

# Facilitating Market Development to Advance Financial Inclusion

## A Tale of Two Countries and Hundreds of Millions in Donor Funding

Two African countries have been “donor darlings” for decades. One of these countries, Country A, has achieved levels of financial inclusion—measured by adults with bank accounts—of over 40 percent, a significant increase from the 25 percent level only four years ago. The other country, Country B, remains stubbornly stuck at around 10 percent. Both countries have received hundreds of millions of dollars for financial inclusion projects over at least two decades, with Country B having received significantly more funds from select donors.

Country A’s market has blossomed with innovative financial services firms offering remittances, payments, and credit through a relatively low-cost mobile-phone-based payment platform. The innovations were supported by a global donor challenge fund and a locally based multidonor-funded trust established in 2005 to facilitate development of the financial market to advance financial inclusion. The trust has conducted demand studies, gathered information on existing and new providers’ outreach, and supported efforts to adopt

regulations and legislation on innovative financial service delivery. In Country B, an apex fund channels wholesale donor funds to associations and other financial services providers, most of which would not survive without donor subsidy. The funding serves primarily to finance providers’ microlending operations. Very little has been done to understand or support the demand side of the picture, to encourage innovations in products and services (other than microloans) or their delivery to the poor, or to build an enabling environment or the market infrastructure (e.g., credit bureaus).

The two different market outcomes are a result of a multitude of issues—including demographics, market structures, and legal systems—and not just donor funding. However, today there is an understanding that donor funding can be designed and channeled in a way that increases the *likelihood* of building sustainable financial markets for the poor. This Focus Note presents the theory and lessons from Country A and other countries like it—models that we hope will become the standard everywhere.

The work of developing financial services for the poor has evolved considerably over the past 30 years. The genesis of today’s picture is the sustained effort in the 1970s and 1980s of donors, nongovernmental organizations (NGOs), and governments to design and use—in countries across the globe—new methods of providing the poor with access to affordable and manageable credit. The 1990s introduced the initial wave of “commercializing” these efforts through greenfields and the transformation of NGO microfinance institutions (MFIs) into for-profit finance companies, nonbank deposit-taking institutions, and banks. Donors and development finance institutions (DFIs) enabled many of these commercial ventures directly through capital investment and indirectly through support to regulators and policy makers and through ongoing efforts to build financial

systems infrastructure—particularly, credit information systems and rating agencies. These uses of subsidized funding—to promote innovations that serve as demonstration models and to fund public goods, such as evidence-based policy advice and enabling environments—are consistent with responsible market development.

Over the past decade or so, largely in response to a growing understanding of the financial needs of the poor, there has been a dramatic shift in the focus of donors and DFIs from microcredit to the broader concept of financial inclusion: the provision of a range of formal financial services, including savings, payments and transfers, insurance, and credit.<sup>1</sup> Donors have continued to play a critical role in supporting financial service providers and their innovations through direct investment and technical

<sup>1</sup> As some realized in the 1990s and early 2000s with respect to microcredit, to represent a positive step for access, a financial service or product should be (i) appropriately designed and affordable for poor and low-income households and businesses and (ii) responsibly and sustainably provided. While informal financial service providers (such as village savings groups) are critical to poor and low-income households and businesses, they may not provide the desired flexibility or level of security. In addition, informal services typically are not subject to financial consumer protection rules. Financial inclusion means that customers can choose between formal and informal services.

assistance. Donors' appreciation of the particular needs of the poor with respect to financial services has translated into new efforts to support the poor as financial consumers through demand-side research, the development of financial capability training programs, and encouraging providers to design financial products and services that meet the needs of the poor. Some donors have focused on the enabling environment by providing continued advice and support to policy makers and regulators (regarding, for example, banks' use of agents, nonbank electronic-money [e-money] issuers, and the adoption and enforcement of financial consumer protection rules). Others have supported development of financial system infrastructure, such as national payment systems. This multi-pronged approach—which we refer to in this Focus Note as a “market development approach”—aims to build markets that include and serve poor consumers, beginning in each market with an understanding of why such a market does not work for the poor.<sup>3</sup>

Yet, notwithstanding significant donor support of financial inclusion efforts, globally there remain 2.5 billion adults who are currently excluded or underserved by the financial system.

