

Financial Services for the Poor

A strategy for the Australian aid program 2010-15

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These icons symbolise the Millennium Development Goals (MDGs)—eight goals representing an agreement by world leaders to reduce poverty and enhance human development by 2015. More information about the MDGs is available online at www.ausaid.gov.au/keyaid/mdg.cfm

Ministerial Foreword

In a world driven by the cash economy and international flows of capital, the majority of poor people still remain excluded from financial services. There are as many as 2.7 billion adults in developing countries – or almost three quarters of the adult population – who still do not have access to banking services.

For the poor, this exclusion exacerbates the challenges of living on very low incomes. Their inability to borrow or save money makes finding a way out of poverty even more difficult.

Australia has long supported microfinance initiatives and is committed to broadening its focus on access to financial services to further break down the barriers to economic participation by the poor.

By increasing consumer access to deposits and lending, payment and transfer services and insurance, Australia is helping poor people have access to opportunities which have the potential to transform their lives. Through financial services, poor people can set up small businesses, insure against crop losses, and save in case of illness or disaster. Over two-thirds of clients around the world are women, who are empowered and then invest more heavily in their household than men.

This Strategy presents a considered framework to improve poor people's access to financial services. Over the next few years Australia will double spending on financial services for poor people.

The Strategy builds on the lessons Australia and others in the international community have learnt. We know that one size does not fit all and we tailor our efforts to the region and context in which we are working.

From training women entrepreneurs in Peru to building the capacity of financial institutions to serve poor people in Afghanistan, Australia will be doing more to expand financial services across the world, including in the Pacific, West Asia, Latin America, the Caribbean, and Africa. As one example, Australia will also support the Indonesian Government's efforts to encourage more professional and sustainable financial services to the poor.

Australia will build the capacity of financial institutions to offer quality, affordable and fair financial services to the poor and assist governments to create an enabling policy and regulatory environment. And we will support financial literacy programs to help clients understand their finances and the services offered to them to make informed decisions for their future.

For the poorest of the poor, who often have no stable cash flow, access to credit may only increase their indebtedness and vulnerability. In these instances, services such as training, access to productive assets such as cows or goats, or cash transfers may be more appropriate until they are able to generate a more sustainable livelihood.

New technology is creating opportunities to transform the financial services industry. Mobile phones and branchless banking allow even remote and rural communities to access services securely, quickly and cheaply. These technologies have been piloted in several countries, including the Pacific where remittances represent a significant proportion of many countries' Gross Domestic Product. In Vanuatu, Australia is supporting the National Bank of Vanuatu to establish a satellite communications network powered by renewable energy that will bring rural branches online and allow them to provide full services to their communities.

We are also working with the international community and drawing on their experience and expertise. Australia remains a long-standing member of the Consultative Group to Assist the Poor and, with Brazil, co-chairs one of two sub-groups undertaking work under the auspices of the G20 Financial Inclusion Experts Group.

All of this alone will still not solve the complex causes of poverty. However, in the right settings access to financial services can help some of the most disadvantaged and marginalised people improve their standard of living and achieve their dreams.

Stephen Smith
Minister for Foreign Affairs

Bob McMullan
Parliamentary Secretary for International Development Assistance

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Executive summary

Financial Services for the Poor: A strategy for the Australian aid program 2010-2015 provides a coherent framework to guide the Australian Government in achieving its goal of increasing access to financial services in developing countries. The document reflects the Government's increased commitment to expand financial service provision in order to reach those people previously excluded or underserved.

Financial services are increasingly being seen as important to poverty reduction and achievement of the Millennium Development Goals. By borrowing, saving or buying insurance the poor can plan for their future beyond the short term. They can build up assets and invest in education and health. Financial services can help them cope in times of need and hardship. Beyond this, access to financial services can promote social inclusion and build self-confidence and empowerment, in particular among women.

While significant progress has been made in expanding access to financial services by the poor, there is still more to be done. It is estimated that more than 2.7 billion people in developing countries – the majority of adults – are still excluded from the financial services market.

The overarching goal of the Australian Government is to increase access to financial services by the poor in developing countries. In order to achieve this goal we will pursue the following outcomes:

- Outcome 1: A policy and regulatory environment that allows institutions offering financial services to the poor to enter the market and grow
- Outcome 2: Financial service providers and infrastructure that have the capacity to provide high quality financial services to the poor
- Outcome 3: Innovative models of financial service provision that are used effectively to extend outreach to underserved regions and groups
- Outcome 4: Increased capacity of clients to understand and utilise financial services effectively.

The Strategy recognises the multiple layers involved with building financial systems that serve the poor. It focuses simultaneously on building the capacity of governments to regulate appropriately, on building the capacity of financial institutions to deliver services fairly and in response to demand, and on ensuring that the client is both protected from abusive or unethical practices and well informed about his or her rights and responsibilities.

The Strategy draws on the experience of a multitude of actors to establish guiding principles for engagement in the sector. Emphasis is placed on the Australian Government playing a complementary role to private investors in the financial sector, encouraging delivery of a range of financial services, striving for sustainability, advocating the reporting of social and financial performance and utilising financial service provision to pursue gender-specific objectives.

