more acute. For instance, the Middle East will need to double the number of jobs available

Figure 2 The Demographic Divide



Source: United Nations, Population Division: World Population Prospects: The 2004 Revision Population Database.

to accommodate jobseekers arriving on the market in the next 20 years.¹⁵ Will the new generation seek different ways of earning a living than their parents? Will self-employment be less or more attractive to them compared to a job? What about the new HIV-AIDS orphans who need to be “breadwinners” at a very young age? Can new financial products be developed to meet the needs of this burgeoning mass of un- and underemployed youth? Are existing microfinance methodologies (such as village or group lending) appropriate for younger clientele who are first-time entrepreneurs? Does this mean that microfinance will be increasingly urban based? What are the implications for microfinance in rural areas?

In BRIC countries, attention will increasingly turn to the large and growing middle class. As Figure 3 illustrates, the fabled “pyramid” is really shaped more like a tall diamond—in India at least—with a newly bulging middle class and a relatively slim “stem” of very poor people. Of course, the projected 37 million poor households in India still represent an enormous number of people who will need access to finance and other services. Other

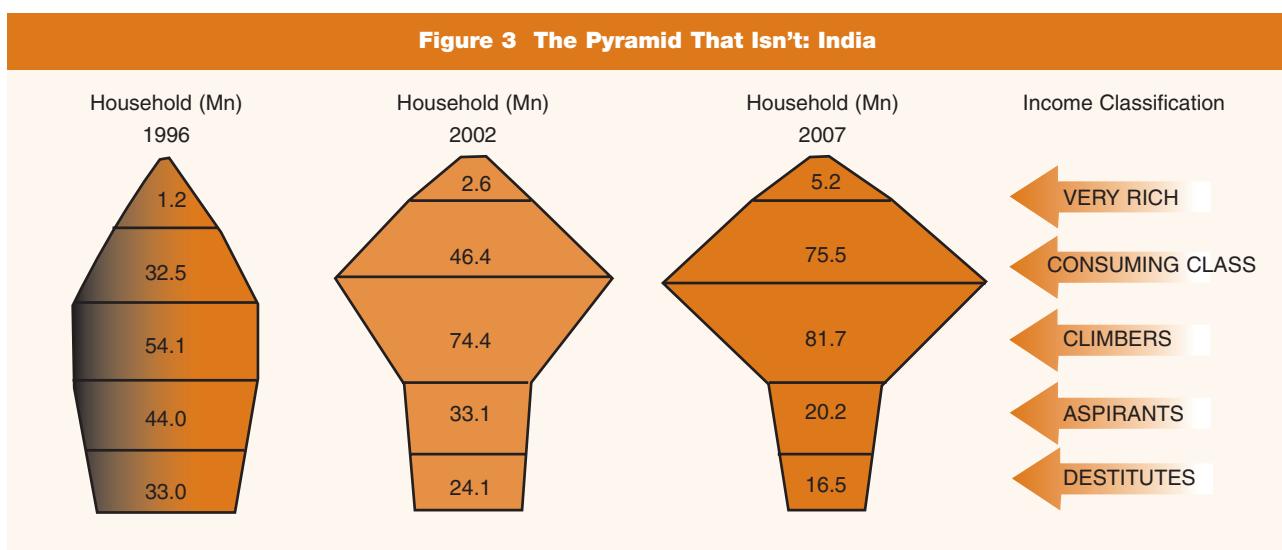
¹² Demeny, *Population Policy Dilemmas in Europe at the Dawn of the Twenty-First Century*, page 8.

¹³ UN Habitat, *Urban Millennium Partnership: Localizing MDGs Meeting the Challenge of MDGs in Cities*, page 3.

¹⁴ World Resources Institute, 2006.

¹⁵ World Bank, MENA Brief, “Development Challenges.”

Figure 3 The Pyramid That Isn't: India



Source: Sinha et al. (2005) Ogilvy and Mather India.

BRICs have similar socioeconomic distributions, although LICs do look more like pyramids. As the BRIC economies flourish and financial inclusion improves, the question is whether the people in those stems of the diamonds will benefit or be left behind.