Emerging evidence from countries benefiting from donor and DFI interventions that are *coordinated, catalytic, and responsive to the market* show significant increases in access to financial services (see Box 1). Given that markets are in a constant state of flux—with new providers and consumers continually entering and exiting and new regulators and policy makers acting and reacting—market responsiveness<sup>2</sup> is best effected through the use of an independent actor that is **close to the market** and thereby **able to monitor market developments on an ongoing basis**. Such

an independent actor can also be well-positioned to address the challenges and coordinate the efforts of donors and DFIs with varied priorities, pressures, and skills. In this Focus Note, we refer to such an actor as a “**facilitator**,” although its role is not merely passive—coordinating and gathering information—but active: designing and promoting catalysts to spur market participants (financial service providers, customers, policy makers, market infrastructure firms), as needed. It is this critical facilitation role, which could be undertaken by multiple coordinated facilitators, that distinguishes the market development approach from other approaches, including financial systems development and sector-wide systems programming. Donors and DFIs can themselves be facilitators, and they can—individually or jointly—support facilitators.

The remainder of this Focus Note explains the role of a facilitator and then discusses several areas critical to building financial markets that work for the poor: information, capacity building, incentives, and a well-designed enabling environment.

## The Role of a Market Facilitator

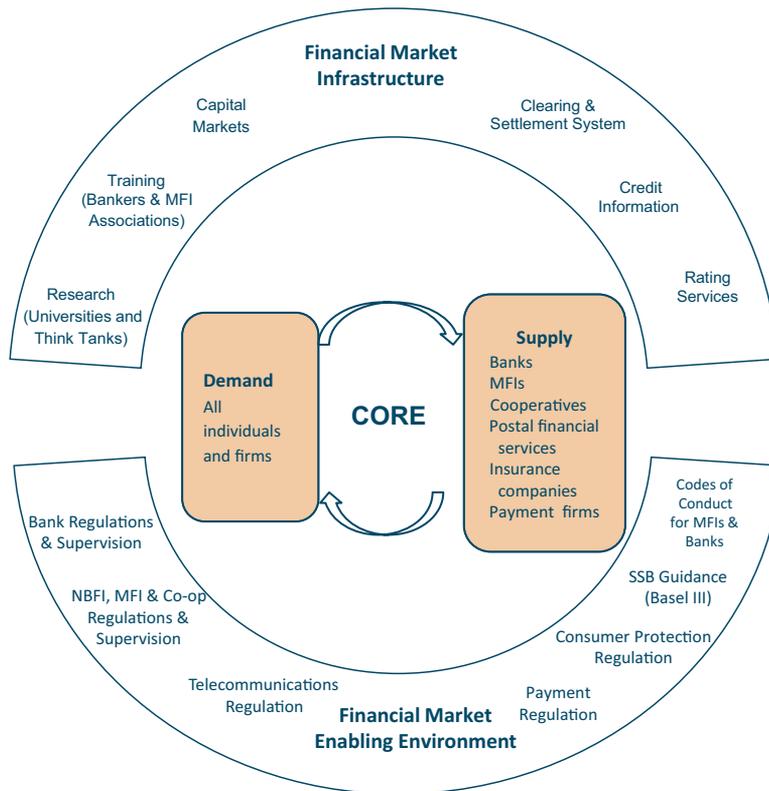
Using in-depth knowledge of the market, a facilitator's role is (i) to **identify** the problems, distortions, and inefficiencies that are hindering expanded outreach and increased access as well as the opportunities for building a market, (ii) to help **determine** what actions to take to address distortions or seize opportunities and by whom, and (iii) to **catalyze**—directly and in collaboration with donors, DFIs, and others<sup>4</sup>—market actors to build a sustainable market that serves the excluded. In-depth market knowledge and understanding requires access to accurate, comprehensive, and

2 Although donors may wish to replicate projects and programs that have been successful, responsiveness to a particular market's needs may mean taking a new approach or supporting another donor's work.