The Government's performance against Strategy outcomes, and adherence to the guiding principles articulated, will be measured at the mid-point of the Strategy's cycle. Key findings will be disseminated to stakeholders and partners in the region to inform future decision making in the sector.

Development challenge

Despite progress in many countries, poverty remains a very real global problem. The World Bank estimates that more than 2.5 billion people were living below the international poverty line of US\$2 a day in 2005.¹ In addition to having low incomes that are inadequate for maintaining a decent standard of living, poor people suffer from illiteracy, malnutrition, food insecurity, illness, vulnerability to external shocks, powerlessness and social exclusion. Women, children and people with a disability are disproportionately affected.

For many poor people, finding a way out of poverty is limited by their inability to borrow or save money. Financial services have failed to adequately reach poorer populations for a number of reasons, including: inadequate infrastructure; perceptions that lending to the poor is too risky to be commercially viable; inhibiting regulatory and legal environments; and limited understanding and awareness of financial services by the poor.

Financial inclusion, microfinance and microcredit – what are they and how do they differ?

The expansion, through development assistance or other means, of a range of financial services to poor or disadvantaged people previously unable to gain access, is commonly known as **'financial inclusion'** and is increasingly being seen as important to poverty reduction and achievement of the Millennium Development Goals (see also page 8). By borrowing, saving or buying insurance the poor can plan for their future beyond the short term. They can build up assets and invest in education and health. Financial services can help them cope in times of need and hardship. Beyond these very tangible impacts, access to financial services promotes social inclusion and builds self-confidence and empowerment.

The United Nations defines the goals of financial inclusion as follows:

- access at a reasonable cost for all households to a full range of financial services, including savings or deposit services, payment and transfer services, credit and insurance
- sound and safe institutions governed by clear regulation and industry performance standards
- financial and institutional sustainability, to ensure continuity and certainty of investment
- competition to ensure choice and affordability for clients.²

The concept of financial inclusion is evolving and builds on the ideas of microcredit and microfinance. **Microcredit** is the provision of small loans to poor people to assist them to develop small-scale businesses ('micro-enterprises') to address poverty and exclusion. **Microfinance** is the provision of a wider array of financial services including savings and deposit services, payments and transfer services, credit and insurance products.

Today it is estimated that over 150 million poor people have access to collateral-free loans. However, there are still large segments of the world population that are excluded from the financial services market. A recent study conducted by the Consultative Group to Assist the Poor (CGAP) suggests there may be as many as 2.7 billion unbanked adults in the developing world, equivalent to 72 per cent of the adult population.³

The microfinance industry has seen fundamental transformations in recent years. The industry has moved away from 'one size fits all' modes of service delivery towards models that are more targeted towards meeting the varied demands of the poor. New regions are gaining access to financial services, including those with difficult-to-reach populations and post-conflict areas. New technology has improved the potential for financial services to reach the poor on a sustainable basis. Yet there is still more to be done before the financial services industry realises its true potential. While the private sector is expanding its engagement, and developing country organisations and institutions are increasingly contributing to the microfinance sector, donors can and should play a catalytic role in the development of the sector.

¹ Chen Shaohua & Martin Ravallion, *The Developing World Is Poorer than we Thought, but No Less Successful in the Fight against Poverty*, Policy Research Working Paper No. 4703, World Bank, Washington, DC, 2008.

² United Nations Capital Development Fund, *Building Inclusive Financial Sectors for Development*, United Nations, New York, 2006.

³ CGAP, *Financial Access 2009: Measuring Access to Financial Services Around the World*, Consultative Group to Assist the Poor, the World Bank, Washington, 2009.

This Strategy provides a coherent framework to guide the Australian Government in achieving its goal of increasing financial services to the poor in developing countries.

Financial services and the Millennium Development Goals	
Through careful and context-specific implementation, financial services can make an important contribution to achieving the Millennium Development Goals (MDGs).	
MDG	How can financial services help achieve these goals?
Eradicate extreme hunger and poverty	By borrowing, saving and purchasing insurance, the poor can build and diversify income sources, invest in assets and reduce their vulnerability. When shocks hit - such as a natural disaster, a sudden rise in prices or illness within the household - the poor can use microfinance products to smooth consumption and curb the seasonal, short-term and intergenerational effects of shocks. Furthermore, by using financial services to invest in business opportunities, the poor often have more stable income flows, reducing the incidence and impact of shocks.
Achieve universal primary education	Evidence indicates that households with access to financial services are more likely to send their children to school and those children are more likely to stay in school longer. Improvements in income and better access to credit, savings and insurance services can reduce the need to rely on children as labourers.
Promote gender equality and empower women	Microfinance clients are overwhelmingly female, and it is widely recognised that access to financial services contributes to women's empowerment. Microfinance can help to build women's self-confidence and assertiveness, often resulting in women obtaining greater decision-making power, control over assets, and mobility within both the household and the broader community.
Reduce child mortality, improve maternal health and combat HIV/AIDs, malaria and other diseases	Increased access to financial services can lead to improved nutrition, housing and health. It can provide mechanisms, such as micro-insurance for the poor to deal with sickness when it occurs. Moreover, in some instances microfinance is delivered in conjunction with health education programs, often creating greater awareness of health issues and methods to prevent and mitigate illness. This too has the potential to improve health outcomes and contribute to the achievement of health related MDGs.
Ensure environmental sustainability	Financial services can be used to promote environmentally sustainable business and household practices. The provision of microcredit to purchase sustainable energy products, for example solar powered lamps, is becoming more widespread. With considerable amounts of microcredit being provided for agricultural purposes, there is scope for financial service providers to take a lead in advocating environmentally sustainable farming practices.

