

# A Market Systems Approach to Financial Inclusion Guidelines for Funders

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## Acknowledgments

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## *List of Acronyms*

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AFI	Alliance for Financial Inclusion
AFS	Access to Finance Scorecard
CBK	Central Bank of Kenya
CGAP	Consultative Group to Assist the Poor
DCED	Donor Committee for Enterprise Development
DFID	Department for International Development
DFS	Digital financial services
DTM	Deposit-taking microfinance institution
FSD	Financial Sector Deepening
FSDA	Financial Sector Deepening Africa
FSP	Financial service provider
IFAD	International Fund for Agricultural Development
LSEG	London Stock Exchange
M4P	Making Markets Work for the Poor
MAP	Making Access Possible
MFI	Microfinance institution
MIXMarket	Microfinance Information Exchange
MSMEs	Micro, small, and medium enterprises
NGO	Nongovernmental organization
OECD	Organisation for Economic Co-operation and Development
PIIF	Principles for Investors in Inclusive Finance
SDC	Swiss Agency for Development and Cooperation
SEEP	SEEP Network
SPTF	Social Performance Task Force
TFI	Total Financial Inclusion Index

## Foreword

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When I look back at the “frontier issues” featured in CGAP’s *Good Practice Guidelines for Funders of Microfinance*, it is evident how far the industry has come in the past 10 years. Compared to 2006, our work is now guided by universal standards on social performance, with responsible finance a cornerstone of all financial inclusion efforts. Digital financial services have revolutionized how we think about financial access and product diversification, and early graduation programs have proven that even the poorest can be empowered to become active managers of their financial lives. In other areas, however, there is still much to be done: smallholder families around the world continue to search for financial services that meet their needs, new technology innovations challenge regulators and service providers who must adapt to the quickly changing landscape, and there is still a need to more consistently translate knowledge about poor clients into client-centric financial services that are resilient in times of crisis and meet the needs of particularly excluded groups, such as women and youth.

As a community of funders, we continually reexamine and refine our role as promoters of inclusive economic growth in the countries we serve. The new funder guidelines, “A Market Systems Approach to Financial Inclusion,” build on our collective experience and learning over the past decade and suggest a new approach to supporting financial inclusion. This approach acknowledges that building strong financial service providers is an important element for expanding financial access, but insufficient for developing inclusive financial market systems that are self-sustaining and do not rely on external aid. Developing these systems will not be easy, as it requires addressing the underlying causes that prevent poor people from benefiting from financial services. But the potential gains are huge—both for the economies of the countries where we work and the individuals and businesses who will benefit from greater participation in local financial markets.

At JICA, we will use the guidelines to rethink our approach to financial inclusion and encourage staff at headquarters and in our country offices to use them when designing and managing interventions. JICA’s counterparts in Honduras, Albania, and Egypt have started to understand funders’ renewed role in facilitating responsible market development rather than filling financial and technical resource gaps. And we are looking forward to exchanging with other funders and CGAP to share our experience putting the guidelines into practice.

Lastly, I believe that the guidelines will have profound implications to market development for other socioeconomic developmental areas for the poor beyond financial services.

**Kazuto Tsuji**

Visiting Senior Advisor at Japan International Cooperation Agency (JICA)  
Chair, CGAP Executive Committee

## 1. Introduction

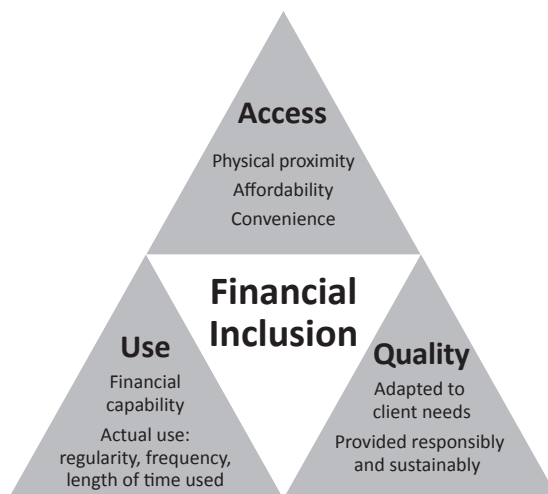
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Impressive gains have been made toward increasing access to finance for poor and low-income people since *Good Practice Guidelines for Funders of Microfinance* was published in 2006. During this time we have seen major progress in terms of achieving sustainability and scale with the introduction of new product offerings, development of innovative business models, technology-enabled delivery channels, and the engagement of a much broader range of private and public actors, both in terms of financial service providers (FSPs) as well as funders. Policy makers have increasingly recognized that access to and use of formal financial services not only have a positive impact at the client and household levels but, if done sustainably and at scale, can have a broader positive impact on national economic development by helping to lower transaction costs, manage risks, and even mitigate economic inequality, a development objective shared by funders and policy makers alike (Karpowicz 2014; Dabla-Norris, et al. 2015; Turegano and Garcia-Herrero 2015).

Understanding the potential impact of financial services for households and economies, policy makers, practitioners, and funders have shifted their focus from classic **microfinance**, the provision of financial services to the poor by specialized service providers, to **financial inclusion**, a state where both individuals and businesses have opportunities to *access*, and the *ability to use* a diverse range of *appropriate* financial services that are *responsibly* and *sustainably* provided by formal financial institutions (see Figure 1). This move reflects a growing recognition that microfinance is just one entry point among many (e.g., government-to-people payment schemes, small and medium enterprise finance, digital financial services [DFS], “no-frills” bank accounts, etc.) for achieving universal financial inclusion and its associated social and economic development goals.

However, despite this global shift toward responsible financial inclusion, there is still substantial variation in the diversity, quality, and use of financial services available in the market, with 2 billion adults remaining without access (Klapper 2015). Poor and low-income people—particularly women, youth, and those living in rural areas—are the most excluded and must depend on less reliable and often more costly informal mechanisms to manage their financial needs. At the same time micro, small, and medium enterprises

Figure 1. Dimensions of financial inclusion



(MSMEs), many of which are part of the informal economy, are limited in their ability to sustain and grow their businesses due to a lack of working capital. Seventy percent of MSMEs in developing countries lack access to formal financial services, with informality being a major constraint (Stein, Goland, and Schiff 2012). This leaves much work to be done toward achieving the vision for universal financial inclusion.

Historically, the lack of institutional capacity to deliver financial services has been seen as the major bottleneck of access to finance for the poor. Therefore, funders have prioritized financial and technical assistance to support the creation and growth of FSPs, with the largest share of funding earmarked for supporting portfolio growth (Lahaye and Dashi 2015). But while this provider-focused, institution-building approach helped increase financial inclusion, it failed to address underlying constraints. Funder support paid too little attention to understanding client needs, fostering enabling regulatory environments, strengthening the market infrastructure—all things needed to create the proper incentives, tools, and control mechanisms to develop diverse, innovative, and transparent financial services markets. At the same time, many FSPs continue to rely on subsidies, which also raises concerns about sustainable access over the long term.

Within this context, there is a growing discourse among funders about the relevance and applicability of a **market systems approach** to financial inclusion. This approach looks at the market system around the delivery and use of financial services. At the core of this market system, poor and low-income people exist as consumers of financial services and interact with providers to access and use financial services. Multiple market functions (supporting functions and rules and norms) are needed to support the core exchange between supply and demand (see Figure 2 and Box 2). These market functions



### Box 1. Global commitments to responsible finance

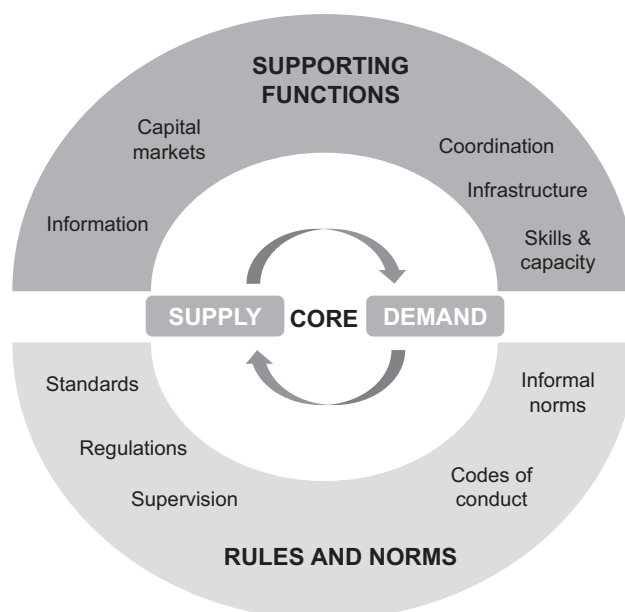
Responsible finance has become a cornerstone to financial inclusion efforts to ensure funders are not only promoting access to finance, but also the development of markets that are fair, transparent, and responsive to client needs. A number of global initiatives have been launched to achieve that end.

- **Policy makers and regulators.** G20 and the Organisation for Economic Co-operation and Development (OECD) are developing high-level principles and advice on building national strategies for financial inclusion and consumer financial education (see G20 High-Level Principles on Financial Consumer Protection). The Alliance for Financial Inclusion (AFI) offers mutual learning through working groups and sharing best practice.
- **Investors.** Principles for Investors in Inclusive Finance (PIIF) engages investors and their clients in mutually accountable relationships to promote responsible finance practices throughout the financial market.
- **Industry associations.** SEEP Network works with its association members to undertake consumer protection market diagnostics and FSP assessments, develop industry codes of conduct, and establish client complaint mechanisms.
- **Financial service providers.** The Social Performance Task Force (SPTF) promotes compliance with Universal Standards for Social Performance Management to diagnose FSP social performance practices, manage goals, design client-centric products and services, protect clients' interests, and treat staff fairly.
- **Consumer protection advocacy.** The Smart Campaign advances client protection certification of FSPs and assessments of practices for improvement.

are performed by a range of different **market actors**, both public and private, who are motivated by their own capacities and incentives. A market systems approach to financial inclusion aims to change the dynamics in this multifunction, multiactor system to the benefit of the poor.