3 A market development approach has been applied to nonfinancial markets in several countries. See, for example, the following case studies: Anderson and Hitchins (2007) in Uganda; Elliott (2006) in the Balkans and South Caucasus; and Springfield Centre (2008) in Armenia. It is consistent with CGAP's *Good Practice Guidelines for Funders of Microfinance* (2006) and builds off of the Making Markets Work for the Poor (M4P) framework developed and supported by the Springfield Centre and others.

4 Some donors may act as facilitators or fund facilitators; others may take actions promoted by a facilitator.

**Figure 1. Key functions and actors in the financial market system**



Source: Adaptation from M4P framework by the Springfield Centre. Note: NBFI = nonbank financial institution; SSB = standard-setting body

up-to-date information on existing and potential demand, the range of providers and potential providers, the strengths and weaknesses of the legal and regulatory environment and the supporting infrastructure, and the political economy as it impacts all of these elements (See Figure 1). Having the ability to monitor the market effectively and to continually update information requires a facilitator that is close (physically) to the market and is independent—both in appearance and reality—so that it can be trusted by all market players. In addition, the facilitator needs analytical capability and expertise in financial markets and financial inclusion.

Catalysts in a developed financial market will be different from catalysts in a nascent market. In mature markets with well-functioning providers and the necessary regulation, the facilitator's focus may be to catalyze innovation, to improve market efficiency, or to extend the reach of the existing providers.

In nascent markets, where there may be only relatively few financial service providers with capacity to serve low-income segments, facilitation may focus on providing information on the market size and potential to stakeholders, catalyzing new firms to enter the space, and educating policy makers on the importance of financial inclusion and how it may be supported through enabling regulation. However, in any market, facilitators should engage in specific temporary activities to build capacity and catalyze market actors and thereby bring about permanent change in a market—i.e., so that services can be provided sustainably in the long term. Facilitators can provide subsidies directly and can coordinate with donors and DFIs to provide such subsidy in the form of a grant, direct technical assistance, in-kind donation, or subsidized debt to support sustainable financial services for the poor. The most successful examples of country-level facilitation have mainly been through multidonor-funded facilitators (see Box 1).

### Box 1: Financial Sector Deepening Trust—Kenya at the Heart of Financial Inclusion Progress

The Financial Sector Deepening Trust—Kenya (FSD—Kenya) is a facilitator for financial sector development at the country level. It was established in January 2005 as an independent trust managed by KPMG and initially funded by DFID. Since its creation, FSD—Kenya has received funding from AFD, the Bill & Melinda Gates Foundation, SIDA, and the World Bank. Its multidonor structure, which places the donors on a project investment committee, allows for donor coordination at an operational level.

As of 2012, FSD—Kenya had supported over 55 projects: four at the macro level, 17 at the meso level, and 34 at the retail level, including support to MicroSave and M-PESA. A recent evaluation by Oxford Policy Management (Arora, Roe, and Stone 2012), which aimed to quantify the value that FSD—Kenya has brought to the British tax payer, found certain

remarkable increases in financial access (as measured by the number of commercial bank accounts and the number of money transfers per month)—noting that it is difficult to attribute the changes to any one actor. Formal financial inclusion, as measured by FinAccess, has increased from 26.5 percent in 2006 to 40.5 percent in 2009.<sup>a</sup> The number and penetration of bank accounts has increased substantially (from 2.5 million in 2005 to 12.8 million in 2010), money transfers are at much lower costs and at much higher volumes (30 million transactions per month as of July 2011), and there are lower risks associated with savings and credit cooperative failures.

Source Arora, Roe, and Stone (2012).

a. Defined by FinAccess as access to financial services provided by a bank, PostBank, insurance product, or nonbank financial institution.

### Who can act as a facilitator?

A facilitator can be a for-profit firm, an NGO, a special purpose vehicle (i.e., a legal entity formed specifically for the purpose of facilitating market development work), a donor, or a DFI. A government agency can also theoretically act as a facilitator, although there is a risk that political pressures will inappropriately influence its work. Depending on the market that is being addressed, a facilitator can be global (such as CGAP whose role is to facilitate global knowledge on financial inclusion), regional (such as FSD—Africa whose role is to make technical capacity more accessible to country-level facilitators), or local (such as FinMark Trust).