The aging of developed nations guarantees a continuing stream of migrants from the South taking jobs in the north, especially in service industries. For instance, every day more than 3,100 Filipinos leave their country, and more than 1 in 10 Filipinos work abroad, leading President Arroyo to call them “our greatest export.”¹⁶ Remittances flows will probably continue to expand, strengthening the business case for linking them to retail payment systems.

However, if these workers are barred from legalization (as is threatened in many northern countries today), then they also may be denied access to formal financial services, including cheaper, safer remittances. In this case, the ranks of the financially excluded are certain to grow within developed countries.

These seismic shifts in demographics will affect all countries differently. For the purposes of this paper, however, the authors have chosen not to weave these demographic forces into the scenarios that are developed about the future for financial inclusion. Leaving aside the demographic forces allows for more focus in the scenarios on forces specific to financial access and on forces that the international comments can influence.

Four Trends and Their Uncertain Implications

After the demographic analysis, we focused on four trends that could help or hurt financial access: wireless technology, activist governments, new international actors, and international regulation. For each of these, we developed extreme scenarios, one positive and one negative, and looked at the implications for the international community promoting financial access.

1. Wireless Technology: Connecting or Dividing

Over the next decade, the most significant technological change that could open up access to finance for large numbers of excluded people is pervasive extension of wireless access, even in poorer countries. Wireless technology could radically reduce transaction costs and create anytime, anywhere access, even for very poor and remote clients.

The International Telecommunication Union (ITU) estimates that just over half of people in LICs are already within range of a wireless service.¹⁷ The ITU’s “Connect the World” initiative proposes to raise coverage to 100 percent by 2015. Such widespread access will change not only information flows but also financial service delivery. In the coming wireless world, corner grocers, petrol

¹⁶ Paddock, “The Overseas Class,” *Los Angeles Times*, April 20, 2006.

¹⁷ ITU, www.itu.int.

stations, and lottery outlets with cell phones can become delivery points/channels for financial and other services. Private and public banks in Brazil established nearly 60,000 such points since 2000, when one-quarter of Brazil's 5,800 municipalities lacked any access to formal financial services. Today, these points offer formal banking services in every municipality in the country.

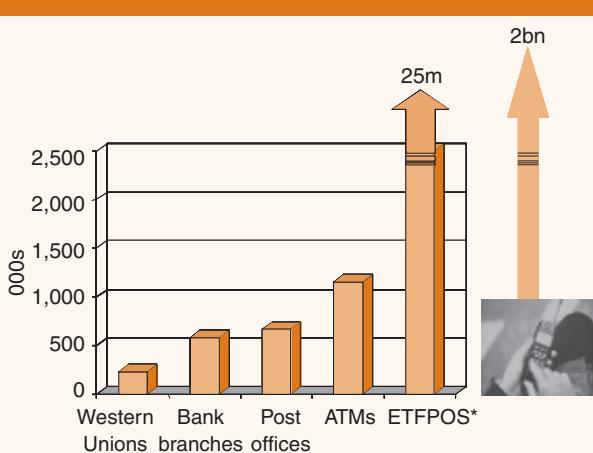
As seen in Figure 4, the 2 billionth cell phone has now hit the market. It took 12 years to reach the first billion, but only two-and-a-half years to reach the second. And 82 percent of the second billion went to developing countries both in BRICs and LICs.¹⁸ The 2 billion cell phones in the world today vastly outnumber the estimated 25 million point of sale (POS) devices linked to the major credit card associations. These POS devices, in turn, dwarf the number of more traditional points of contact for those using financial services (bank branches, ATMs, postal and Western Union outlets.). These cell phones and POSs may hold the key to bringing access to financial services into poor people's neighborhoods—and pockets.

Whereas the overwhelming majority of the traditional access points and POS devices are in developed countries today, developing coun-