Applying a market systems approach to financial inclusion affects what funders do, with whom they work, and how they support interventions on the ground. A market systems approach aims to catalyze **systemic change**: change that is significant in scale, sustainable, and with built-in momentum for replication and adaptation beyond the direct beneficiaries and timeframe of programs. Funders need to think of their role not as providers of missing

Figure 2. The market system and main market functions



Source: Adapted from The Springfield Centre (2014).

services in the market but rather as facilitators who incentivize and enable market actors to provide these services by performing their market functions more effectively. **Facilitation** involves a more flexible engagement than conventional development programming, as it attempts to catalyze change in a dynamic market context and requires working with a range of market actors to address the barriers of financial inclusion related to demand, supply, supporting functions, and rules and norms.

These guidelines are intended to provide guidance for funders promoting financial inclusion or pro-poor financial services markets as part of their development mandate. The target audience includes multilateral and bilateral donors, development finance institutions, and foundations.

The guidelines are structured as follows:

**Section 2, Positioning Financial Inclusion Programs**, discusses the importance of defining a clear theory of change that explicitly links development outcomes with financial inclusion objectives, systemic change in the market, and a funder's intervention.

**Section 3, Diagnostic Process**, explores how the diagnostic process is a critical entry point into facilitating market development, which not only serves program design, but also allows project management to constantly adapt interventions and inform market facilitation throughout the life of a program.

**Section 4, Understanding Barriers to Financial Inclusion**, looks at the specific constraints to financial inclusion at different levels within the market system. It explores how a mar-

## Box 2. Key concepts in a market systems approach

**Market System:** The interaction of multiple market actors performing multiple market functions, including the core function (such as the demand and supply of financial services), supporting functions, and rules and norms.

**Supporting Functions:** A range of functions that support, shape, inform, and enable transactions between demand and supply. Important supporting functions in financial services markets include information, coordination, skills and capacity building, market infrastructure, and capital markets.

**Rules and Norms:** Formal and informal rules and norms shape incentives for market actors and determine who can participate in financial services markets and under what conditions.

**Market Actor:** Any organization or individual that performs a function in a market system, including both private and public sector organizations.

**Systemic Change:** A change in the underlying dynamics and structure of a market system, which is significant in scale, sustainable, and resilient. It occurs if market actors beyond those directly involved in a funder's program adopt a new behavior that improves the poor's participation in financial services markets.

**Facilitation:** An intervention approach that focuses on addressing systemic constraints by incentivizing and enabling market actors to perform their functions more effectively.

**Financial Services Markets:** The term “financial services markets” is used as an umbrella term that includes markets for specific financial services (e.g., credit, savings, insurance, payments, leasing, Sharia-compliant financial products, etc.).

*For full definitions, see Glossary.*

ket systems approach requires funders to move beyond supporting providers to address the constraints related to demand, supply, supporting functions, and rules and norms.

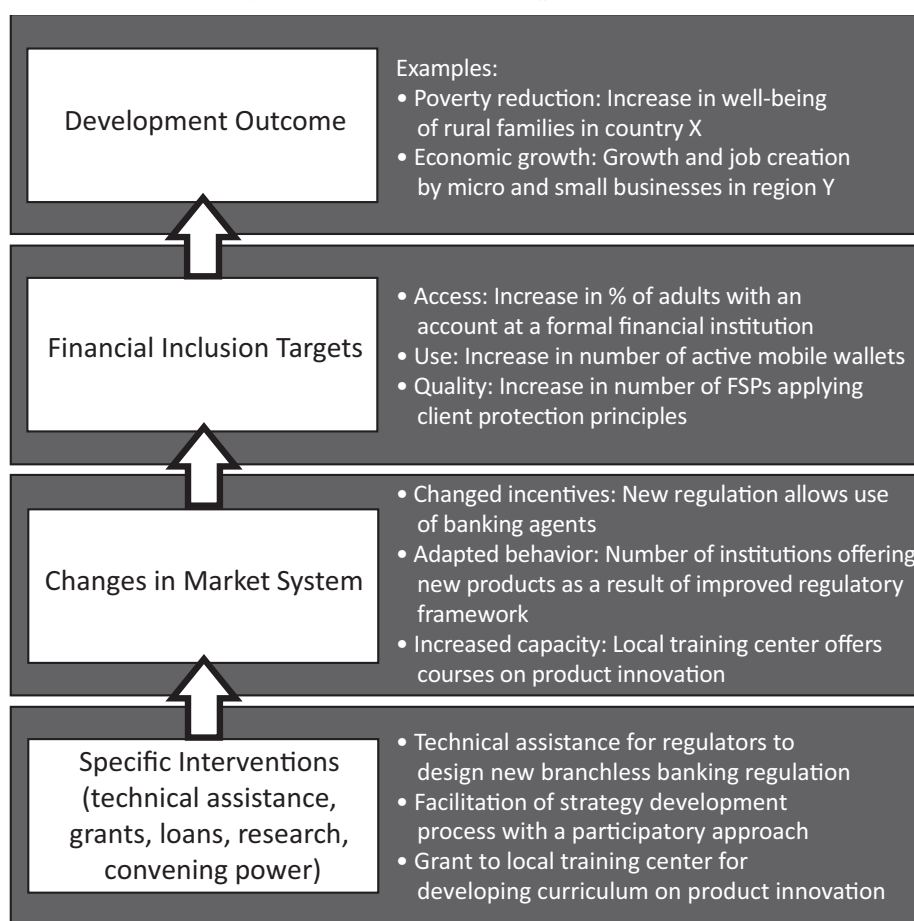
**Section 5, Facilitating Systemic Change,** examines how facilitating systemic change requires funders to play a catalytic role to incentivize and enable market actors to perform their functions more effectively. This involves engaging a range of market actors beyond FSPs and is based on partnerships and strategies for crowding-in.

**Section 6, Assessing Change,** explores how to measure impact at different levels of the theory of change and how to design monitoring and evaluation systems that both help to prove impact of interventions and improve the facilitation process itself.

## 2. Positioning Financial Inclusion Programs

Most governments and development organizations support financial inclusion as a means for achieving overarching development outcomes and not as an end in itself. A theory of change helps to articulate how a program will lead to changes in the market system and, ultimately, to the intended development outcomes (see Figure 3). It is a best approximation of the change process as it articulates the assumptions of how change will happen, the types of change one would expect to see, and the risks that could prevent the program from achieving its intended results. Defining the theory of change upfront provides clarity of purpose for a

Figure 3. Theory of change for financial inclusion programs



Source: Adapted from The Springfield Centre (2014).

funder's program and helps focus program design, while creating room for the use of different options during the implementation phase. The theory of change sets the scope for the diagnostic process and provides the basis for designing monitoring and evaluation frameworks.

**At the highest level**, the theory of change should clearly state the intended development outcome(s) in terms of the expected impact on the target group, defined as a market segment (women, youth, smallholder farmers, small and medium enterprises, etc.) and/or geographic designation (e.g., country, region, district, etc.). Funders should draw from the growing body of evidence that confirms financial inclusion has a positive impact on a number of microeconomic indicators including self-employment, diversification of business activities, and business investment and is positively correlated with macroeconomic indicators including economic growth and reduced inequality.<sup>1</sup> The theory of change should be informed by available demographic and economic data, market studies, and evaluations of similar programs.

**At the next level**, the theory of change should define the specific financial inclusion targets to which the program intends to contribute (e.g., in terms of improved access, use, and quality). Funders can use standardized indicators for defining financial inclusion targets such as the Global Partnership for Financial Inclusion (GPIFI) Financial Inclusion Indicators (e.g., number of formally banked adults, formally banked enterprises, points of service, etc.) (GPIFI 2012).

**At the lower level**, the theory of change should identify the systemic change that will help achieve the desired financial inclusion targets. It specifies what will work better or differently in the market system as a consequence of interventions supported by the funder (e.g., better application of consumer protection principles and social performance standards, improved credit information sharing, more enabling regulatory environment, etc.).

**The last level** should describe the interventions that will bring about these changes in the market system (e.g., product innovation around mobile technology, capacity building of regulators around consumer protection regimes, etc.). Together, the theory of change should demonstrate how the funder's intervention will stimulate the desired systemic change, rather than directly deliver or pay for missing market functions.

Because market systems are complex and dynamic, defining the theory of change for a market systems program requires a greater degree of analysis than for traditional funding interventions. The theory of change also requires room for flexibility during interventions, so that funders are able to adapt and adjust to market change. The following considerations should help funders establish a theory of change for programs that are in

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<sup>1</sup> For a review of the literature, see Cull, Ehrbeck, and Holle (2014); Andrianaivo and Kpodar (2011); and Ellis, Lemma, and Rud (2010).

line with their intended development outcome(s) and likely to create the desired change at significant scale.