Although donors can be facilitators, most donors do not have the attributes of successful facilitators. Donors often have limited staff capacity to operate at the market level. Most donors have strict administrative and operational budgets, and staff are required to manage large (often multi-country) portfolios, making it impossible to operate close to the “pulse” of the market. Many donors use loans to governments as their primary funding instrument, limiting their ability to direct the ultimate use of funds. For many donors, selecting and working with strong facilitators is the most appropriate way to ensure funding is additional. The selection of which entity will serve this critical function is based on

many factors, including the political economy in the country, the existing actors on the ground, and the donors involved. In some countries, donors have come together to create special purpose vehicles to serve as facilitators. Some existing institutions, such as NGOs or firms, may be able to serve the function of facilitator, as long as they meet the independence and local presence criteria. However, some donors will not be able to fund facilitators directly (due to internal institutional requirements) and must look for ways to collaborate and work alongside facilitators to leverage market knowledge and increase the likelihood that funding is catalytic.

DFIs also can be facilitators but their main activity—investing in the market—presents a challenge to the “independence” criterion. A DFI’s principal role is to invest in a market when there is an absence of investors due to perceived or real risks. A main objective of such investments is to catalyze private financial market development, although DFIs also engage in information-gathering, capacity-building, and advocating for an improved enabling environment. Regardless of whether a DFI acts as a facilitator, a market development approach would mean following similar principles as those applied to facilitators:

- Base their investment decisions first and foremost on the needs of the market as opposed to the instruments they possess or their menu of products.

- Use temporary interventions, ensuring that their actions catalyze other actors in the market and do not distort the market. This would require thinking about a responsible exit at entry and putting in place benchmarks or identifying market signals as to when exit is necessary.
- Ensure sustainable delivery of service beyond the period of support/investment. This may involve supporting capacity-building services.
- Coordinate with facilitators and donors.

The story of Country A and Country B (described at the start of this paper) illustrates the importance of an independent facilitator. In Country A, the donor community created an independent trust and, although the government and supporting donors have guided its work, the trust has retained an independent status and profile. This model has now been used in numerous countries in Africa with the establishment of special purpose vehicles.<sup>5</sup> As evidenced from emerging results on financial access in Kenya, FSDs have the potential to catalyze market development in a way that few if any traditional donor projects have done thus far.

In Country B, the donor community works through a government-owned apex institution, which is sometimes mistakenly thought to be a facilitator. Most apexes have direct political intervention through their governing structures, and the one in Country B is no exception: the apex reports directly to the Prime Minister's Office. CGAP's research on apex institutions has shown that in only a very few cases do apexes address challenges beyond direct financing of financial service providers (Forster, Duflos, and Rosenberg 2012). Few apex institutions have been able to evolve their strategies and roles to meet other market needs such as research, capacity building, or advocacy. Primarily this is due to their institutional design, which focuses on refinancing, and their governance, which is highly politicized.

## Priorities in Financial Market Development

While there are many different kinds of projects that facilitate change in financial markets toward inclusion, in most markets, the following areas should be prioritized:

1. **Information.** Improve the scope and accuracy of information and its availability and accessibility to market actors so that they can better serve their function.
2. **Capacity Building.** Build the capacity of market actors (providers, consumers, regulators, and others) to deliver services and/or engage in necessary or new activities.
3. **Incentives and Enabling Environment.** Offer incentives to market actors to provide and/or support financial services to the poor and support the development of a legal and regulatory framework that advances financial inclusion.

The following subsections illustrate possible approaches a facilitator might take based on its analysis and critical understanding of the market.

### **Information**

Information plays an important role in all markets at different levels: the core (demand-supply) exchange, market infrastructure, policymaking, and rulemaking. A well-functioning financial system will produce and process information that promotes (i) the efficient allocation of capital to firms that provide needed and desired products and services to consumers, including the poor, and (ii) effective regulation and supervision of such firms, their products, and their services. As described below, the lack of information and unequal access to information (when comparing consumers with providers) is a particular problem in financial markets. This section discusses how information is important to the different market actors and suggests possible approaches to improve the availability, accuracy, and accessibility of information.