tries already account for half of all cell phone users. Cell phone use in Africa is growing faster than any other region and jumped from 63 million users two years ago to about 152 million today. The Democratic Republic of Congo, for example, has 3.2 million cell phone customers and just 20,000 conventional land lines. At least 8,000 new mobile phone customers sign up each day, and the number of users has increased more than tenfold in the last five years.¹⁹ With more than 1,000 new customers added every minute, about 59 percent of users are in developing countries, making cell phones the first telecommunications industry in history to have more users there than in the developed world. Subscriber numbers there are growing rapidly, though it is uncertain how long this pace of growth will continue. The ultimate penetration levels will depend on cost to the subscribers and revenue possibilities for the networks. The cost of a new entry-level handset is approaching €20 and is projected to decline further, while second-hand phones cost even less. Revenues are linked to the volume of transactions (including financial transactions) that can be delivered through the mobile phone network. In the Philippines, South Africa, and Kenya, experiments using cell phones for financial transactions among previously excluded populations are already showing positive results.²⁰ WIZZIT, a division of the South African Bank of Athens, offers basic cell phone and card-based current accounts in tribal and rural areas as far as 100 kilometers from the nearest bank branch. Rather than the fixed monthly fee that most South African banks charge, WIZZIT charges only a low sign-up fee and transaction fees.

The use of technology could result in massive, widespread access to financial services among poor, low-income, and remote people. Alternatively, a subset of these same people could be left behind,

Figure 4 Global Electronic Touch Points



*Electronic Funds Transfer POS—the S name for POS machines connected to card networks

Sources: Western Union offices: company website; Post offices: UPU Web site (2005); Banks and ATMs: Beck et al, World Bank (2005), EFT POS: estimate from VISA and Mastercard numbers after controlling for overlap

¹⁸ GSM Association. *GSM Hits Two Billion Milestone*.

¹⁹ Washington Post, "In War-Torn Congo, Going Wireless to Reach Home," 9 July 2006.

²⁰ Ivatury, "Using Electronic Payments to Build Inclusive Financial Systems." 2006.

exacerbating the digital divide at a lower level. These two possible future scenarios are fleshed out in the box below.

2: Activist Governments: Friends or Foes?

Most of the microfinance community believe that the government's best role is to create a friendly policy environment for microfinancial services and

not to provide them directly, at least when it comes to credit. However, in the BRICs, but also increasingly in countries with populist governments, governments are getting more involved in delivering financial services to the poor directly. In BRIC countries, large state retail banks and other state credit institutions have long been important providers of financial services, and the governments seem

Unwiring the World: Scenarios for 2015

Scenario 1: Massive Access. Wireless technology revolutionizes the way financial institutions and other businesses offer financial services to low-income people. Hundreds of millions of poor and unbanked clients gain access to cell phones, either by owning their own or using someone else's. This sparks the interest of domestic banks because the costs of executing low-value transactions can be lowered substantially. Because international banks are capturing most of the corporate clientele, domestic banks turn more to retail business. They invest in delivery systems that can reach more people at lower cost, thus improving access for lower-income clients. In BRIC countries, the movement down-market starts with the burgeoning number of lower middle-class consumers. Major mobile phone operators form a new hub that enables international remittances to be securely and cheaply routed to mobile phone numbers. Innovation in handsets and software design spurs rapid customer adoption even among poor and illiterate clients.

Regulators appreciate the potential of technology and especially the combination of cell phones, smart cards, and POS, to extend access. In addition, they see wireless technology as a fast and transparent way to track transactions, making it easier, among other things, to comply with international standards that combat money laundering and the financing of terrorism. They amend regulations that limit banking transactions to conventional bank branches, allowing other infrastructure to do double duty as virtual branches. Once customers can make payments, transfers, cash withdrawals, and deposits outside of conventional branches, banking becomes more convenient and less intimidating for them. User-friendly products, some tailored for illiterate and semi-literate customers, attract many poor clients. The increased volume of remittances and internal transfers stimulates demand for other services. Higher volumes and lower costs allow deeper penetration.

In the BRICs, as well as LICs such as Botswana, Kenya, and Namibia, governments opt to make social transfer payments to their "stem" of poor citizens through banks and other financial institutions, using electronic payments and wireless technology.

Once deployed, this wireless backbone can handle huge numbers of transactions, including not only financial services but also other development activities. For instance, cell phones and wireless Internet kiosks transmit basic health education to poor households, market information to remote farmers, and rainfall conditions to holders of weather insurance. Easy access to information makes it far simpler for those in developing countries to tap into global best practices. It also ensures that governments are held more accountable.

Scenario 2: Deeper Digital Divide. Technology is adopted mainly to serve the easier-to-reach, wealthy clients and the substantial middle class in BRIC countries. The high fixed cost of technology infrastructure allows large banks to push out small players. The large banks find other opportunities more attractive than extending the lower income frontier of the retail market, thus leaving most of the poor outside the system and worsening the digital divide.