The Australian Government and financial inclusion: some success stories

The Pacific

Estimates of access to financial services in the Pacific and Papua New Guinea vary but at best only 20 per cent of the population in the region have access to financial services. This is substantially lower than in most other regions. Moreover, with small and highly dispersed populations, weak infrastructure, low levels of formal enterprise, outdated financial regulations and low levels of financial literacy, the Pacific is a challenging market to serve on a sustainable basis.

To further understand and address the challenges the Pacific faces in terms of delivery of financial services, the Australian Government has supported the development of **Microfinance Pasifika**. Microfinance Pasifika is a regional network of non-government organisations (NGOs), microfinance institutions, commercial banks and support and training organisations which acts as a regional information hub for members to improve and build the microfinance industry regionally.

Past experience in the Pacific has shown that it is not always possible to replicate traditional microfinance models that originated in South Asia, and practitioners are now exploring alternative models of financial service delivery. Since 2002 the Australian Government, in partnership with the Asian Development Bank, has been working to assist the Government of Papua New Guinea to expand the provision of microfinance through the **Papua New Guinea Microfinance and Employment Project**. The project has successfully linked 35 small village-based providers with formal microfinance institutions to expand outreach and formalise the sector. Training in market research, product development and product costing was provided to 12 microfinance institutions, resulting in more refined, demand-driven products. The project has contributed to a significant increase in the number of people making deposits, which grew from 45 000 in 2002 to almost 312 000 in 2008, offering many Papua New Guineans a safe place to save for the first time.

In 2008 **remittances** to the Pacific were worth US\$446 million and represent a substantial proportion of the Gross Domestic Product (GDP) in many countries. For example, remittances in Tonga were equivalent to over 39 per cent of GDP in 2007, and remittances in Samoa more than 22 per cent. However, due to low competition and high cost structures, money transfer costs in the Pacific are among the highest in the world, at around 15–20 per cent of the amount transferred, compared with the global average of around 10 per cent. The Australian and New Zealand Governments have developed a joint initiative, **Reducing the Cost of Remittances to the Pacific**, to assist Pacific Islanders based in Australia and New Zealand to transfer money to Pacific Islands. The initiative provides web-based information and advice on the different options for and costs of remitting funds to the Pacific.

Vietnam

Between 2001 and 2008, the Australian Government supported the **Capital Aid Fund for Employment of the Poor (CEP)** in Vietnam. The program supported the availability of credit and the development of a demonstration model for a sustainable Vietnamese microfinance institution. The program extended its outreach to 50 000 new clients and at the conclusion of the project CEP was considered a strong and operationally sustainable institution by both the CGAP (see page 16) and internationally recognised ratings agencies. Beneficiaries of the program were found to have improved standards of living and greater control over the factors that determine their access to income, nutrition levels, access to drinking water and the ability of children to attend school on a regular basis. CEP is one of the Australian Government's most successful interventions in the area of microfinance.

Afghanistan

In post-conflict and conflict environments microfinance can offer mechanisms to stabilise livelihoods, stimulate economic development, finance reconstruction and facilitate renewed remittance flows. Since 2003 the Australian Government has provided \$9.25 million to the **Microfinance Investment and Support Facility for Afghanistan (MISFA)**, initiated by CGAP. MISFA is a limited liability company fully owned by Afghanistan's Ministry of Finance, which receives funding from the Government of Afghanistan, the World Bank, bilateral development agencies (including those of the United States, Canada, United Kingdom and Sweden), Oxfam-novib, and the Embassies of the Netherlands, Denmark and Finland. MISFA has fostered the development of microfinance in Afghanistan by providing grants and loans to microfinance institutions and banks offering financial services for the poor, and staff and institutional capacity development. The program now covers 72 per cent of provinces. Since its inception more than 1.4 million loans have been disbursed and there are over 445 000 active borrowers, 62 per cent of whom are female.

Bangladesh

Between 2002 and 2008 the Australian Government supported BRAC, the largest NGO in Bangladesh, to expand into the north-western districts of Bangladesh, considered to be the country's poorest area. At the conclusion of the program BRAC had more than 52 000 clients in the region and substantial capital to enable further lending. A 2007 study of the project's impact found

economic improvement and greater financial resilience, increases in off-farm business, improved status of women, and reduced domestic violence among clients.