<sup>5</sup> The following countries have special purpose vehicles (SPVs): Kenya, Nigeria, Rwanda, Tanzania, and Zambia. Country-level SPVs are in development in Mozambique and Malawi. There is also a regional facilitator: FSD Africa.

For the **core (demand-supply) exchange**, information plays a particularly critical role in financial markets due in large part to the intangible nature of the product in advance of the purchase. Information enables consumers to understand the providers and their various products and services and to assess their value and pricing. It helps service providers to understand consumers and their needs. And it enables both consumers and providers to understand their respective rights and responsibilities. However, consumers—and in particular, the financially excluded who may have no experience using formal financial services—often have little or no information about the providers and their products and may therefore not appreciate the risks or benefits of formal financial services. Improving consumer access to relevant information can be facilitated through the support of associations that provide financial capability training as well as consumer protection rules on disclosure and transparency. Facilitators can also advocate for and support the development of consumer protection measures, such as rules requiring clear and simple marketing and descriptions of products and transparency requirements for marketing by financial service providers.

On the supply side, except for institutions established specifically to serve the poor, most financial service providers do not understand and appreciate the specific financial service needs of the poor or the risks and costs of serving them, making it difficult to satisfy demand. Data on poor and low-income clients can be helpful in quantifying the potential demand (see Box 2). Once convinced of the significance of the business case of particular client segments, many providers require deeper information on the specific segments they seek to serve. Additional market research—qualitative or quantitative—can provide financial service providers with the information they need to improve product design and adapt business models to better serve these segments. A facilitator such as FinMark Trust can fund broad market studies that can inform providers of the potential market size and pique interest in particular segments. A facilitator could also support other efforts to strengthen information on consumers, such as establishing a credit information market that captures data on poor

consumers or researching particular segments or market trends.

In addition, providers as well as funders, regulators, and other policy makers, need information on other providers for competition and benchmarking purposes. This type of data is provided locally, regionally, and internationally by industry associations and other providers, such as MIX. Facilitators can improve such industry information by supporting these associations to collect and make this market information available. In designing the intervention to support improved information, facilitators need to think about the long-term sustainability of the information service and how the data will be collected and maintained beyond the temporary support provided by the facilitator.

Effective **policy-making** and **rule-making** depends on information on all aspects of the market: its participants, products and services, and market dynamics. With respect to financial services for the poor, policy makers often have a limited understanding of the demand side—due in part to the lack of historical data as well as low prioritization of the poor as financial service consumers. Policy makers can benefit from the same studies and information as providers. Regulators also generally have a limited understanding of the particularities of the financial products and services that the poor need and use, especially when they are provided by new and/or unregulated providers. Regulators benefit from data provided by facilitators (such as CGAP and the Alliance for Financial Inclusion [AFI]), researchers, global policy makers, as well as the other sources referred to above (MIX, industry associations).

There are several recent and significant initiatives to gather national-level data on financial inclusion that enable cross-country comparison: the International Monetary Fund's Financial Access Survey, which gathers supply-side data; the World Bank's Global Financial Inclusion Database (Global Findex), which measures how the poor, women, and rural residents in 148 countries save, borrow, make payments, and manage risk; the World Bank's Enterprise Surveys, firm-level data on 135

## Box 2. FinScope: A Tool to Improve Information on Consumers

Many countries have found that sound information on consumers can help to inform policy makers and providers about the market size and potential demand of low-income consumers. Providers can also use consumer information to design and adapt their service delivery to meet the needs of different market segments. South Africa's FinMark Trust, like the facilitator in Country A, found that information on consumers was a critical input to the market facilitation process.

In its first year of operation, FinMark Trust<sup>a</sup> initiated the FinScope program to gather national data in South Africa on consumer demand for four types of financial services: transactions, savings, credit, and insurance. FinScope's goal is to help change the long-term landscape of the financial system by supplying market information to providers, policy makers, and regulators.