- **Clarify the target group(s) and define the anticipated impact.** The poor are not a homogeneous group. A variety of socioeconomic factors, including gender, religion, ethnicity, geographic location, level of poverty, occupation, etc., determine whether and how they can access and use financial services. Therefore, funders should identify specific target group(s) or market segment(s) to be supported. It is important that the target group is large enough for the program to have significant impact (e.g., women, youth, rural populations, economically active poor, etc.) but that the group also faces common constraints in accessing and/or using financial services (e.g., micro or small business owners, salaried employees, smallholder farmers, members of the same religious or ethnic group, internally displaced people, etc.). The theory of change should identify where the financial services market is failing to meet the needs of the target group and how the funder's program will improve their economic or social situation. If, for example, a program is focused on reducing the vulnerability of poor wage-earning women, it should articulate how financial services can address their needs and how the funder's intervention contributes to their participation in financial markets. This might involve supporting women-focused product development (including savings products and health insurance) or working with a consumer protection organization to roll out a financial literacy campaign specifically targeted to women.
- **Define market system boundaries.** The boundaries of the market system should be defined based on its relevance for the target group, while taking into consideration the funder's internal strategy, instruments, and capacity to support financial inclusion. For example, a funder who has prioritized access to finance for youth might choose to define its market system around flexible financial savings products for youth in a given geographic area, as an important building block to more complex financial service use in this market segment. Defining the market system boundaries includes mapping out the different market functions and relevant market actors, beyond clients and providers, that influence how the particular market segment accesses and uses financial services.
- **Investigate related market systems.** When analyzing supporting functions that are necessary for the core exchange to work, it is useful to treat them as related market systems (see Box 3). It is important to understand who demands and

### **Box 3. Working in related market systems: The example of credit information sharing in Ghana**

The SEEP Network, under the MasterCard Foundation project “Responsible Finance through Local Leadership,” is working to promote responsible finance in Ghana. As part of its ongoing diagnostic work under the project, lack of credit information sharing was identified as one of the key constraints: information on historical loan balances, individual salaries, and payment histories greatly facilitate credit application and granting processes, can help reduce over-indebtedness and credit risk, and serve to identify and prevent fraud. As a result, SEEP Network broadened the support from its local partner association GHAMFIN to include the **related market system** surrounding credit information. This market comprises at its core the credit bureaus and providers of data (i.e., FSPs) that are supported by a series of actors performing related market functions (credit providers association, credit ombudsman, information technology companies, consultants) and governed by dedicated rules and norms (including a Credit Reporting Act and data protection law).

The initial diagnostic helped identify that while the infrastructure for credit reporting was technically in place, with a legal framework and regulations creating the three existing credit bureaus, capacity issues of the FSPs have led to uneven levels of data submission and poor quality data. As a result, SEEP Network launched a process to expose market actors (credit bureaus, regulators, FSPs, member-based associations, and private-sector consultants) to a mature credit information market system in South Africa. The objective of the ongoing peer exchange was to better understand the incentives that drove the development of that market system, as well as the complementary roles and functions of the various institutional providers that emerged, including a credit providers association, credit ombudsman to address client complaints around their data, and assorted private credit bureaus. What began as a request for support to establish a private credit bureau turned into a much broader dialogue around the development of the entire system of credit information sharing, which is now being championed by the Central Bank of Ghana.

Source: MasterCard Foundation and the SEEP Network

provides supporting functions and who pays for them to reflect on how they can be made available on a sustainable basis. For example, increasing access to client-centric financial services may require improving the skills and capacity of providers to innovate, which has implications for the capacity-building services market. In this example, the capacity-building services market would be considered a related market. A funder's intervention should be based on a thorough understanding of the demand and supply for capacity-building services and should aim at providing the proper incentives to improve the core exchange of capacity-building services on a sustainable basis.<sup>2</sup>

- **Identify the opportunities for stimulating system-level change.** Funders should look for opportunities in markets where stimulating systemic change seem feasible. Changes in the political, regulatory, or economic environment; technological innovations; and new entrants into the financial services market might present such opportunities by changing incentives and market dynamics in a given system. For example, new legislation that allows using agents for banking transactions can create an opportunity for market actors to develop new distribution channels that are more inclusive for rural communities.
- **Create proper incentives.** Funders should set the appropriate incentives for implementation of their programs. Indicators linked solely to the outreach and financial performance of the funder's partners or defined in terms of direct outputs (e.g., number of people trained, market research undertaken, client protection assessments done, etc.) might incentivize the direct provision of services rather than market change. Such indicators therefore need to be complemented with indicators that measure whether and how the behavior of market actors has changed, such as whether consumer uptake of a service has improved, or an innovation has been picked up by FSPs not directly supported by the funder, or if market research undertaken has become imbedded in functions of local market actors.
- **Keep the theory of change flexible.** The theory of change should be seen as dynamic and should be developed at a level high enough to set broad strategic parameters, but flexible enough to allow for adaptation during implementation. It is important that the theory of change be revisited regularly to

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<sup>2</sup> See El-Zoghbi and Lauer (2014).



ensure the framework reflects the realities of the market dynamics, incentives, and opportunities on the ground. Feedback loops should be established to continuously verify the program logic and boundaries, as well as detect early signals of change (see Box 4). This will help create a learning environment that allows for adaptive implementation throughout the course of the intervention.

Many of the initial assumptions underpinning the theory of change need to be validated based on a thorough market analysis before and during program implementation, especially if the implementation is outsourced to a partner. Establishing a clear theory of change helps focus the diagnostic process by identifying the scope of the additional information needed, the geographic focus or target group, and the market system targeted by the funder's program.

#### **Box 4. Feedback loops for real-time decision making**

Faced with dwindling development funding, the Kenyan microfinance sector pushed the Central Bank of Kenya (CBK) to develop deposit-taking laws to enable microfinance institutions (MFIs) to offer deposits as a service for consumers and to mobilize lower-cost funds. CBK developed the laws and regulations to govern deposit-taking MFIs (DTMs) and licensed six DTMs. Shortly after the law was implemented, it was determined that clients in the market did not recognize these new DTMs as deposit-taking institutions, but rather continued to see them as lenders, limiting uptake of new savings services. As such, the licensing of DTMs to mobilize deposits did not have the desired effect. Feedback from clients was that the term "DTM" did not signal to them a bank as they knew it and did not convey the confidence of a "safe keeping" institution. This feedback was conveyed to the regulator. After several consultations, "DTM" was changed to "microfinance banks" in an attempt to address these perception issues.

This case highlights the importance of feedback loops in testing strategic direction and intervention assumptions and involving market actors in the process, in this case clients themselves, to understand their financial perspectives and incentives for accessing new financial products.

Source: IFAD/AFRACA

### Key Messages

- Funders should develop a theory of change at the outset of the program to focus program design, while creating room to use different interventions and partnerships during the implementation phase.
- A program's theory of change should specify the intended development outcome(s); the specific financial inclusion targets to which the program intends to contribute; the systemic change that will help achieve the desired financial inclusion targets; and the interventions that should bring about these changes in the market system.
- Funders should identify specific target group(s) or market segment(s) to be supported. It is important that the target group faces common constraints in accessing and/or using financial services (e.g., women entrepreneurs or small business owners, smallholder farmers, internally displaced people, etc.).
- The boundaries of the market system should be defined based on its relevance for the target group, while taking into consideration the funder's internal strategy, instruments, and capacity to support financial inclusion. Defining the market system boundaries includes mapping out the different market functions and relevant market actors beyond clients and providers that influence how the particular market segment accesses and uses financial services.
- Improving financial inclusion may require working on related markets, with actors that are not directly involved in financial service provision, such as capacity-building service providers, credit bureaus, consumer protection bodies, telecommunication regulators, or tax authorities.
- Feedback loops should be set up to constantly verify the assumptions underpinning the theory of change and the system boundaries set for programs. Strong feedback loops allow for ongoing learning and adaptive implementation.

### 3. *Diagnostic Process*

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The diagnostic process is the backbone of a market systems approach. It is the critical entry point for establishing contacts with market actors, galvanizing potential partners, bringing people into the process, sharing initial ideas, and in so doing, gaining buy-in from stakeholders who are indispensable to the process. Unlike traditional diagnostics that attempt to map out the problem and then design a program to fix it, a market systems approach seeks to identify the root causes that prevent poor and low-income people from accessing and using financial services. Diagnostics help do this by exploring how poor people use financial services; identifying the factors that constrain their uptake of new and existing services; understanding why FSPs are not meeting the demand of low-income clients; who the drivers of change are; what the greatest leverage points for catalyzing change are; and creating or modifying the incentives needed to change the behavior of market actors.

In a market systems approach, the diagnostic exercise is a continuous process that not only serves program design, but also allows project management to constantly adapt interventions and informs market facilitation throughout the life of a program. It should be seen as a valuable learning experience that will help guide ongoing project management. If parts of the diagnostic process are outsourced to consultants, funders should make sure the learning feeds into program implementation.

As a starting point, diagnostics should map financial inclusion in the target country or region to identify key challenges and opportunities. This mapping exercise should assess the level of financial inclusion, based on an analysis of the demand and supply of financial services, as well as evaluate government priorities and the existing market infrastructure and regulations affecting financial inclusion. The mapping exercise should provide the baseline data for measuring change against the financial inclusion targets the program intends to achieve, as defined in the theory of change. Wherever possible, funders should draw on existing financial inclusion data or analysis (see Box 5). Existing information should be triangulated with data collected by the funder to ensure information is up to date and representative.

If national data on particular market segments or specific products are unavailable, funders should assess the opportunities to undertake a data collection effort. Collaborating with other funders or market actors might be opportune when there is a significant change

### Box 5. Data sources and diagnostic processes

Funders and policy makers are increasingly coming together around multi-stakeholder data mapping exercises to support the creation and maintenance of data sets on access to and use of financial services for poor and low-income people. The main aim is to inform evidence-based decision-making and provide a baseline against which to set time-bound targets and goals. The following nonexhaustive list gives an overview of data sources and market mapping methodologies used in financial inclusion.

#### Demand- and Supply-side Data

- **Global Findex** is the world's largest demand-side database on financial inclusion. It is housed at the World Bank and conducted by the Gallup World Poll, drawing from interviews with almost 150,000 adults in more than 140 countries.
- **FinScope**, a demand-side survey developed by FinMark Trust in South Africa, measures and profiles the levels of access to and uptake of financial products/services (both formal and informal) in a particular country, across income ranges and other demographics. The household survey, which has been conducted in more than 20 countries, captures market obstacles, as well as attitudes and perceptions of consumers toward financial services.
- **The IMF's Financial Access Survey (FAS)** is the supply-side counterpart to the Global Findex. It provides annual data from 189 jurisdictions on 47 key indicators that capture the geographic reach and use of financial services. FAS offers data from 2004 to the present; in 2014 the survey began covering access to and use of mobile money services.