The Australian Government is now supporting BRAC to target the poorest of the poor through its innovative and highly effective Challenging the Frontiers of Poverty Reduction program. Recognising that microfinance may not be appropriate or viable for the poorest of the poor, the program provides them with productive assets such as cows or goats, intensive training to ensure successful generation of income from these assets, and in some instances a regular cash transfer until their new small business creates a stable livelihood. Components to improve access to finance are integrated into

Strategy

Goal

The goal of the Australian Government's Financial Services for the Poor Strategy is to increase access to financial services by the poor in developing countries.

Outcomes

The Australian Government will pursue the following outcomes in line with the overarching goal of the Strategy. These outcomes recognise the many layers involved in providing effective financial services to the poor.

Outcome 1: A policy and regulatory environment that allows institutions offering financial services to the poor to enter the market and grow

Outcome 2: Financial service providers and infrastructure that have the capacity to provide high quality financial services to the poor

Outcome 3: Innovative models of financial service provision that are used effectively to extend outreach to underserved regions and groups

Outcome 4: Increased capacity of clients to understand and utilise financial services effectively.

These outcomes are elaborated on below, and will be pursued consistently with the guiding principles and the priorities for implementation set out in this Strategy.

Outcome 1: A policy and regulatory environment that allows institutions offering financial services to the poor to enter the market and grow

An enabling policy environment and supportive legal and regulatory framework are essential for sustainable growth of financial services for the poor. However, the provision of financial services to the poor is impeded by the policy, legal and regulatory barriers that continue to exist in many countries.

Governments play a crucial role in creating a policy environment that facilitates the expansion of financial services while also protecting consumers against predatory service providers. Effective policy should encourage the provision of a range of financial products, foster competition among service providers, minimise barriers of entry into the market for a range of institutional players (beyond just conventional microfinance institutions), encourage effective interest rate disclosure and support the adoption of new technology.

The pace of microfinance growth can be closely linked to a supporting regulatory environment. For instance, in countries with interest rate restrictions on microfinance, such as China, India and Vietnam, the expansion of services has lagged behind those with no such restrictions. In countries where interest rate ceilings were absent or were removed early, such as Bolivia, Cambodia, Indonesia and Mongolia, industry growth has been impressive.

The Australian Government is committed to addressing policy, legal and regulatory constraints inhibiting the development of inclusive financial services. Governments need to be supported to create effective, appropriate and efficient oversight mechanisms to protect both clients and the broader financial system and promote growth in the sector and product range. This is a challenge requiring careful contextual analysis of each regulatory environment and the Australian Government's assistance will depend on the context and the priorities within each partner country.

Recognising the large number of actors with strong technical expertise in policy and regulatory reform, the Australian Government will seek to partner with others working in the area when appropriate.

Where possible, the Australian Government will:

- support the development of legal and regulatory frameworks conducive to the growth of financial services for the poor (from both a consumer and provider perspective)
- encourage policies leading to the removal of interest rate ceilings in microfinance and to the improvement of consumer protection, ensuring that clients are not exposed to exploitation and unfair practices
- assist national governments to implement strategies to expand poor people's access to financial services
- provide assistance to develop the technical expertise of regulatory authorities responsible for the oversight of the financial services sector
- support a regulatory environment that enables institutions offering financial services to the poor to play an increasing role in encouraging deposits mobilisation and micro-insurance
- assist regulators to examine how new technology can be integrated into the delivery of financial services to the poor in a manner that will ensure sustainable growth and protect clients' rights and interests.

Reaching the most excluded

Women

Over two-thirds of microfinance clients around the world are women. The strong participation of women in microfinance programs can be attributed to a number of factors. Evidence suggests that when women are provided with access to finance, the whole household benefits, not just the individual client. Furthermore, targeting women is recognised as an effective mechanism to improve gender equality within communities. In return, women borrowers tend to have higher repayment rates relative to men.

Microfinance can enable women to diversify their income flows, accumulate assets and increase their economic activity. Women with access to microfinance can have greater control over their incomes and more power in household decision-making. Through microfinance programs, women often gain new vocational skills, self-confidence and greater leadership, resulting in an enhanced ability to drive change within both the household and the community.

Microfinance is not, however, a panacea for addressing gender inequality, and there is evidence indicating it can, in some circumstances, generate unintended consequences. For example, microfinance targeted at women can confine them to low value-added activities, push them into rigid and unrealistic repayment schedules, and further add to workloads. Instances have been reported where, as women challenge traditional roles within the household and public domains, domestic violence has increased.

To ensure that positive gender-related development outcomes are achieved, gender considerations and analysis need to be explicitly integrated into microfinance programming, from design phases right through to monitoring and evaluation and impact assessments.

People with a disability

Disabled people have traditionally been excluded from accessing financial services due to a number of barriers including a lack of self-confidence, discrimination, lack of flexibility by financial service providers to tailor products and/or a lack of knowledge among their staff members.

Australia is committed to playing a leadership role in driving forward development that addresses the needs of people with a disability, including supporting the consideration of their needs when developing new initiatives to expand access to financial services.

Targeting: the poor, the poorest or both?