The heart of FinScope's work—which has now reached 15 African countries plus Pakistan—is its national surveys on consumers' and business owners' perceptions on financial services and issues. The survey aims to create insights into how

consumers source their income and manage their financial lives. Its sample covers the entire adult population, rich and poor, urban and rural, to create a segmentation, or continuum, of the entire market and to lend perspective to the various market segments. FinScope explores consumers' usage of informal as well as formal products and builds a picture of the role that each sector can play in the financial markets of developing countries. The surveys also look at attitudes, behavior, quality-of-life factors, and consumption patterns.

The specifics of studies and dissemination strategies are determined differently in each country. For example, in Uganda, the studies are coordinated by a Steering Committee made up of the Bank of Uganda; the Ministry of Finance, Planning and Economic Development; donors; and key financial institutions.

Sources: FinScope.co.za

a. FinMark Trust is an independent trust that acts as a market development facilitator. Established in 2002, it is funded primarily by the United Kingdom's Department for International Development (DFID).

emerging markets and developing economies gathered from surveys of representative samples of an economy's private sector; and the G-20's Basic Set of Indicators, which draws on AFI's Core Set of Financial Inclusion Indicators. To enable informed policy action, these databases seek to gather information on both access *and* use of financial services by the poor and financially excluded. Although they are useful to market development, to date, they have not yet measured the *quality* of financial services (e.g., value proposition, safety, or other consumer protection considerations); however, there are plans to move in that direction.

### Capacity Building

The lack of capacity is often a bottleneck for many actors in the financial system, including providers, consumers, and regulators. Lack of capacity manifests in many ways: consumers may not understand the benefits or risks of different financial products and services; providers may not have the staff capacity to design and develop products relevant for poor segments; and regulators may not have the capacity to regulate and supervise

new innovations that serve the poor or the types of institutions that serve them.

Poor and low-income **consumers** may not have the ability to assess or judge financial services and are thus more vulnerable to manipulation. Consumer capability work should typically be viewed as a good or service requiring subsidy. Experiments with consumer capability services have included financial capability as part of school curricula, embedding financial capability training into mainstream television shows (such as soap operas), and mandating that providers integrate some elements of consumer education into the delivery of their services. A facilitator would need to work with regulators, consumer advocacy groups, and researchers to determine the best approach. Is reforming school curricula a possibility? Are consumers more influenced by "info-tainment"? Are provider incentives appropriately aligned?

**Providers** need support to develop their own internal capacity to design and deliver products and services for the low-income consumer. Facilitators

can help providers to better understand the market segment through product development. Facilitators can fund providers that show the most willingness to serve these segments with direct technical assistance on marketing, pricing, and distribution of services to low-income segments. In all cases, the facilitator will need to be careful to limit (in time and funding) the subsidized technical assistance so that the providers have the right incentives to develop an appropriate business model that can ensure sustainability of service beyond the support from the facilitator. When working with individual providers, facilitators aim to demonstrate the market viability of a particular model or product in the hope that other market actors enter the market (See Box 3).

Beyond working directly with individual providers to enhance capacity, facilitators can support and promote the development of sustainable markets for affordable capacity-building services. This approach is preferred when there is sufficient interest by providers for these services and there is potential for providers to pay for these services themselves. Facilitators would first identify viable capacity-building organizations, which may include private training institutes, consulting firms (local, regional, global), banking associations, microfinance associations or networks, training divisions within central banks, training units of commercial banks, universities, nonprofit

organizations, and apex institutions that offer training and capacity-building services. The next step is to assess the ability of these organizations to address the capacity-building constraints identified in the financial market system, with the facilitator providing support where necessary.

Capacity can also be a constraint for other market actors, such as credit bureaus or collateral registries. The facilitator can support their capacity to expand their scope to include information on poor consumers. It can also help the service provider price and design products that are adapted to the financial services firms that reach the poor. For example, the transaction cost per inquiry for an MFI would need to be significantly lower than that for banks given the much smaller loan sizes and much larger number of transactions a typical MFI would process in any given month.