#### Data Platforms

- **FINclusion Lab**, a project of the MIXMarket, draws on existing data sources on the supply and demand side of financial services, including MixMarket and FinScope data, overlaid with relevant demographic and infrastructure data to create geospatial digital maps of financial inclusion in a given country. These maps are meant to be living sources of data that can be continuously updated to respond to the evolving nature of financial markets.

#### Diagnostic Processes

- **Making Access Possible (MAP)** is a multicountry initiative to support financial inclusion through a process of evidence-based analysis, incorporating a robust

demand-side survey with a comprehensive supply and regulatory analysis feeding into a financial inclusion roadmap jointly implemented by a range of local stakeholders. MAP was initiated by the United Nations Capital Development Fund (UNCDF) and is implemented in partnership with FinMark Trust and the Centre for Financial Regulation and Inclusion. In each country, MAP brings together a broad range of stakeholders from within government, the private sector, and the donor community to create a set of practical actions aimed at extending financial inclusion tailored to that country. The framework has been done in 15 countries and is intended to become a public good that can advance the global financial inclusion agenda.

- **Total Financial Inclusion (TFI) Index and the Access to Finance Scorecard (AFS)** form a diagnostic framework that has been developed by the Microfinance Centre (MFC) to assess access to finance within a given market. The TFI Index captures national use of financial services using publicly available data and AFS complements these data with household surveys and analysis. AFS looks at six elements of inclusion: financial infrastructure, availability of financial services and products, user-friendliness of products and openness of institutions, public confidence, financial literacy, and pro-access policies and regulations.

in the political or economic context or when a government makes global commitments to financial inclusion in its policy agenda. A collaborative diagnostic process can lay the groundwork for future coordination and is an entry point for building relationships, both of which are critical for market facilitation (see Box 6). Working with local stakeholders to conduct a mapping exercise can support national capacity building, help establish locally owned sources of data, and provide incentives among partners that spur ownership of the process. Data sets should be made available and easy to use by a range of stakeholders. Designing an easily accessible and attractive interactive platform is an advantage and promotes more use by stakeholders, prompting regular updates of relevant information.

In addition to the mapping exercise, funders should do a **detailed systems analysis** to understand the dynamics at play in the market system defined for their intervention (e.g., DFS for market vendors, agricultural credit products for smallholder farmers, savings products for youth, etc.). The systems analysis will contribute to a better understanding of the target group and validate the assumptions in the theory of change. Understanding the target group might require detailed, qualitative research, such as demand-side surveys for

**Box 6. Diagnostics: An opportunity for greater coordination**

New information and insights are powerful ways of changing the perceptions of market actors. When analysis is done right (i.e., led by project staff, in consultation with local actors, and with country-level ownership of key market actors), it becomes the basis to facilitate catalytic change: fostering dialogue, convincing, crowding-in, raising profiles, catalyzing investment, etc.

In October 2014 the World Bank and CAWTAR (Center for Arab Women for Training and Research) decided to implement a demand-side assessment to better understand the financial behaviors of low-income Tunisians, as well as barriers and opportunities related to the development of DFS. The study, based on a survey of over 1,200 adults, also analyzed the legal and regulatory framework to advance DFS in Tunisia and provided recommendations for the sector's development.

The World Bank launched a participatory consultation process with key market actors (Central Bank, Ministry of Finance, Ministry of Telecommunication, Autorité de Contrôle [microfinance supervisor], La Poste Tunisienne, Société Monétique de Tunisie, mobile network operators, MFIs, banks, and other funders) to oversee the study's content and development. A senior adviser facilitated the steering committee process and oversaw the overall quality of outputs.

The consultative process surrounding this study brought together actors that would rarely—if ever—be in the same room together. And while the steering committee did not have formal policy-making authority, it has become the premier forum to discuss DFS opportunities and bottlenecks in the country and is leading to more concrete policy reform actions with the Central Bank of Tunisia.

Source: World Bank

specific client segments, to better understand uptake and use issues. The systems analysis should take into account social and economic relationships in the market system and focus on understanding formal and informal rules and norms, the capacity of market actors, power dynamics and incentives, information flows, as well as pinpointing actors and leverage points that can catalyze the greatest change. It should also explore the supporting functions that influence the core exchange of financial services for the target group, such as credit information, capacity-building services, financial education, or business development services, where the root causes of exclusion often lie. This involves looking beyond FSPs as

the main partners and considering other market actors, such as training institutes, member-based associations (e.g., microfinance networks, bankers, or trade associations), research institutes, etc., needed to provide these services on a sustainable basis.

### Key Messages

- The diagnostic process is the backbone of a market systems approach. It is the critical entry point establishing contacts with market actors, galvanizing potential partners, bringing people into the process, sharing initial ideas, and in so doing, gaining buy-in from stakeholders who are indispensable to the process.
- In a market systems approach, diagnostics seek to go beyond symptoms to identify the root causes of the problem: the market dynamics that prevent the poor and low-income people from accessing and using financial services.
- A diagnostic is a continuous process that not only serves program design, but also allows project management to constantly adapt interventions and inform market facilitation throughout the life of the program.
- Diagnostics should start with a mapping exercise to assess the level of financial inclusion, based on an analysis of the demand and supply of financial services, as well as evaluate government priorities and existing market infrastructure and regulations affecting financial inclusion.
- If national market data are unavailable, funders should assess opportunities for collaborating with other actors in the market to collect data. Collaboration can support national capacity building, help establish locally owned sources of data, and provide incentives among partners that spur ownership of the process.
- In addition to market mapping, a more detailed systems analysis should be done to understand the dynamics at play in the market system defined for the funder's intervention. It should take into account social and economic relationships in the market system and focus on understanding formal and informal rules and norms, the capacity of market actors, power dynamics and incentives, information flows, as well as identifying actors and leverage points that can catalyze the greatest change.

## 4. *Understanding Barriers to Financial Inclusion*

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Inclusive financial markets allow the poor to access and make use of a full range of financial services. In this ideal market, consumers know their financial needs; have information on and understand the financial services being offered; are able to access, select, and use the services that meet their needs; and are protected against abusive practices by providers. At the same time, providers understand the characteristics and potential of poor and low-income clients, offer services that meet clients' needs, have viable business models that allow them to grow and innovate, and act responsibly toward clients, competitors, and the environment. However, in reality, specific constraints prevent an efficient match between demand and supply of financial services, limiting access and use and quality of available services. The diagnostic process aims to identify constraints faced by clients and providers, which are often caused by gaps in supporting functions or unfavorable rules and norms.

### 4.1 Demand-side characteristics

Some of the constraints that restrict access and use of financial services are linked to the characteristics and financial behavior of poor and low-income people. Over the past decades, demand-side research, including financial diaries, Findex, FinScope, and the cumulative experience of FSPs that serve the poor, has helped provide a better understanding of poor people's financial behavior and how this behavior constrains their access to financial services. However, misperceptions and knowledge gaps around the constraints that are directly linked to the poor's position in the market persist and need to be taken into account when thinking about pro-poor financial services. These characteristics include the following:

- **Lack of trust in formal financial services and providers.** In countries where financial institutions traditionally serve wealthier clients, poor and low-income people are often intimidated by formal bank facilities that they may assume are not intended for them or by staff that may not treat them with respect. Incidents of unfair treatment or widespread scams fuel further distrust and fear toward formal financial institutions. A financial relationship is based on trust, which is difficult to establish if clients perceive a wide gap between themselves and the provider. Lack of trust is also one of the factors limiting the uptake



and use of DFS and can explain the high levels of inactive accounts and clients' reliance on over the counter (OTC) transactions, even if agent misconduct is widespread.

- **Cultural, social, and demographic factors.** Depending on the context, some population segments face additional constraints in accessing and using financial services based on their religion, ethnicity, gender, age, or other sociodemographic factors (see Box 7). Constraints can be linked to formal rules (e.g., minimum age to open a bank account, requiring women to have their husband's signature for financial transactions, formal guarantees, national identification, etc.), religious practices (e.g., receiving interest may be shunned by some faiths), or informal norms of what is socially acceptable (e.g., women might not want to be seen travelling to town alone to visit a bank branch).
- **Lack of information on providers and services.** Many potential clients do not have access to relevant information on available financial services, the conditions and terms, or the trustworthiness of providers. Inexperienced clients tend not to appreciate the benefits and risks of formal financial services and might not be aware of the different providers in the market. While digital communication channels can help address information gaps, they also do not reach everyone.

### Box 7. Cultural challenges

DFS are receiving a lot of attention as the next frontier for increasing financial inclusion among poor and low-income people. Technological innovations in countries such as Kenya have helped reduce some of the constraints to financial access with the phenomenal growth in DFS such as M-PESA (cash transfers) and M-Shwari (bundled credit and deposit product delivered digitally), as well as many other innovations that use technology to address different facets of development in the country. At the same time, studies have shown that in countries with large gender disparities, such as in India, women are being left behind by digitization of financial services. This is due to cultural norms within the household that impact women's ability to comfortably and confidently use mobile phones and limit their trust of FSPs more broadly. Therefore, understanding the unique behavior of low-income populations and their heterogeneous reactions to technological innovations will be critical to understanding uptake and use issues around DFS.

- **Limited financial capabilities.** Low levels of awareness, numeracy, literacy, and exposure to technology limit client uptake. Along with these factors, a limited understanding of clients' rights, obligations, and benefits make many clients (particularly women, illiterate, and rural poor) more vulnerable to abusive business practices.