Although microfinance has been proven successful in improving quality of life and reducing vulnerability amongst the moderately poor, its capacity to assist those suffering more entrenched forms of poverty is less clear. When made available to the extremely poor, most of whom have no stable cash flow to make repayments on loans or to save on a regular basis, microfinance can cause harm, including by creating indebtedness and compounding vulnerability. While many financial service providers have socially oriented missions, extremely poor clients with no income and no collateral are often considered unattractive to financial service providers who need to ensure a financial return on their investment.

Does this mean we should not aim to extend services to the poorest of the poor?

Put simply, no. There are many financial products, in particular savings and transfer services, that are well suited to this demographic. There is also much that can be done with extremely poor clients to help ready them for the responsibility of financial service utilisation.

To this end the Australian Government has made practical and tangible commitments to increasing financial capacity and consumer protection and invested in programs specifically targeted at assisting the poorest of clients get a fresh start in life, including for example the Challenging the Frontiers of Poverty program in Bangladesh (see page 9 for details).

Where feasible and appropriate the Australian Government will assess how poverty levels are affected by its financial inclusion initiatives.

Outcome 2: Financial service providers and infrastructure that have greater capacity to provide high quality financial services to the poor

a) Financial institutions that have the capacity to provide high quality services to the poor
Limited capacity within the financial services sector remains a key constraint to the growth and development of the industry in many developing countries.

As the industry grows, an increasing number of institutions struggle to establish sufficient management information systems, effective governance structures and appropriate pricing policies to expand their outreach to the poor in a sustainable and cost-effective manner. A recent study of 124 microfinance institutions in 49 countries found that only half of the institutions were profitable and generating sufficient revenue to cover their costs.⁴ Moreover, as new types of service providers enter the market it is important they are supported to develop the capacity to expand products and services to the poor. This may involve supporting commercial banks to target poorer clients or assisting institutions with established supply chains to expand into the delivery of financial services.

While there is significant demand from the poor for a range of financial services beyond micro-credit (including savings, transfers and insurance), few financial service providers effectively diversify their product and services mix to meet this demand or to sufficiently tailor products and services to cater to different socio-economic groups.

Greater capacity of financial service providers will enhance the ability of institutions to deliver demand-driven, well-targeted services at a lower cost to more clients, including clients previously unserved or underserved.

The Australian Government is committed to building the capacity of institutions to expand financial services to the poor by:

- supporting improvements to governance, management information systems, risk management systems and performance measurement of institutions that offer microfinance services
- promoting the development of a range of demand-driven products and services
- encouraging commercial banks to target poorer clients and expand outreach.

⁴ Cull, Robert, Asli Demirguc-Kunt and Jonathon Morduch, 'Financial Performance and Outreach: A Global Analysis of Leading Microbanks', *Economic Journal*, 117(517): 107-F133, 2006.

Support will be strategic and specific to the context of each region and institution. Care will be taken to ensure that any support provided does not distort the financial market or create dependency, and that support will be provided to those institutions offering microfinance services that demonstrate the potential to achieve financial sustainability.

b) Financial infrastructure that has greater capacity

A wide array of infrastructure and institutions is needed to connect the provision of pro-poor financial services to the broader banking system and provide essential support functions. These include credit bureaus, secured transaction frameworks, registries, accountants and auditors, microfinance training institutes, technical assistance service providers, associations, microfinance rating agencies and networks of microfinance institutions as well as other institutions involved in advocacy and information dissemination. In many contexts, these structures and institutions are inadequately resourced and lack technical capacity to effectively perform the functions required. Accordingly, the Australian Government will seek not only to build the capacity of financial service providers but also to strengthen the broader financial infrastructure. This support will provide the necessary enabling environment for the sector to expand in a sustainable manner.

The Australian Government recognises the breadth of this challenge and will look to contribute in priority areas and institutions within the financial system identified in each country.

Outcome 3: Innovative models of financial service provision that are used effectively to extend outreach to underserved regions and groups

High transaction costs can significantly inhibit the expansion of financial services to the poor, especially in rural and sparsely populated areas. Recent advances in technology such as mobile telephones, point-of-sale devices, and low-cost automatic teller machines (ATMs) offer great potential for overcoming this barrier, especially in remote areas, making areas once too costly to serve a viable prospect for the first time.

When new technology is appropriately used, financial institutions no longer have to open numerous bricks-and-mortar branches to provide and expand services. In addition, new technology-based microfinance models can significantly reduce client and provider transaction costs compared to conventional banking models. Early successes in the adoption of mobile phone banking have been seen in countries such as the Philippines, Kenya and South Africa.

Innovative models of financial service delivery, such as these, often provide a breadth of services unseen in many microfinance institutions, including payments and transfer services and methods of savings.

Key to the success of many innovative models of financial service provision is the formation of partnerships between financial service providers and non-financial service providers, such as mobile telephone companies and agents. Third-party outlets or banking agents, such as post offices and retail outlets, are increasingly being used to link clients to banking services. A bank's agent can provide most of the services with the help of new technology, enabling the rapid expansion of financial services in areas where no banking services were available. In Brazil for example, use of technology by commercial bank agents has enabled improved access to finance for people in nearly all municipalities across the country, in some instances for the first time.