With increasingly more complex financial products and technology, **regulators** must keep abreast of market developments (and the different risks introduced thereby) and adjust and upgrade their regulations and their supervisory policies and techniques. With a global financial system heavily focused on stability and integrity, many regulators do not fully understand how to regulate and supervise the financial service providers that serve poor and low-income people (such as financial cooperatives, depositary MFIs, postal banks, and new providers and approaches such as MNOs and bank agents) or the products that may be best positioned to serve them (such as e-money). Facilitators can fund interventions aimed at increasing a regulator's capacity to regulate and supervise providers that serve poor consumers. Interventions may include peer exchange, site visits, training, direct technical assistance, or some combination thereof.

#### ***Incentives and Enabling Environment***

Incentives guide choices and behavior. Incentives can be explicit—i.e., they are offered as a reward for accomplishing certain goals or targets. For example, some governments have offered matching savings to encourage parents to open up savings accounts and to save for their children's future. Incentives may also be implicit—i.e., the market or a provider may reward certain behavior

#### **Box 3: From Demonstration to Market Outcome**

When supporting one or more providers directly, facilitators are often demonstrating to the market the possibility of providing certain (new) products or services or delivering products and services via a new channel or method. The ultimate objective is that other providers will learn from the demonstration and copy. In some cases, this can be accomplished without a directed knowledge transfer from one provider to the next. In other cases, the facilitator may need to explicitly direct or require such a transfer. For example, when working with mobile operators, CGAP (with funding from the Bill & Melinda Gates Foundation, DFID and The MasterCard Foundation) has an explicit agreement with providers that knowledge products will be generated (and often shared publicly) as a result of the collaboration.

or choices, such as bundling of products for a lower aggregate price.

Incentives for **providers** to serve the poor can be used to reduce risk—perceived and actual, to reduce costs for serving these clients, and to promote innovations to serve them. Incentives for providers should be designed (i) to support initiatives that would not otherwise be undertaken or to accelerate initiatives as opposed to providing funding to organizations and companies that already have the intention to take a certain action and (ii) to promote sustainable change as opposed to temporary action or reaction to subsidy. Incentives for first movers can reduce the perceived risks of innovation (e.g., research and development costs). Financial incentives may be useful, but often funding is not the most limiting constraint. Technical know-how, networks, and information on different client segments can help to allay some of the concerns private providers have with respect to serving poor consumers (Koning and McKee 2011).

At the **consumer** level, emerging evidence from behavioral economics shows that consumer choices are not always based on rational behavior. In some cases, notwithstanding access to relevant information, consumers may choose to do nothing rather than take action to improve their financial situations. However, consumers can be nudged to behave a certain way that is beneficial if incentives are designed appropriately.

**Regulators** are typically inclined to focus on the needs of banks and other large financial institutions and their clients as opposed to small institutions and poor customers.<sup>6</sup> This often results in inappropriate regulatory requirements for MFIs, nonbank financial institutions, and banks serving the poor. In contrast, properly designed regulation (e.g., adjusted capital requirements and a risk-based approach to anti-money laundering

regulation) can eliminate unnecessary barriers and provide incentives to firms to provide financial services to the poor. To encourage and enable this, facilitators can provide support to regulators to raise their awareness of financial inclusion issues and the approaches that are being taken to craft proportionate regulation and supervision.<sup>7</sup> This may include adjusting capital requirements and other prudential regulations for nonbank deposit-taking institutions, crafting a risk-based approach to anti-money laundering that increases the promotion and use of simplified bank accounts, enabling banks to use agents, or providing a clear legal framework for nonprofit MFIs to transform into for-profit entities. Support of an enabling environment also includes encouraging robust consumer protection, including effective enforcement.

Policy and regulatory incentives can have a positive impact on financial market development. Solutions to encourage the adoption of such incentives require strong awareness and understanding of a country's political economy. Ultimately, modifying incentives often confronts entrenched power dynamics within a society. For example, altering regulatory incentives to encourage new entrants or to incentivize new business delivery channels to support “creative destruction” can be viewed as a threat to the entrenched businesses that serve the existing market.