As financial institutions move toward automated processes, clients interact more with machines than with people. Poor people who do not fit lenders' automated profiles lose out on the benefits of conventional microfinance, including the personal relationships with loan officers that make uncollateralized, unscored credit possible, and interaction with other poor clients, which builds confidence and empowerment, especially for women.

Governments in developing countries are concerned that increasing numbers of financial transactions, including deposit collection, occur outside of the banking sector, beyond their limited capacity to supervise. In reaction, they tighten financial regulations, prohibiting banking services via cell phones and other electronic means outside of bank branches. Governments also clamp down on nonbanks, such as telecommunications companies, offering card and cell phone-based payments/banking services.

The trend away from legalizing immigration in Europe and the United States blocks access to bank accounts and possibly even easy cell phone subscriptions for immigrants in the North. This makes it harder to send funds safely and cheaply back home to family members.

The traditional donor community and other international actors supporting microfinance assume that technology can solve the access problem commercially: they think most of the job is done. They lose interest in financial inclusion. Most poor people are left behind, and entire LICs as well. This shift in interest leaves countries like Sudan and Zambia with limited support for building financial access, even while they remain on the fringes of the wireless revolution.

poised to use their own retail institutions as vehicles to achieve greater inclusion.

In populist Latin American countries, new state credit programs are springing up, reflecting frustration with persistent poverty levels and with the pace, price, and geographic coverage of private sector financial service delivery. For instance, the Venezuelan government recently announced that it will invest \$223 million to create 800 new community microbanks.²¹ Subsidized state credit could drive many private MFIs out of business and destroy the general repayment culture (many borrowers see government loans as social and political transfers and do not feel compelled to repay them). The potential damage from these populist approaches in Latin America is particularly worrisome because a number of countries in the region have large, sustainable private microfinance sectors.

The pendulum seems to be swinging back from widespread privatization and liberalization toward more state control—and possibly even nationalization in some cases. In between, there are several other options: requiring institutions to lend to priority social sectors (India, Colombia); requiring financial institutions to serve the communities from which they receive deposits (as with the U.S. Community Reinvestment Act); linking government contracts to banks' social performance (South Africa); creating fiscal incentives to invest in priority sectors (as has been done in the Netherlands); or fostering moral suasion for banks

to commit to access targets (South Africa's Financial Sector Charter).

Basic principles of good lending for poor and low-income clients are increasingly well known and accepted.²² As states exercise more control over retail financial services, some may heed the accumulated lessons of microfinance experience. Armed with good practice guidance, governments could potentially provide these services directly and do a good job. On the other hand, governments may continue naturally to succumb to the significant social and political pressure to deliver subsidized, uncollectible loans.

3. New International Players: Dealing with Popularity

International actors such as donors, technical assistance providers, and microfinance networks have played an important role in the growth of microfinance to date. While modern microcredit was developed by local social entrepreneurs in countries from Bangladesh to Bolivia, international agencies supported many of these entrepreneurs as they developed their models and enabled them to scale up successful ones. Going forward, however, the influence of the international community is

²¹ See 9 March 2006 article available via www.bnamicolas.com.

²² See "Building Inclusive Financial Systems: Donor Guidelines on Good Practice Microfinance," CGAP 2004.

Activist Governments: Scenarios for 2015

Scenario 1: Successful State Involvement. A few governments take an informed, long-term approach to the use of their massive state bank infrastructure to offer sustainable financial services. They follow examples such as Bank Rakyat Indonesia, a state bank that successfully built firewalls between politics and the technical business of banking, resulting in sustainable provision of more than 31 million savings accounts and 3.2 million small loans outstanding at present.* Based on sound practices and fuelled by massive injections of start-up capital, access skyrockets. Loan repayment is high, and state banks become profitable.

BRIC and other governments channel social transfer payments to the poor through state and other commercial banks, enabling many people to have bank accounts for the first time. Governments professionalize their state savings banks, which become better at collecting, protecting, and investing poor people's savings.

Other governments successfully motivate private banks, for instance by entering into public/private compacts to extend access. They also encourage developments like credit bureaus that enable the poor to develop credit histories transferable from one provider to another. They work together with banks to develop common financial architecture like interoperable ATMs and POS machines and cell phone-based transaction networks that reduce costs and increase mobility of poor people's money.