The Australian Government is committed to supporting institutions and fostering partnerships that push the frontiers of technology and innovation to expand the provision of financial services to the poor.

To achieve this outcome, the Australian Government will:

- provide support to institutions offering financial services to the poor to increase their capacity to adopt innovative technologies that can expand their outreach
- create incentives to expand the use of new technology that can be easily used by poor people with low literacy levels in instances where private sector support is not forthcoming
- support and build the capacity for partnerships between banking service providers, technology companies and non-bank institutions to encourage innovative models of financial service delivery.

Australian Government support for new and as yet untested approaches to expanding access to financial services will be guided by robust risk management strategies.

Managing the risks of partnering with the private sector

As the microfinance industry develops, a broader mix of institutions is entering the sector. New technology options have created huge potential for the microfinance industry to increase its reach to levels previously unseen. There is, however, the potential for high risks and costs.

Evidence suggests that without adequate incentives and ways to mitigate risks, institutions cannot be relied upon to enter new markets and push the frontiers of financial service delivery. Donors are in a position to assist institutions to expand financial services by sharing risks associated with projects that have strong benefits for poor and remote communities. Given the diversity of institutions in the market, there is increasing value in partnerships with private sector providers.

Any partnership with the private sector needs to meet the following criteria:

- assistance should not distort the market, but should demonstrate what can be achieved and serve as a catalyst for further market development
- it needs to be demonstrated that the institutions supported could not receive commercial funding or that the project would not proceed without donor support
- selection processes need to be transparent and based on merit, and conflicts of interest should be avoided
- support will be provided in response to demonstrated unmet demand among clients and/or potential clients
- support initiatives demonstrate the potential to become sustainable
- supported institutions should contribute resources to the project.

Outcome 4: Increased capacity of clients to understand and utilise financial services effectively

Client capacity refers to the ability of people to make informed decisions in relation to financial choices when given adequate information.

Financial education can provide the poor with the requisite skills, knowledge and behaviours to take advantage of financial opportunities and plan for the future in an informed manner. Without basic levels of financial literacy it is hard for people to use financial services appropriately and with confidence. Lack of financial education is also a key contributing factor to over-indebtedness which, when it reaches an unmanageable level, can push poor people even deeper into poverty.

Financial education forms an important cornerstone to ensuring that clients are protected and treated fairly when using financial services. Those who have low levels of financial capability are more vulnerable to predatory financial service providers and are often unaware of their options for recourse when they have been exploited. Working with service providers and clients to establish understandable and appropriate mediums to disclose product attributes and conditions is key to ensuring the ethical delivery of financial services to the poor.

Financial education can provide people with the confidence to effectively manage their money and utilise a variety of banking services. Ultimately, well-informed clients make more responsible banking clients and this generates greater demand for banking services—key ingredients of effective banking systems.

In many developing countries, there are large disparities between levels of male and female literacy, including financial literacy. In these contexts, targeting women to attend financial education programs is appropriate as a way of addressing these gender inequalities and providing women with the skills to access financial services.

Financial education can be conducted by many different institutions, from schools and tertiary institutions to private banks, NGOs and microfinance institutions. A range of techniques and curriculum can be developed to reflect the variance in literacy and numeracy levels in each context. Delivering impartial financial education in tandem with financial services has been shown to be an effective method to both increase skills and knowledge and usage of financial services.

Financial literacy is critical to ensuring sustainable expansion of financial services to poor people and will be supported by the Australian Government through education programs and initiatives relating to service provision. We will support a range of stakeholders to deliver financial education to the poor to empower them with adequate knowledge and awareness to effectively access and use financial services.

To achieve this outcome, the Australian Government will, where appropriate:

- support governments to formulate and implement national policies for financial education for the poor
- assist organisations to launch and expand targeted financial education programs
- encourage public–private partnerships in financial education for the poor
- where appropriate advocate the provision of financial education in conjunction with financial service delivery by a range of service providers
- sponsor research, analysis and dissemination of information on the effectiveness of targeted financial education programs.

Guiding principles

In June 2004, the Group of 8 (G8) endorsed *The Key Principles of Microfinance* at a meeting of Heads of State in Georgia, USA. The Consultative Group to Assist the Poor has translated these principles into concrete practical guidance for practitioners, investors and donors through publication of *The Good Practice Guidelines For Funders of Microfinance*.

In working to achieve the outcomes set out in this Strategy, the Australian Government, a CGAP member, will use these guidelines to inform our overarching principles.