## 4.2 Supply-side constraints

Many FSPs have succeeded in addressing the particular needs of low-income clients. For instance, the microfinance business model of specialized financial institutions serving the poor has helped create a new type of relationship with poor and low-income people, gaining their trust and meeting some of their financial needs. By showing that the poor are willing and able to pay for financial services, microfinance pioneers have demonstrated that inclusive financial services can be provided sustainably and commercially. A diverse range of providers, including banks, nongovernment organizations (NGOs), credit unions, nonbank financial institutions, rural banks, as well as savings and postal banks, now offer financial services to poor and low-income people and small businesses. Mobile network operators (MNOs) and retailers are increasingly involved in providing financial services to the poor as technological innovations have also opened new opportunities to reduce costs and increase outreach through DFS. Yet constraints facing FSPs continue to impede a more adequate supply of financial services for the poor, including the following:

- **Limited institutional capacity.** Many socially oriented FSPs that were set up or entered the market to achieve social outcomes lack the strategic vision, leadership, and internal capacity to innovate and develop services for new market segments or that increase client value. Weak governance structures, deficient risk management systems, and a lack of strategic vision and leadership are among the most common capacity constraints facing FSPs.
- **Weak value proposition for customers.** Poor and low-income people have diverse financial needs to manage their personal and professional lives, which are often not met by standard financial services designed for clients with stable income sources. FSPs generally focus on working capital loans for microentrepreneurs, mostly traders—failing to meet the financial needs of other segments of the population (including smallholder farmers, fishermen, casual laborers, youth, etc.). As a result, poor people continue to use informal financial services, such as rotating savings and credit associations for savings and credit; hawala for money transfer;

gold or livestock as a form of savings; and cash as their only means of payment. Offers from formal FSPs should add value to the poor in terms of reliability, accessibility, flexibility, and cost. They should recognize the diversity of needs of the poor and low-income population, who depend on a range of livelihoods and require financial services not only for productive investments but also, and often mainly, for their daily lifecycle needs.

- **Underdeveloped delivery channels.** Seventy-five percent of the world's poor live in rural areas where there are fewer access points for financial services and where mobility constraints and weak infrastructure make travelling to the closest access point even more costly and difficult (World Bank 2008a). DFS and agent-banking models reduce costs and thereby help increase outreach. However, FSPs still rely on brick-and-mortar branch networks, which are too costly to expand to remote areas, and even providers who have started using agents question the viability of this model in secluded, low-density areas.
- **Limited understanding of market opportunities.** Despite increasingly available data on the potential of low-income financial services markets, many commercial actors do not see a business case to serve these market segments, lack the necessary understanding of clients' financial behavior, and are not investing in their own market research. As a consequence, these providers continue to serve client segments that require limited adaptation from their established products and do not look to expand to new market segments.
- **Limited incentives to innovate.** Many FSPs are either too small or do not see the benefit of making heavy investments in product innovation around serving low-income clients. Also, FSPs tend to underestimate the alternatives poor people have and don't invest sufficiently in developing new services that provide better client value.
- **Predatory and irresponsible business practices.** Competition can create a positive dynamic for market development, but it can also lead to practices that potentially hurt poor people if there are not mechanisms in place to protect the consumer. In some markets, providers have developed rapacious lending practices and unethical collection efforts that have overheated credit markets and increased mistrust by consumers. Risks linked to DFS, including fraud, agent misconduct, or network downtime, hurt clients and undermine their trust in financial services.

- **Lack of capital.** Innovation and growth in the financial services market require financial resources, knowledge, and skills that many providers working in low-income financial markets do not have. In many markets, FSPs face constraints accessing investment capital or funding to seed new product ideas, train staff in evolving client-centric business practices, or simply fuel growth.

### 4.3 Supporting functions and rules and norms

Many constraints that appear to be either demand- or supply-side in nature have their roots in the supporting functions, rules, and norms that shape financial services markets. When absent or dysfunctional, supporting functions, rules, and norms result in weak markets that limit demand and supply and thereby exclude the poor from financial services. Funders should help provide the proper incentives and/or capacity to get market actors to perform those supporting functions and rules effectively and inclusively. Solutions require mechanisms that defray risk, make accurate information sustainably available, build skills and capacity, encourage coordination, and protect consumers. Therefore, supporting financial inclusion requires not only an understanding of the supply and demand exchange, but also an understanding of how this exchange is shaped by rules and supporting functions present in the market.

Typical supporting functions in financial services markets include information services, skills and capacity-building services, coordination mechanisms, capital markets, and market infrastructure. Constraints related to these supporting functions vary from one market to another. The following list highlights some of the constraints as well as opportunities linked to supporting functions found in most financial services market:

- **Limited market information.** Lack of quality information and information asymmetry between clients and FSPs are key factors that drive up costs for both clients and FSPs. Without access to accurate information, clients find it difficult to assess the quality, risks, costs, and benefits of financial products and the trustworthiness of financial institutions, limiting effective demand and uptake for financial services. Providers find it costly to evaluate clients' risk profiles and the potential of new market segments leading to an undersupply of financial services to certain market segments. Without more accurate information on client financial use, habits, and preferences and their real risk profile, providers lack the incentive to adapt and innovate. Even for those providers that do introduce innovative business models, such as DFS, client uptake may be low, as they may lack sufficient information as to how these services benefit them. At the same time, regulators and policy makers have only limited information about the soundness of emerg-

ing financial institutions and emerging risks of innovations for customers and, therefore, are unable to make the necessary legal and regulatory changes to spur supply-side innovation.

- **Underdeveloped skills and capacity development services.** Despite significant funding, the weak capacity of FSPs remains a major constraint. Funders' interventions to address these weaknesses often provide only limited and temporary solutions rather than the building of sustainable markets for capacity-building services that meet the needs of those serving low-income clients (CGAP 2014). Funders' direct provision of capacity-building services, often through international consulting firms, can discourage local capacity-building service providers from filling this market gap and often reduces FSPs' willingness to pay for such services.
- **Weak or inefficient industry-level coordination.** In competitive environments, there is little incentive for providers to coordinate to develop a sector strategy, exchange information, establish standards, or lobby policy makers. As a result, in many markets coordination mechanisms are weak or inefficient. With the emergence of new business models for delivering financial services to the poor, new types of coordination are needed among a more diverse set of actors, including technology firms, mobile operators, national consumer bodies, as well as financial and telecommunications regulators. Coordination can be informal or institutionalized (e.g., through member-based organizations, such as banking associations, microfinance networks, consumer organizations, or trade unions).
- **Limited efficiency and inclusiveness of retail payment systems.** Payment systems are the backbone of the financial system, enabling the transfer of funds and additional forms of value (such as e-money) (World Bank 2008a). Electronic retail payment systems play a substantial role in providing access to formal financial services, and technological innovations are increasingly used to make payment channels more affordable and more accessible (e.g., debit cards, mobile wallets, etc.). However, there are large differences among countries regarding the volumes and value of transactions being handled by retail payment systems. While a majority of central banks have a payment system oversight function, many lack even basic information on transactions made through retail payment systems and coordination among relevant authorities remains an issue. In some countries, access to the existing payments infrastructure remains limited due to restrictions preventing nonbanks from accessing the national payment system,

or as a result of the limited interoperability of the existing infrastructure. The limited efficiency and inclusiveness of electronic retail payment systems restrict the availability of affordable payment channels to low-income populations, especially those in remote areas, and inflate costs for recurrent transactions (including international remittances).

Rules and norms include all formal and informal codes, standards, and regulations that shape the terms by which demand and supply interact, as well as the supervision processes that help enforce these rules. Rules and norms govern which providers can operate in financial services markets and under what conditions. Given the important role of financial services in an economy, financial markets are subject to heavier regulations than markets for many other products. Regulatory constraints vary greatly among countries; regulations that are too restrictive, too lax, or inappropriate can hinder financial inclusion. In general, regulations that are proportionate to the risks that certain activities or institutions pose to consumers or the stability of the financial system are more conducive to financial inclusion.

The rules and norms influencing financial market systems for the poor are subject to the political economy in a given country. Because of the complexity of the issues at stake and the entrenched vested interests that may be at play, a long-term perspective for engagement is needed to build up the trust and relationships to affect change. Important constraints related to rules and norms, which offer opportunities for funders to strengthen market systems, include the following:

- **Restrictive, outdated, and unresponsive regulatory frameworks.** The emergence of new services and new business models for delivering financial services to the poor require regulatory frameworks that leave enough room for innovation, while ensuring safety and soundness of the financial system and protecting customers from emerging risks. However, even if policy makers and regulators are aware of emerging risks, they are often overstretched and can dedicate only limited resources to adapt regulatory frameworks. Innovations such as DFS, which span the financial and the telecommunications sectors, raise new challenges for coordination among authorities.
- **Weak supervisory capacity.** A proportionate prudential supervision of deposit-taking institutions and insurance companies is essential to protect clients' assets and, ultimately, the stability of the financial system (CGAP 2012). The lack of strong supervision mechanisms undermines clients' trust in financial institutions and creates uncertainty among market actors. This can lead to limited client uptake and discourage providers from investing in new client segments and ex-

perimenting with new products and delivery channels. However, supervisory capacity remains low in many countries both for prudential and market conduct risks. Given the growing complexity of the financial services industry, these constraints are likely to be exacerbated, as supervision expands to new entities, such as e-money issuers, and new financial products, whose risks are still largely unknown.

- **Weak representation of consumer and industry voices in policy-making and regulatory processes.** In functioning markets, the interests of different market actors are heard during policy-making and regulatory processes. However, in many markets the interests of poor customers and institutions providing financial services to the low-income market are not well organized and represented, which can result in regulations that are not balanced and do not adequately address their concerns.
- **Limited industry self-regulation.** Industry self-regulation can help address some of the core consumer protection issues, such as transparency and disclosure, dispute resolution and complaint channels, responsible lending, and fair treatment (see Box 8). However, there are few incentives<sup>3</sup> for socially motivated and mainstream commercial FSPs, who do not necessarily share a social mission, to adopt and respect common codes of conduct to ensure responsible finance practices. This lack of clear codes of conduct, consumer protection policies, and strong recourse mechanisms reinforces the poor's fear and distrust of formal financial institutions and hinders their uptake of financial services.
- **Adverse political intervention by governments.** Politically motivated policy-making and government interventions are still common in financial services markets. Such interventions (e.g., government institutions lending at subsidized rates, unsustainable interest rate caps) can distort markets or create disincentives for private-sector players to offer financial services to the poor. Government-run credit programs are in general problematic, as they follow political rather than commercial or developmental objectives and therefore rarely lead to sustainable access to finance. Government-controlled apexes and state banks also face risks of political interference.