The few success stories where governments in both BRICs and LICs have really insulated credit from politics and replaced traditional approaches with sounder practices draw imitators throughout the developing world.

* Robinson, "Why the Bank Rakyat Indonesia Has the World's Largest Sustainable Microbanking System."

Activist Governments: Scenarios for 2015 (continued)

Scenario 2: Flood, Distortion, and Collapse. BRIC and populist governments reject so-called international “good practice.” They blame the free market orthodoxy emanating from the West, and especially Washington, for deepening poverty and social divides in their countries. These same governments experience immense pressure to deliver resources quickly to poor and remote constituencies. In addition, a number of governments (especially in BRICs and some Middle Eastern countries) are so concerned about the potential impact of youth unemployment that they rush to create unsustainable microcredit schemes as a solution.

As a result, state-owned “Banks for the Poor” crop up in dozens of countries. Interest charged on the loans is far below the cost of delivering them, and borrowers are not compelled to repay them. This kind of unfair competition squeezes out sustainable private MFIs. In BRIC countries, the governments finance these efforts as part of their welfare policy. In LICs, donors grudgingly agree to bankroll these new state players, in fear of being completely left out of the development debate in countries increasingly hostile to free-market ideas.

Some countries reinforce each other’s stances, as happened in 2006 when oil-rich Venezuela donated \$100 million to the Bolivian government for state-run microcredit, threatening to undermine Bolivia’s well-established and viable private MFIs. South-to-South dialogue and technical support hasten the spread of the new state credit initiatives throughout the developing world.

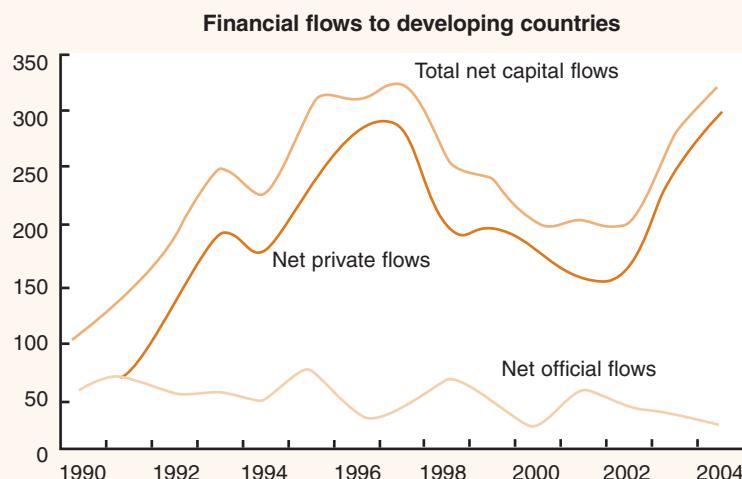
Interest rate ceilings are imposed at levels too low for private microcredit players to survive, and so the subsidized and weak state-run Banks for the Poor are left as the only source of financial services for the poor. Thus poor people have access to their services only as long as the subsidy and political interest lasts.

changing. For one thing, aid flows, except in the poorest countries, are increasingly small relative to private capital flows and even smaller compared with remittances from workers abroad (see Figure 5). In 1988 remittances were less than half of official flows: by 2001 they were more than twice the size of official flows. As the cost of wiring money drops, and the number of migrants increases, remittances are likely to become an even more important source of money for the poor.

The composition of the international donor community is also changing. New actors are emerging

on the scene, both governments and private players. The BRICs and some of the oil-rich Islamic states are playing an increasing role as donors. Fortunes made in business, and especially in technology, are now being deployed to solve some of the problems of development. Warren Buffett’s spectacular \$31 billion contribution makes the annual budget of the Bill and Melinda Gates Foundation (already the largest private foundation in the world) bigger than the GDP of over 40 countries. The annual disbursements of the Gates Foundation and several others in the United States now dwarf the foreign

Figure 5 Traditional Aid Becoming Marginal?



Source: Global Development Finance, 2005

aid budgets of some countries. A key uncertainty will be the extent to which these new funders, many of them enormously successful in making money, will learn from the traditional donors' many years of successes and failures in spending it.