1. **Australian Government support will complement, not crowd out, private capital and stakeholders.** Support provided by the Australian Government will be demand-driven and catalytic. The Government will not support areas of market development that are likely to be supported by private capital and will endeavour not to distort markets or create dependency.
2. The Australian Government will support the provision of a range of financial services in addition to the provision of credit, including savings and deposit products, payment and transfer services, and insurance.
3. The Australian Government will work with microfinance providers that demonstrate potential to become financially self-sustainable. The Government does, however, recognise that, in some instances where financial markets are particularly underdeveloped, organisations may require higher levels of support. In these instances, comprehensive risk management strategies will be developed.
4. The Australian Government will strongly encourage partners to measure and report on both their financial and social performance, in line with internationally agreed performance indicators, in order to improve performance, promote transparency and build understanding within the sector. Australia strongly supports the practice of gender-disaggregated data collection.
5. **The Australian Government will work with partner governments to develop enabling environments for microfinance:** Australia will give priority to assisting governments to create an environment in which the commercial sector can effectively provide financial services.
6. The Australian Government will pursue the advancement of gender equality wherever possible through the provision of financial services: The Government will consider gender at all stages of the program cycle. Australia is committed to developing a deeper understanding of the impacts of microfinance on women, so as to ensure no harm results from programs and development impact is maximised.

International initiatives to expand financial access

The Australian Government is committed to participating in international initiatives focused on industry best practice and on supporting efforts to sustainably and effectively expand financial services to the poor. Australia will look to support the following key international initiatives.

CGAP

Established in 1995, CGAP is an independent research, policy and advisory organisation dedicated to expanding access to affordable financial services for the poor. It has become the most important international platform and network for generating and disseminating knowledge in the industry. Australia is one of over 30 members of this group alongside multilateral and bilateral development agencies and private foundations. The Australian Government has been a member since 1996.

Core areas of the group's work include:

- generating market intelligence on trends and best practice within the industry
- developing innovative models of financial service delivery
- advocating clear standards within the industry
- providing expert advice to donors, governments, microfinance providers and investors.

The Australian Government will continue to provide core contributions to support the group's activities, and its research and knowledge will continue to inform Australia's microfinance activities.

G-20 Financial Inclusion Experts Group

On 25 September 2009, G20 Leaders agreed to establish a Financial Inclusion Experts Group focused on supporting the safe and sound spread of new models of financial service delivery capable of reaching the poor and scaling up the successful models of small and medium enterprise (SME) financing. Recognising the importance of this issue, the Australian Government accepted an invitation to co-chair, with Brazil, a sub-group focused on increasing access through innovation. This work will culminate in November 2010 with a final report to G20 Leaders.

Alliance for Financial Inclusion (AFI)

AFI was established by the German Organisation for Technical Cooperation (GTZ) in September 2008 in recognition of the role that developing countries have played in the development of appropriate and innovative mechanisms to expanding financial services to the poor. With financial support from the Bill and Melinda Gates Foundation, AFI seeks to collect and disseminate the lessons learnt from this experience by:

- linking developing country policy makers together to share and building knowledge
- provide grants to policy makers together to develop and implement solutions
- linking policymakers with strategic partners, including research institutions, technical experts and funders.

Priorities in implementation

The Australian Government will accord high priority to the following approaches as it implements this Strategy.

1. **Performance measurement:** The Government will place high priority on performance measurement and assessment of both this Strategy and individual programs and activities.
2. **Evidence-based programming:** The Government will use and support best-practice research and analysis to inform the development of the sector. Research will be commissioned focusing on emerging areas of interest and gaps in knowledge, such as the impact financial services have on women, the impact of access to savings on households, and the role of technology. A key aspect of the Government's involvement in research and analysis activities will be the dissemination of findings to partners and stakeholders within the region.
3. **Context-specific programming:** The design of programs and approaches to implementation will vary depending on the country and sector context and the priorities of partner governments. Close consultation with key stakeholders—including governments, financial service providers, potential clients and other donor partners involved in expanding financial access—will be an integral part of the implementation approach. The Australian Government will consider programming options in the context of other aid priorities and activities, including health and education programs, and where possible will exploit synergies. Depending on the context, the Government will use a range of aid modalities, including technical assistance, grants (including performance-based grants) and training, to increase poor people's access to financial services.
4. **Alignment with partner government priorities:** Through consultation with partner government and stakeholders in the region, the Australian Government will align activities with partner governments' priorities, strategies and policy frameworks. Australia will seek to work within national systems and procedures and foster local and national ownership of activities to expand access to financial services.
5. **Working in partnership:** The Australian Government recognises the critical importance of working in partnership with other organisations to achieve the maximum development impact and avoid duplication among donor activities. In keeping with aid effectiveness principles, Australia will work in partnership when appropriate and closely collaborate with other donors, NGOs and governments working in the sector.
6. **Coordination and collaboration:** Many national and regional networks and associations are active within the microfinance sector. These networks serve to disseminate knowledge and best practice, promote performance standards, discuss issues relating to the sector, and advocate for changes in policy. Australia will actively participate in networks and forums to share knowledge and build strategic relationships. Where appropriate, the Government will consider providing support for networks to build their capacity.
7. **Skilled, knowledgeable and effective staff:** To achieve the core outcomes of this Strategy, the Government is committed to developing the skills and knowledge of its staff and fostering a learning environment. Through training and mentoring, staff will understand the core principles of pro-poor financial services and be able to effectively monitor and evaluate these programs. Senior leadership will be established within AusAID to provide expert input and disseminate knowledge.