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<sup>3</sup> The SPTF Universal Standards for social performance management (SPM) is a self-regulatory effort that offers FSPs a set of global standards for managing toward their social goals. It includes the Smart Campaign's Client Protection Certification Standards, which are the minimum standards a client should expect when interacting with a financial institution.

**Box 8. Industry coordination through associations: The Indian case**

Industry associations play important roles in market **self-regulation**, harmonizing codes of conduct in the marketplace, implementing responsible finance in practice, and publicizing emerging good practice in the sector. After the 2009 crisis, MFIN and Sa-Dhan, India's two largest microfinance associations, were instrumental in regaining the confidence of both regulators and clients. MFIN and Sa-Dhan drafted and adopted a unified code of conduct for their memberships, which together represented 90 percent of the total microfinance market. The code of conduct included practical guidelines for systems design, processes for recruitment and training, staff conduct, client protection, and product pricing. IFC supported the two member-based associations in this effort, and then helped FSPs integrate responsible finance in operations with training programs and assessments. MFIN and Sa-Dhan organized national conferences and enhanced communications channels among policy makers, the media, and industry associations to rebuild confidence in the market. Efforts were redoubled to tackle over-indebtedness through credit reporting: over 95 million records were recorded, covering more than 90 percent of the market. MFIN designed and disseminated a credit bureau awareness toolkit for borrowers in India, and one of its members, the MFI Ujjivan, launched a widespread campaign on client awareness of credit reporting.

Source: Responsible Finance Forum Report, IFC, and GIZ

**Key Messages**

- Misperceptions about the financial behavior of poor and low-income people continue to discourage providers from offering better services for this segment of the market and hinder policy makers and development organizations from designing appropriate policies and programs that support financial inclusion.
- While microfinance business models of specialized financial institutions serving the low-income market have helped to address some of the challenges, standard financial services still fail to meet the diverse financial needs of poor and low-income people.



- Many constraints that appear to be either demand- or supply-side in nature have their roots in the supporting functions, rules, and norms that shape financial services markets. When absent or dysfunctional, supporting functions, rules, and norms result in weak markets that limit demand and supply and thereby exclude the poor from financial services.
- Rules and norms vary greatly from country to country and require a long-term perspective for engagement with policy makers and regulators to craft regulation and supervision regimes that spur innovation and inclusion by balancing the objectives of financial inclusion, stability, integrity, and protection.

## 5. *Facilitating Systemic Change*

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Constraints to financial inclusion can be found within different functions of the market system and often work together to thwart uptake and innovation at the client and provider levels. Because these constraints are systemic, deeply rooted in norms, rules, and established practices, they do not lend themselves to quick fixes. Instead they require funders to take a *facilitative* approach that seeks to change the way market actors behave, so that they provide for the missing or underperforming function(s) beyond the funder's support.

Funders can act as facilitators themselves or outsource facilitation to an implementing partner (see Box 9). When outsourcing, funders should still invest in internal staff with complementary skills to oversee the work of the facilitator and make sure learning feeds back to the funder. Different types of organizations can facilitate systemic change as long as they are seen as independent and have the capacity to adapt to change and opportunities that inevitably arise in dynamic market systems (see Box 10).

### **Box 9. Outsourcing facilitation**

One example of market facilitation comes from the network of country-level Financial Sector Deepening (FSD) Trusts established by the Department for International Development (DFID) and supported by the Bill & Melinda Gates Foundation, the MasterCard Foundation, SIDA, and others. These independent trusts aim to translate the concept of “making markets work for the poor” (M4P) into an on-the-ground reality by deeply analyzing the markets where they work and identifying underlying constraints that limit access to financial services. They focus on building capacity within the financial services sector, partnering with FSPs, regulators, and supporting services organizations. FSDs aim to invest in sustainable and scalable solutions, which means they do not offer quick-fix interventions that distort markets. Their interventions can take many forms depending on the context and needs of the market.

**Box 10. The key characteristics for successful facilitation**

**Closeness and In-depth Understanding of the Market System.** A relationship with market actors that shows understanding and informed empathy, without being unduly influenced by them. The task of facilitation can be seen as a bridge between the development objectives of funders and the aims of individual market actors. The necessary in-depth understanding of a dynamic market system is best acquired through regular physical presence and interactions with market actors.

**Critical Analytical Abilities.** Able to assess and analyze complex market systems and understand relationships between market actors.

**Entrepreneurial Instincts.** The capacity to see where opportunities may lie and be able to shape and convey an offer to different actors in the market that responds to their situation and addresses systemic constraints.

**Political Economy Skills.** Ability to tune into the incentives and relationships of different market players and people and intervene in a way that adds value and optimizes public benefit.

**Trustworthiness and Independence.** A status that allows facilitators to be and—equally important—to be seen as independent and trustworthy in the eyes of market actors so that their role and their status is understood and accepted.

**Longer-Term Commitment.** Facilitation takes time; funders need staying power and should be able continue their engagement until systemic change is achieved. However, funders' interventions should remain temporary and not become a permanent role in the market system.

Source: Adapted from The Springfield Centre (2014).

**Flexibility**

A key to successful facilitation is a funder's ability to adapt to change. While thoughtful upfront analysis is very important in identifying opportunities for funders to be catalytic, the design and management arrangements of their programs should also be sufficiently flexible to allow for adaptation to changes and opportunities that inevitably arise. Facilitation can take many different forms, depending on the needs and opportunities in the market and level of system change desired, from piloting a new financial

product in an effort to initiate market uptake and adaptation; undertaking market research to help FSPs in a market better understand client needs and adapt their products accordingly; advocating with regulators on the need for industry-wide guidelines for consumer protection; or coordinating with other funders around a common agenda for supporting national financial inclusion goals. It means being able to engage a variety of market players; enter and exit into partnerships as the need arises; adapt strategies based on changes; and use funding opportunistically to spur innovation or fund key activities necessary to nudge the change process. The ability to be flexible will depend heavily on a funder's results framework and monitoring and evaluation plan. It is critical that this concept of facilitation and the corresponding need for flexibility be conceptualized in all stages of the funding process. Adopting a facilitative approach does not preclude a funder from directly providing missing services. In fact, the provision of underperforming functions (such as capacity-building services) may sometimes be required in the short term to develop relationships, learn about market dynamics, and kick-start missing market functions.

### **Partnerships**

One of the keys to successful market facilitation lies in the way interventions engage with and support local market actors (see Box 11). This involves partnering with a range of public and private sector institutions (such as member-based associations, technical service providers, credit bureaus, research institutes, FSPs, and regulators). The type of partnership will vary depending on the type of system-level change a funder wants to achieve and the constraint being addressed. Funders attempting to support client-centric product development may choose to focus on demand-side market information and partner with the local statistics bureau to serve as a hub for information and market data for the sector. To improve consumer protection standards, funders may choose to work with a member-based association promoting responsible market conduct among its members. In some cases, funders may also choose to engage with selected FSPs directly to pilot innovations or to demonstrate a successful business case on which to build.

Regardless of the institutional type, these partnerships should be based on a clear understanding of the incentives and motivations of the market actors engaged. They should be structured in a way that supports partners to improve, innovate, and adapt their functions, so that they can play their role more effectively in the future. Specifically, when identifying partners and building relationships, funders should take into account the partner's capacity and commitment to broader market development and design transparent partnerships with strong communication processes.

**Box 11. Building and managing partnerships**

- **Check capacity.** Funders should take care not to overwhelm partners and to size support in a way that acts as an incentive for positive change and encourages local ownership.
- **Identify incentives.** Funders should identify the reasons for underperformance of a missing function and design support to encourage desired behavior.
- **Ensure shared commitment.** Whether working with industry leaders who have the capacity to adapt and invest and can serve as a role model for other actors, or with a range of actors to test out and identify market barriers, funders should select partners that share a common commitment to better serve the target group.
- **Promote local ownership.** Funders should put partners in charge of key strategic and operational decisions and support their plans, rather than the other way around.
- **Ensure transparency.** When working with FSPs or other private companies, funders should clarify from the beginning that achieving systemic change requires sharing knowledge with other market stakeholders. There must be an agreement with partners on how results from pilots will be shared with the broader market, without jeopardizing the partner's business model.
- **Ensure ongoing communication.** Funders should regularly assess progress to identify when and where modifications are needed. This includes ensuring that systems, procedures, and documentation allow staff to reflect on the performance of partnerships, and withdraw when needed. This should not be seen as a one-time upfront activity, but rather as an ongoing process to help guide and adapt program actions as needed.
- **Provide results-based support.** Funders should structure support around performance-based agreements and cost sharing that demonstrate and strengthen partner commitment and ownership (CGAP 2010).
- **Offer smart subsidies.** When supporting FSPs or other private companies, any use of grant funding should be temporary, linked to clear objectives, and proportionately sized. Funders should avoid subsidizing the day-to-day operations of the partner, but rather provide grant support for innovation and for reaching new client segments. Grant agreements should include projections of how the partner will cover the subsidized costs in the future.