Technology allows even small givers to bypass traditional donor channels and directly reach recipients: In 2004, Oxfam ran a campaign on its Web site that provided an alternative to traditional Christmas presents, offering to send a brood of

chickens to a family in a developing country for 10 pounds (UK), a goat for 24 pounds, mosquito nets for 15 pounds, and a month's food for 25 pounds.²³ Web sites such as kiva.org promise to allow individuals to provide credit to a microentrepreneur in Ouagadougou as easily as they can order flowers for delivery on Mother's Day.

²³ BBC Online, 2004. "Oxfam Offers Chicks for Christmas." 3 October 2004. www.bbcnews.com.

New International Players: Scenarios for 2015

Scenario 1: Making good on the promise. New international funders bring a fresh perspective and support innovations and activities that traditional donors cannot easily handle, such as the application of technology to pro-poor finance. They bring to bear their expertise in business, technology, and governance. Their instruments are flexible, and their approach accelerates innovations that lead to hundreds of millions more people accessing financial services.

The new entrants understand the idea of building, rather than bypassing, domestic funding markets. They structure investments that catalyze rather than displace domestic lenders and investors. The private donors are less swayed by geo-political considerations than the traditional donors have been. They are not as driven by asset-bookkeeping considerations as traditional social investors. They use subsidies to create new IT networks and payment platforms that reduce operating costs and enable new players to enter the market of providing financial services to poor clients.

Against this backdrop, traditional donors seek to innovate and adjust to new roles. They focus on poor people beyond the present reach of microfinance. They experiment with social transfer schemes even in LICs with weak or corrupt governments, transferring grants directly to very poor people via the financial system. They bring formal financial services to the poorest households and link them into the retail payments system. They are run successfully at large scale in a number of LICs.

International activists and celebrities remain engaged and continue to advocate for permanent, long-term access to finance. Instead of simply arguing for more aid, they also take up the subtler yet more powerful cause of making aid more effective.

Scenario 2: Backlash. Large volumes of new international funding are generated by over-advertising the benefits of microcredit. The supply exceeds the absorption capacity of local MFIs, encouraging imprudent lending, even attracting irresponsible lenders that take advantage of poor clients. Consumer lending expands rapidly in BRICs and other countries with burgeoning middle classes and young, urban populations. Over-indebtedness becomes a major problem. Most of this lending is done by purely commercial actors, not socially motivated financial institutions. But in the minds of consumers, governments, and activists, the distinctions blur; so that when evidence mounts of over-lending, all credit providers are painted with the same brush.

The new international funders repeat some of the less effective practices of the past, flooding domestic markets with cheap and/or easily accessible foreign funds. The benefits flow mainly to financial institutions that are closest to the funders and the most skilled at accessing these funds. Incentives for mobilizing poor people's savings or otherwise linking to the domestic financial markets are further reduced. Those investors that took on increased risk in hopes of higher returns are surprised when the returns turn out to be much lower than expected. The pressures to take on and deploy excess funding and attention pushes some MFIs into failure.

In places such as Africa, the international community becomes increasingly discouraged because quick wins are scarce, and money is slow to move. In addition, impact remains difficult to prove, disillusioning some newcomers and causing them to shift funding away.

At the same time, the well-publicized plans of new funders with large sums of money cause traditional donors to reduce their focus on the sector or bow out altogether. As they exit the field, large segments of the population are left without service.

The combination of increasing consumer credit, over-indebtedness of people around the world, and disenchantment in the funding community fuels an international mobilization against predatory lending practices. International and local activists decry consumer over-indebtedness and denounce microfinance as anti-poor. They call for a moratorium on consumer debt repayments and a cancellation of debt levels beyond a basic level, akin to the Jubilee Campaign for national debt. This movement further pushes official aid flows away from microfinance. It also spurs national-level initiatives for new laws and regulations to limit abuse. In many countries, rather than protecting consumers, these regulations further restrict access to finance, for instance by imposing interest rate ceilings that make sustainable delivery of microcredit impossible.

Furthermore, national governments may be bypassed, too: Donors have expressed increasing interest in providing cash transfers directly to the very poorest groups. Particularly in countries with weak or corrupt governments, the incentives for donors to go this route will be strong.