Measuring performance

The Australian Government is committed to maximising the development outcomes of its financial services initiatives. The Government will monitor and evaluate the implementation of this Strategy and undertake comprehensive and timely analysis to:

- ensure the outcomes and priorities articulated in this Strategy are on track
- foster an environment of transparency and accountability
- ensure the adoption of a learning approach

Assessment of performance will focus on both the results achieved against each outcome and the quality of financial inclusion initiatives. Results will be measured at the policy, infrastructure and institution level using the Performance Assessment Framework (see page 20).

Adherence to the guiding principles articulated in this Strategy will be assessed in conjunction with assessments against outcomes.

A mid-term and final review of the Strategy will be conducted using reporting from program areas and implementing partners, commissioned research and information drawn from other donors, organisations engaged in microfinance and partner governments. At the conclusion of each review, key findings and results will be disseminated to stakeholders, including AusAID staff members, implementing partners and organisations actively engaged in the sector. Reviews will also be used to inform program management decisions and the design and focus of future initiatives.

As part of the Australian Government's bid to remain accountable and transparent, the level of expenditure on initiatives to expand access to financial services will be publicly disclosed on an annual basis.

The Performance Assessment Framework seeks to complement existing quality performance processes within AusAID. Given the challenges associated with collecting aggregate data on financial services activities, the Australian Government will develop specific and comprehensive monitoring and evaluation frameworks at the initiative level to collect important data to measure performance that may be unobtainable on a macro level, such as changes in behaviours resulting from financial education and the impact of initiatives on poverty levels.

Performance measurement – the double bottom-line

Given that the financial sector is largely commercial, a strong temptation exists to consider only financial performance indicators when determining the success of donor support to improve financial access. The Australian Government is committed to measuring both the financial and social performance of microfinance initiatives over the lifetime of programs.

Partners will be required to report against the following **financial indicators**, in line with international standards:⁵

- number of clients served
- client poverty level
- portfolio quality
- profitability
- efficiency.

Acknowledging the importance of providing a range of products to the poor, partners will be required to disaggregate the first two indicators by financial product, i.e. number of depositors, borrowers, other clients, average outstanding loan balance and average outstanding savings balance.

Partners will also be required to measure and report on **social indicators**. Social performance can be defined as 'the effective translation of an institution's mission into practice in line with accepted social values'.⁶ Given that microfinance was developed largely to address issues of poverty, social and economic exclusion and disempowerment, it is vital that initiatives continue to be measured against these social indicators in addition to the financial indicators.

The Australian Government will be guided by the social performance standards under development by the Social Performance Task Force, a coalition of 350 microfinance stakeholders, convened by CGAP, the Ford Foundation and the Argidius Foundation. General performance areas will include:

- social mission and objectives of the organisation
- internal systems to promote achievement of the organisation's mission, including: governance, leadership, human resources, training, incentive structure, market research and marketing, range of products, impact assessments and exit interviews
- results, including: client retention, outreach (percentage of female clients, level of poverty among clients, geographic coverage), poverty impact, and impact on employment, education and women's empowerment.

⁵ Rosenberg, Richard, *Measuring Results of Microfinance Institutions: Minimum Indicators That Donors and Investors Should Track – A Technical Guide*, Consultative Group to Assist the Poor, The World Bank, 2009.

⁶ Social Performance Task Force www.sptf.info

Performance assessment framework

Goal	Key performance indicator	Source of information
Increased access to financial services by the poor in developing countries	<ul style="list-style-type: none"> Number of new clients accessing financial services 	Baseline data from existing sources; program level reporting; mid-term review and final evaluation of strategy implementation
Outcomes	Key performance indicators	Source of information
1 A policy and regulatory environment that allows institutions offering financial services for the poor to enter the market and grow	<ul style="list-style-type: none"> Identification of regulatory and legal barriers that limit poor people's access to financial services in target regions Reforms to regulatory and legal environment in target regions Entrance of new microfinance service providers into the market and performance of institutions in areas where regulatory and policy changes have been made 	Program level reporting; reporting from implementing partners; mid-term review and final evaluation of strategy implementation
2 Financial service providers and infrastructure that have greater capacity to provide high quality financial services to the poor	<ul style="list-style-type: none"> Financial and social performance of targeted financial service providers Capacity of targeted institutions within the broader financial infrastructure 	Program level reporting; reporting from implementing partners; mid-term review and final evaluation of strategy implementation; data and benchmarking from external rating agencies
3 Innovative models of financial service provision that are used effectively to extend outreach to underserved regions and groups	<ul style="list-style-type: none"> Level of access to financial services resulting from the integration of new technology into the market Number and nature of new partnerships between formal financial service providers and non-traditional stakeholders to deliver microfinance services Establishment of replicable demonstration projects to expand outreach and improve efficiency 	Program level reporting; partner reporting systems and data; mid-term review and final evaluation of strategy implementation; commissioned research
4 Increased client capacity to understand and utilise financial services effectively	<ul style="list-style-type: none"> Level of client capacity in target regions Level of client awareness of protection mechanisms in target regions Level of integration of financial education into national governments' strategies and plans Number of poor attending financial education programs in targeted regions 	Program level reporting; partner reporting systems and data; mid-term review and final evaluation of strategy implementation; commissioned research