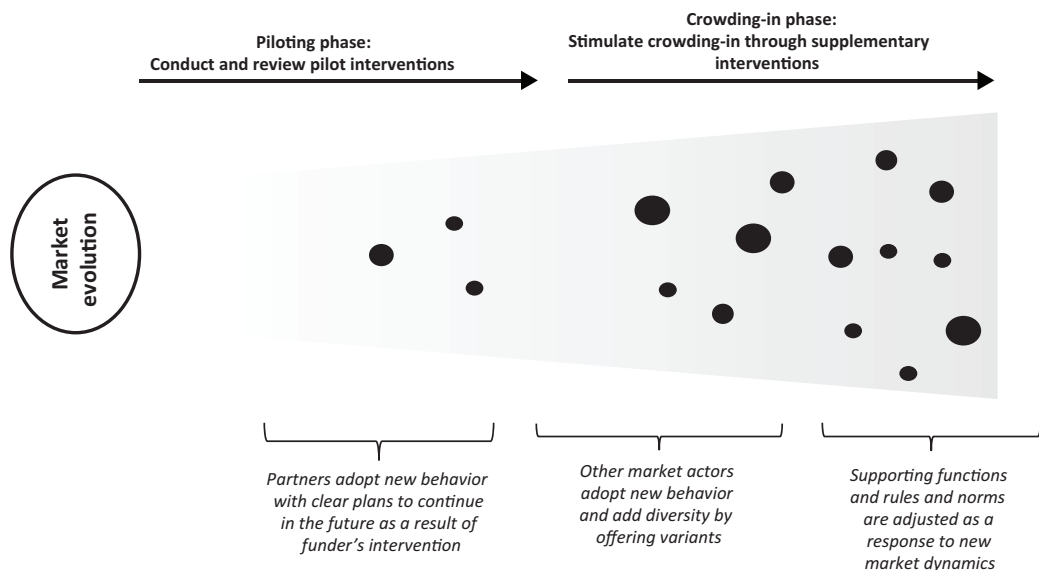
Source: Adapted from The Springfield Centre (2014)

## Crowding-In

Crowding-in will not happen automatically as a result of simple pilot testing, and replication often requires additional interventions before it is institutionalized. Therefore, funders should consider carefully how they expect to ensure crowding-in of other actors beyond their initial partners (see Figure 4). And while it may be unrealistic for funders to know exactly how this will happen before the project starts, it is important, from as early as the design phase, for funders to be thinking about how they will support market actors to adopt new behaviors and maintain or institutionalize these improvements before the end of the program.

Facilitating crowding-in can be embedded in project design with, for instance, the development of open-source products that are available to all actors in the market, or the inclusion of several market players in the initial phase of the program. Crowding-in can also be done through supplementary interventions, to raise wider public awareness and interest in the outputs resulting from the intervention (e.g., a consumer education campaign to support uptake for a newly piloted financial product or a knowledge-sharing initiative through stakeholder forums on outcomes and successes of the pilot). When the initial intervention involves a pilot with a limited number of actors, crowding-in will

Figure 4. Example of crowding-in for an intervention focusing on product innovation



Source: Adaptation from The Springfield Centre (2014).

involve sharing the learning with the broader market without jeopardizing the business model of the initial partners, as well as safeguarding against giving an unfair advantage to some actors in the market or raising the entry barriers for others and distorting competition.

Whatever form these crowding-in activities take, funders should ensure that actors in the market system are able to learn from the intervention and have the incentives to act on the basis of this learning.

### Key Messages

- Funders should see their interventions as time-bound and facilitative, while understanding that market system change requires a longer timeframe to achieve.
- A facilitative approach involves finding solutions that change the way market actors behave so that they provide the missing or underperforming function(s) beyond the funder's support.
- Facilitation can be done by different types of organizations, as long as they have an in-depth understanding of the market system, possess the range of skills necessary to ensure dynamism, and are seen as trustworthy and independent partners.
- Program design and management arrangements should be sufficiently flexible to allow for adaptation to changes and opportunities that inevitably arise in a dynamic market context.
- One of the keys to successful market facilitation lies in the way that interventions engage, partner with, and support market actors to help them innovate and adapt new functions.
- Funders should plan to crowd-in other market actors beyond their initial partners from the design stage, even if they do not know in advance exactly how this will happen.

## 6. *Assessing Change*

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Assessing change is important for two main reasons: to provide transparency and accountability to funders and other stakeholders (to **prove** the interventions are achieving the desired impact) and to promote better program performance and results (to **improve** ongoing interventions) by supporting evidence-based decision-making. Conventional approaches to monitoring and evaluation of financial inclusion programs have tended to focus on consensus-based industry measurements of FSP outreach and financial performance to assess sustainability at the provider level (CGAP 2009). More recently, tools measuring social performance have been introduced to help ensure financial inclusion programs are not only creating access but also addressing quality and use issues by promoting client-centered financial services that are fair, responsible, and transparent (SPTF 2015). However, most of the results frameworks in use to date still focus very much on performance measurements at the provider level and are not set up to monitor and evaluate the complexities of financial market system change.

A market systems approach should result in systemic change: change in the underlying dynamics between market actors and the incentives driving their behavior. Characteristics of systemic change in financial inclusion include the following:

- **Scale**—Change that benefits a significant number of poor and low-income people, in relation to a given context.
- **Sustainability**—Change that survives long after the withdrawal of external support.
- **Resilience**—Change that results in market systems that are able to adapt to the evolving environment, withstand external or internal shocks, and innovate.

Because this approach extends beyond the provider level—to include changes related to supporting functions and rules—it requires results frameworks that define and measure change at these different levels of the market system as well.

The financial inclusion community has begun to explore how to adapt existing measurement systems to capture systemic change in financial services markets. One approach currently being explored is to apply the Donor Committee for Enterprise Development (DCED) Standard (see Box 12) to the specific needs of financial systems development. The rich discussion and diversity of views converging around measurement practices, from both the monitoring and evaluation community as well as from those funders and



**Box 12. Elements of the DCED Standard**

The DCED Standard for Results Measurement (DCED 2014) is a **process** standard widely used by market development programs in a variety of industries, comprised of eight elements that are considered the minimum required for a credible results measurement process. The DCED Standard does not define the set of indicators to be tracked but calls on programs to define indicators that are relevant for the type of changes sought in the market and to assess plausible influence of the program on the market.

1. Articulating the results chain or program logic
2. Defining indicators of change based on the logic
3. Measuring changes in indicators; applying good practice
4. Estimating attributable changes
5. Capturing wider changes in the system or market
6. Tracking associated program costs
7. Reporting results in a responsible way
8. Managing the system for results measurement

facilitators working at the forefront of market development for financial inclusion, have resulted in some emerging principles:

- **Results frameworks should be based on a clear theory of change.** The theory of change is critical for establishing the program logic, i.e., how the intervention's outputs will lead to the market-level changes, financial inclusion targets, and ultimately the development outcomes sought. A well thought out theory of change should also detail the assumptions underpinning the logic and the systemic changes needed.
- **Impact should be measured at the various levels of the theory of change and not only at the development outcome level.** While impact measurement has traditionally focused on client impact, it is also important to monitor and evaluate the changes that are likely to lead to this impact. Emerging experience suggests that change should be monitored at a minimum of three levels: initial changes in behavior of key program partners; institutional changes introduced by program partners; and systemic changes that reflect broader market-level dynamics such as the replication and adaptation of practices by other actors (beyond partners).

- **Monitoring and evaluation is an opportunity for learning and adaptation.** Feedback loops can be regularly used to test and revisit the theory of change and its underlying assumptions. This will help the facilitation process by providing fast, reliable, and relevant information to respond to complex, unpredictable and dynamic markets (see Box 13).

### **Box 13. Results measurement as a facilitation tool**

Market systems projects almost always conduct pilot interventions to deepen and test their understanding of the underlying constraints in a system and to establish entry points for further interventions to achieve broader and deeper change.

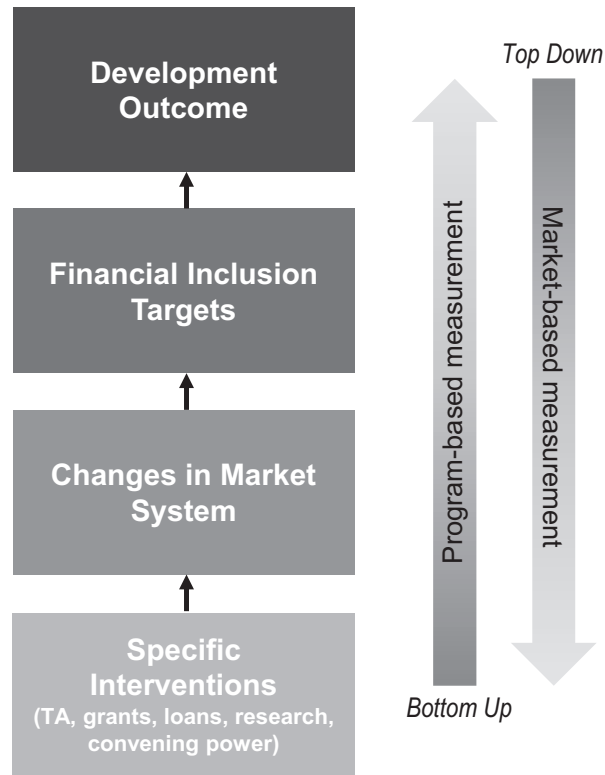
In 2014, Financial Sector Deepening Africa (FSDA), a DFID-funded program, partnered with the London Stock Exchange (LSEG) Academy to train 100 capital market policy makers and practitioners in Tanzania. The intervention logic was clear (i.e., skills development → improved institutional capacity → more efficient and innovative Tanzanian capital markets → economic growth → poverty reduction). As a market facilitator, FSDA was driven by strategic considerations of sustainability from the onset and, therefore, as the project progressed, used its budding partnership with LSEG to better understand the precise needs of the Tanzanian capital markets and modified its initial tactics of direct delivery of training. FSDA facilitated CEO Breakfasts—a gathering of Tanzanian leaders to coordinate work on capital markets between key players and stimulated crowding in, as for example, when a Tanzanian brokerage firm paid LSEG Academy to train 15 staff during the course of the project. Finally, after an introduction by FSDA to the Chartered Institute for Securities & Investment, a global skills standard-setting agency, the Capital Markets & Securities Authority, the key regulatory body in Tanzania, signed a Memorandum of Understanding setting the foundation for a more standardized, internationally recognized approach to capital markets skills development in the country.