International activism on issues of development and global social justice has increased sharply in recent years. The Jubilee Campaign of 2000 successfully mobilized churches and individuals in developed countries to pressure politicians to forgive the debt of highly indebted countries. The Live8 campaigns in 2005 for more aid to Africa motivated millions of individuals to attend concerts and rallies and to send over 26 million cell phone text messages to recruit supporters to the cause. In the UK, private donations to support the Asian tsunami relief effort exceeded the government's initial package within 48 hours.²⁴

Microfinance has generally been regarded as an ally of the development cause, although a few commentators have expressed doubts.²⁵ The new international players could bring the breath of fresh air needed to push financial inclusion to the next level. But the hype and over-selling of microfinance could also lead to overspending, then disenchantment when impact does not meet expectations, and then even to backlash.

4. International Regulation: Safety vs. Access

An increasing number of international financial standards and codes already affect financial systems in developing countries, especially in BRICs and other countries that are better integrated into global trade. These standards are developed by international bodies in which developing countries have little weight. They seldom have access to finance on their minds when developing standards. Measures such as Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) initiatives, certifications by the Office of Foreign Asset Control, and the Basel Capital Accord aim to define a stable architecture for a global financial system. They are ratified at a multilateral level; a country that fails to implement them can be frozen out of important parts of the international financial system. Know-your-customer rules

require financial institutions to collect and report various identifying information for all customers. The expense of complying can make small transactions and accounts unviable, unless they are exempted from the requirement.

Regulation also limits who can provide services. The World Council of Credit Unions has had to shift its business from smaller money transfer operators in developing countries to U.S. operators because the small operators were unable to meet reporting requirements in their countries. In Somalia, the country most dependent on remittances, one million Somalis abroad send US\$1 billion back home every year, equaling two-thirds of GDP and more than 10 times the value of exports in 2004.²⁶ The assets of the largest Somali money transfer company were frozen in late 2001 because of alleged terrorist links. Costs related to licenses, minimum capital, and technology blocked smaller institutions from entering the market and substantially increased the price of remittances to Somalia.

Some of the codes and standards claim to be risk based, which would allow flexibility in how they are applied in local circumstances, so that governments can balance safety and access appropriately. In practice, there is often strong pressure on developing countries to accept and conform to norms that are developed for and applied in the developed countries. Strict application of an inappropriate rules-based approach could exacerbate the divide between formal and informal financial services within developing countries.

The Future Is Here: How Will the International Community Respond?

The scenario exercise began with the driving question, "How can the international community (public and private) contribute toward the greatest possible increase in access to financial services for underserved people and communities by 2015?" So

²⁴ Reynolds, Paul. 2004. "Public Opinion Pushes Governments." BBC Online, December 31, 2004. www.bbcnews.com.

²⁵ See for example, "Hype and Hope: The Worrying State of the Microcredit Movement," Thomas Dichter, SAIIA 9 January 2006.

²⁶ Ismail I. Ahmed, "New Regulations Restrict Somali Remittances," January 2006, p. 5.

International Regulation: Scenarios for 2015

Scenario 1: Achieving Balance. After an initial debate on the tradeoffs between security on the one hand and access (especially in developing country contexts) on the other, an international consensus emerges around the importance of balancing both. The law enforcement orientation of bodies such as the Financial Action Task Force (FATF), which sets AML/CFT standards, is balanced with an agenda that is friendlier to the poor. Some of the new, business-oriented entrants to the field push this agenda. Countries introduce exceptions for small-value accounts and transactions so that financial institutions can afford to work with poor clients.

To comply with FATF know-your-customer standards, more countries establish effective national identity systems, using cards or biometrics. These identity systems become a platform for the development of credit bureaus that give even very poor and remote people the possibility of building a credit record. Credit bureaus also streamline credit decisions by financial institutions, thus lowering costs and attracting more providers into the low end of the market.

Scenario 2: Clampdown. In an increasingly unstable world, AML/CFT rules become even stricter, and more countries come under pressure to implement them. The rules are crafted with reference to their impact on access to finance. Local interpretations of the standards become more rigid as countries wish to be seen as good enforcers. Rigorous documentation, such as proof of residence, required to comply with Know Your Customer rules, effectively block a large proportion of poor people from obtaining bank accounts. Local populations, as well as domestic and international migrant workers, are excluded from any formal financial service.