## Measuring Development of Financial Markets

Donors need to be able to report on the measurable changes they are making on the ground with their scarce development funds. As a result of many years of external pressure to improve accountability, many donors have worked on improving their internal measurement systems to capture data on direct outputs and outcomes of their interventions.<sup>8</sup> Increasingly, many are

6 This focus is often the result of mandated regulatory objectives, such as stability of the financial system, economic growth, and financial integrity, and the lack of any explicit mandate to increase financial inclusion.

7 In the past several years, significant work that has been done on this front with global standard-setting bodies (CGAP 2011).

8 This measurement issue is of interest to donors well beyond their needs in financial market systems: it is pertinent to all of their interventions, regardless of sector. Despite the attention on measurement of results at the highest political levels, the development community at large has not yet made significant progress on the measurement front. There is today considerable discussion and disagreement on what constitutes credible evidence for measuring development outcomes and impacts. [0]

also funding impact studies to try to assess the effects of their interventions. Yet, using a market development approach presents a measurement challenge to facilitators and their donors. Systemic change is a nonlinear process that involves multiple interconnections and a dynamic environment.

Traditional monitoring and evaluation techniques, including new efforts to measure impacts through randomized trials, are not well-suited to capture changes at the market level. To determine attribution credibly, evaluations use control groups to create a counterfactual scenario (what would have happened without the intervention). Only interventions that can be controlled in this way can be used in this type of evaluation design. An intervention that aims to influence the market as a whole, beyond a specific entity or group of individuals, cannot be measured effectively this way.

Because of these very real limitations, measuring progress in financial market systems requires that we think beyond a narrow definition of attribution to one that focuses on donor *contributions* toward change. We can then estimate or develop proxy measures for identifying the approximate contribution that any one donor is making to this change.

Since 2008, the Donor Committee for Enterprise Development (DCED) has been working with its members on measuring market systems and has recently developed the DCED Standard for measuring and reporting on results.<sup>9</sup> At the forefront of the Standard is the articulation of a theory of change. By being clear about the theory of change, donors can be explicit about their assumptions and the logic and sequencing of expected changes. This helps put in place a clear framework against which measurement systems can be developed.

The DCED Standard outlines several important elements for measuring and reporting. First, the process of measurement involves both monitoring and evaluation. Establishing credible indicators that are aligned with the theory of change and that are measured over time, through both monitoring and evaluation systems, allows donors and programs

to assess progress and adapt their interventions accordingly. This cycle of learning and adaptation is critical; without it, programs fall prey to linear thinking, pursuing an objective that may no longer be valid.

Second, this measurement process is essentially an educated method for approximating progress. It is not precise and arguably precision would be the wrong goal. Instead, donors and their partners must use triangulation methods to validate estimated progress.

Finally, it may be necessary to use a variety of methods, both qualitative and quantitative, to measure progress. In some instances, even experimental impact evaluation may be possible as an evaluation method, but fundamentally the broader goal of measuring results in line with the theory of change is the overarching goal. It is not the use of any specific method that should drive the measurement process.

## Conclusion

There is increasing awareness among donors and DFIs that building *sustainable markets* that serve the poor requires focus beyond institution building to the financial system as a whole. While this has been understood in theory for quite some time, we have only recently begun to see examples of donors and DFIs working in coordination and in response to market dynamics. In the more successful cases, they have done such market building through the use of independent facilitators.

For facilitation to be effective, it requires independent facilitator(s) that can use light-touch interventions (e.g., research) to catalyze market action. Market development occurs through a variety of inter-related ways: by encouraging change in behavior through capacity building; by helping market actors to take more informed decisions through access to better and timely information; and by incentivizing innovation through better-informed risk assessment and creation of a favorable enabling environment.

<sup>9</sup> <http://www.enterprise-development.org/page/measuring-and-reporting-results>

Donors and DFIs can themselves be facilitators but often they do not have the qualities it takes to do market facilitation. Instead, donors and DFIs typically fund and work through facilitators. The identity and form of the facilitator and the specific catalysts used will depend on the particulars of the market, the political economy in the country, and the donors involved in financial inclusion efforts.

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