While the overall development strategy did not change, it was only through direct engagement with local partners and beneficiaries and learning by doing in the field that the project was able to gain a better understanding of the needs to adapt its tactics for more lasting change in the skills development market for capital market professionals in Tanzania.

Source: FSDA

- **Flexibility to adapt theories of change and associated results tools is necessary.** While the overall strategy of a program should be clear from the outset, the results framework should be seen as a living document that allows for flexibility to revisit results and assumptions. The results and logical frameworks should provide flexibility to work with different partners over the course of a program or choose a different entry point to trigger systemic change. A program's results reporting should capture unintended (positive or negative) as well as intended effects of a funder's program.
- **Focus should be on contribution rather than attribution.** Market systems approaches aim to catalyze change, creating spillover effects to indirectly drive and scale-up change. Much of the impact of these interventions is indirect and involves influencing actors in the system to behave in certain ways. Changes can take a long time, and there are often many other contributing factors that influence results, making attribution difficult. Therefore, the focus should be more on creating a plausible narrative of a funder's contribution to broader market changes and less on attribution.
- **Apply top-down/bottom-up approaches to measurement.** Top-down approaches investigate change at the development outcome, financial inclusion, and/or market level without assuming the changes are due to a program's interventions. Bottom-up approaches (such as those advocated by the DCED Standard) seek to analyze and assess results against a program's ex-ante defined indicators at various levels of the theory of change. Combining a top-down and bottom-up approach, which triangulates evidence of what has contributed to the changes, creates a more credible contribution narrative (see Figure 5).
- **Draw on existing data wherever possible and develop sustainable data sources where needed.** Collecting and sharing market-level information can be used as an instrument of market facilitation, and not just for a funder's monitoring and evaluation purposes. Setting up mechanisms for measuring market development in a country can be an important part of market building. Different market actors, from the government to providers, have an interest in market information. When selecting indicators to measure market development, funders should be strategic about collecting information that is also useful for market actors and plan early on how this information can be made accessible and used for market facilitation. Funders should explore opportunities for pooling resources with other funders or with market actors to collect and share information that is of general interest.

Figure 5. Developing an overall impact narrative



### Key Messages

- Funder's interventions should aim for systemic changes in the market: changes that are **significant in scale, sustainable, and resilient**.
- Results frameworks should be based on a clear theory of change and measure change at various levels: development outcome(s), financial inclusion targets, changes in the market system, and outputs from program interventions.
- The results frameworks should be seen as living documents that allow for institutional learning and flexibility to revisit results and underlying assumptions, based on feedback loops.
- The focus of evaluations should be on contribution rather than attribution as much of the impact of these interventions is indirect and involves influencing actors in the system to behave in certain ways, making attribution difficult.
- Funders and their implementing partners should apply bottom-up and top-down measurement approaches that create more credible impact narratives.

## 7. Glossary of Terms

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<b>Client Protection</b>	The effort to ensure fair, responsible, and transparent services for clients. It includes avoiding overindebtedness, providing transparent and responsible pricing, having appropriate collection practices, exhibiting ethical staff behavior, having mechanisms for redress of grievances, and keeping client data private.
<b>Core Function</b>	The exchange between demand and supply in a market system. For example, in financial services markets, the core function describes the demand for a financial service (e.g., credit, savings, insurance, money transfers) and its supply by the different providers present in the market.
<b>Crowding-In</b>	Crowding-in occurs when market actors that are not directly involved in a funder's intervention adopt a new behavior as the result of that intervention. Crowding-in can happen spontaneously or might be stimulated by a funder's intervention, e.g., by making lessons learned from a pilot project publicly available.
<b>Demonstration Effect</b>	By testing and proving the validity of a new business model, product, or any other type of innovation, funders aim to create a demonstration effect that stimulates other market actors (beyond the funder's partners) to adopt a new type of behavior. See also <i>crowding-in</i> .
<b>Diagnostic Process</b>	In a market systems approach, diagnostics seek to go beyond symptoms to identify the root causes of the problem: the market dynamics that prevent the poor and low-income people from accessing and using financial services. A diagnostic is a continuous process that not only serves program design, but also allows project management to constantly adapt interventions and inform market facilitation throughout the life of the program.
<b>Drivers of Change</b>	A catalyst or agent of (systemic) change or reform. Drivers of change may be individuals or institutional champions of reform, or the product of the interaction among structural features, formal and informal institutions, and individuals that give rise to a process of reform.

<b>Facilitation</b>	An intervention approach that focuses on addressing systemic constraints by incentivizing and enabling market actors to perform their functions more effectively. Facilitation can be characterized by the temporary nature of interventions, its flexibility, a reliance on partnerships, and the focus on crowding-in market actors beyond the partners of a funder’s intervention.
<b>Facilitators</b>	A role that can be assumed by different kinds of organizations depending on their capacity and perceived independence. Funders can also act as facilitators either directly or through national coordinating bodies, or can fund individuals or organizations to do market facilitation on their behalf. Facilitators can focus on a single country market (such as members of the FSD network in Africa), or address a global market (such as CGAP, Better than Cash Alliance, or GSMA).
<b>Financial Inclusion</b>	A state where both individuals and businesses have opportunities to <i>access</i> and the <i>ability to use</i> a range of <i>appropriate</i> financial services that are <i>responsibly</i> and <i>sustainably</i> provided by formal financial institutions.
<b>Financial Services Markets</b>	The term “financial services markets” is used in these guidelines as an umbrella term that includes markets for different financial services (e.g., credit, savings, insurance, payments, leasing, Sharia-compliant financial products, etc.).
<b>Funders (of financial inclusion)</b>	Funders are public or private organizations that support financial inclusion to achieve a developmental mission or mandate, including bilateral and multilateral development agencies, private foundations, or development finance institutions. Funders are not considered market actors as they only temporarily intervene in market systems.
<b>Incentives</b>	Incentives influence the attitudes and behavior of market actors. They can be rooted in material benefits or social aspects (recognition, reputation) and are influenced by the rules and norms in a market system.
<b>Innovation</b>	New behavior, practice, or technique adopted by a market player that can be the result of program intervention that confers a benefit to the poor. These can be goods or services and/or new roles that support a different way of working.

<b>Related Market System</b>	A sector or market that is tangential yet closely linked to the core market, in this case the market for financial services. Examples include the markets for credit information, capacity-building services, or business development services.
<b>Intervention</b>	A suite of actions undertaken by an organization that is external to the market system (e.g., a funder or facilitator). Interventions can be part of larger projects or programs.
<b>Market Actor</b>	Any organization or individual that performs a function in a market system. Market actors can be private- or public-sector organizations. The main types of market actors in financial services markets include clients, FSPs, technical service providers, policy makers, regulators, and supervisors.
<b>Market Functions</b>	There are three key functions within a market system: (1) The core function, (2) supporting functions, and (3) rules and norms. When designing an intervention, funders should consider which function(s) the intervention will affect, who performs that function currently, who pays for that function currently, and how these will change through the intervention.
<b>Market System</b>	The interaction of multiple market actors performing multiple market functions, including the core function (such as the demand and supply of financial services), supporting functions, and rules and norms. The term “market system” is used broadly to describe the complex and dynamic interactions between all market actors, including private- and public-sector actors.
<b>Market System Change</b>	See <i>systemic change</i> .
<b>Market Systems Approach</b>	A combination of frameworks, principles, and practices that can be used to frame development interventions that lead toward systemic change, rather than filling a void in the market. Historically used in other sectors (e.g., agriculture value chains), it is increasingly gaining the interest of funders and practitioners in financial inclusion.
<b>Results Chain</b>	A model showing the chain of assumed causality through which a program’s activities leads to one or more levels of outcomes.
<b>Results Framework</b>	A matrix containing the program’s results chain and other related information such as assumptions, risks and performance indicators.

<b>Rules and Norms</b>	Rules and norms shape incentives for market actors and determine who can participate in financial services markets and under what conditions. Formal rules include laws and regulations issued by the legislator and public authorities, e.g., banking regulation, licensing criteria for MFIs, or know-your-customer procedures. It also includes rules issued by industry bodies, e.g., industry standards or codes of conduct. Informal rules are the product of local culture and generally accepted practices.
<b>Social Performance Management</b>	The set of practices that allow FSPs to achieve their social goals, including defining and monitoring social goals, developing client-centric products and services, treating clients and staff responsibly, and balancing social and financial performance.
<b>Supporting Functions</b>	A range of functions that falls outside of the core exchange of a market system but significantly affects the strength or weakness of that market. These functions support, shape, inform, and enable transactions between demand and supply. Important supporting functions in financial services markets include information, coordination, skills and capacity, payment systems, and funding. Supporting functions are necessary for markets to work efficiently, ensuring that demand and supply for financial services meet and transactions can take place in a secure manner and at the lowest possible transaction costs. In weak market systems, supporting functions tend to be absent, dysfunctional, or discriminate against the poor. Supporting functions can be provided by a variety of actors from the private, public, or associative sector.
<b>Sustainability</b>	The capability of market systems to respond to changes and provide a means by which poor women and men access social and economic benefits, beyond the period of a funder's intervention.
<b>Systemic Change</b>	A change in the underlying dynamics and structures of how a market system works that is significant in scale, sustainable, and resilient. Systemic change occurs if market actors beyond those directly involved in a funder's intervention adopt a new behavior that improves the poor's participation in financial services markets. Also referred to as <i>system-level change</i> or <i>market system change</i> .



<b>Theory of Change</b>	A narrative that articulates the underlying assumptions of how change will happen in a program at different levels (market system change, financial inclusion objectives, and development outcomes), and the risks that could prevent the program from achieving its intended results. It is the basis for the diagnostic process and the design of an intervention.
<b>Transaction Cost</b>	The costs of participating in exchanges, covering search and information, bargaining, and enforcement costs.

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#### **Section 4: Understanding Barriers to Financial Inclusion**

##### *Demand*

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