Small remittance companies catering to the needs of poor immigrants in the North and South are forced out of the market because the banks dealing with them face reporting requirements that are too costly or because lack of information about clients would violate AML/CFT rules. Monopolistic remittance companies and the few banks left in this market force the prices back up to unaffordable levels, leaving poor immigrants and their families with few good options for transferring their very small sums of cash.

At the national level, concern about extortionate lending practices and rising consumer indebtedness (especially in BRIC countries) leads authorities to copy developed-country consumer protection laws. The resulting increase in costs leads banks to abandon the low end of the market. Authorities also worry about what they see as uncontrolled branchless banking, using technology-enabled delivery mechanisms like wireless POS machines in retail shops. They impose limitations that make it more difficult and expensive to serve customers who don't have access to traditional branches.

how should that community respond to the challenges and opportunities of the coming decade? How can we make the positive outcomes more likely and avert the negative ones? The analysis points to some tentative approaches.

Technology. How can we accelerate the application of mobile phones and other technology to financial services and increase the chances that poor people benefit from the innovations? In developing countries, large private financial service providers and other private players, such as telecommunications companies, will probably do most of the investing in such technology. These companies already have capital, so what is the role of international funders and especially traditional donors? Their role is to share costs and risks of market development.

Funders can support market research focused on product design and customer adoption at the low end of the retail market. Promoting greater ability for clients to transact at equipment owned by banks other than their own bank (interoperability) and supporting a sound regulatory framework will help.

Deploying new cell phone-based technologies may warrant initial subsidies or social venture capital in the early years, when there is uncertainty over which models will work.

Activist governments. Government involvement in retail credit is likely to increase in many countries. How can we increase the likelihood of positive outcomes and prevent this development from hurting the poor by compromising sustainable service delivery? This question is particularly difficult because the levers of policy influence on national governments are changing. The BRICs will become more independent of the development community in crafting solutions to domestic problems. The more powerful BRICs will exert a more powerful influence on the policies of other developing countries. Service providers from the BRICs will probably be in greater demand as advisors.

Given rising expectations of the BRICs' young citizens and the politically tricky menu of options at these governments' disposal, the tone of discourse from developed country policy advisers will matter even more than before: stridently phrased pro-market

messages may be rejected. A more balanced and nuanced case for encouraging market development, with real models from the developed and developing world, is more likely to be well received.

New international actors. How can we encourage new philanthropists and international activists to learn from experience to date, while we remain open to new insights they bring? Over \$30 million was spent on microfinance conferences alone during 2005; after the hype of recent years, how do we avoid disenchantment and even backlash when progress is slower than advertised?²⁷ How do we channel new enthusiasm for microfinance into building domestic markets rather than retarding their development by substituting for them? How can we avoid supply-driven consumer finance bubbles?

After all this publicity, it is essential to temper expectations about the extent to which microfinance can eliminate poverty or reach the very bottom—destitute households—sustainably. A realistic evidence-based story must be provided. The search for better measures of impact remains an important strategy to prepare for the critiques that will inevitably come and capitalize on the real potential of microfinance.

When aggressive consumer and other retail credit indebts low-income borrowers beyond their ability to repay, the repercussions hurt legitimate financial service providers. Support for the develop-

ment of infrastructure like credit bureaus can help restrain reckless over-lending.

International Regulation. How can we best align the poverty and access agenda with the international security and financial stability agendas, rather than having them continue at odds with one another? International regulatory standards are still set mainly by developed countries.

Traditional bilateral and multilateral donors still have important influence via their home governments on the development of appropriate standards. We need to ensure that the cause of increasing financial access is well represented in the development and application of these frameworks.

CGAP launched this scenario exercise to help it and its partners think about financial access in the light of major global trends. The stories laid out here are just a few of many that could be developed. The future is uncertain, and the scenarios are not predictions, but they suggest some insights into where we can best focus our efforts to help make the positive stories come true and deflect the risks posed by the negative ones.

²⁷ At the request of its Executive Committee, CGAP staff undertook an estimate of the costs of microfinance conferences in the year of microcredit (2005). An approximate tally of travel, hotel and per diem for the 120 conferences organized suggests an expenditure of roughly \$30 million that year excluding staff costs (55,000 staff days).



Annex

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Notes

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