How to calm the charging bull

An agenda for CGAP in the decade of the "teenies"[1]

with no apologies to Wall Street

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Synopsis

International microfinance is at a critical juncture in 2010. As a sub-sector of the financial services industry, microfinance has evolved from the slow moving tortoise of the 1990s to the nimble hare of the early "noughties" (2000-05) and, since then, into an overcharged bull growing at 70-100% per annum in some markets. The purpose of this note is to examine some of the key messages propagated by CGAP over the past decade and to propose a substantially modified agenda designed to address the critical challenges faced by the sector today so that the charging bull of the past few years can be transformed into a more serviceable creature in the decade that lies ahead.

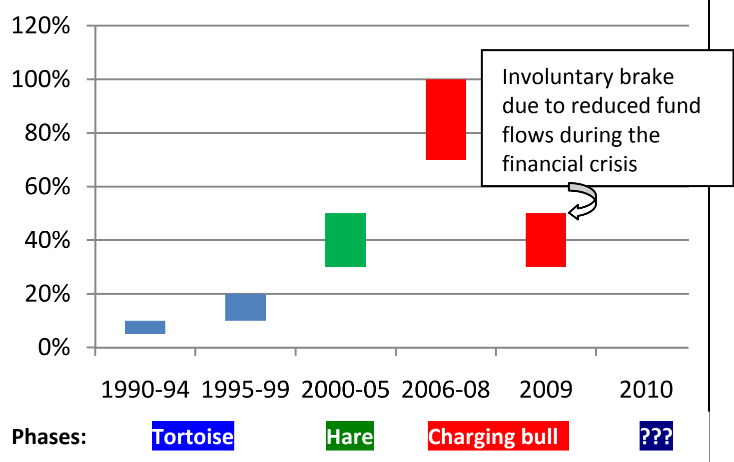
The key conclusions of this note are that CGAP needs to modify its conventional messages such as "zero tolerance of delinquency" and "no restructuring of client loans" in the context of emerging over-indebtedness and the financial crisis. It also needs to strengthen its messages in relation to governance, social mission and improving depth of outreach to the poor. For enabling it to "assist the poor", CGAP should increase its engagement in graduation programmes for extreme poverty and, radically, expand its mandate so that it can support livelihood promotion as it has supported microfinance. Above all it must avoid crowding out initiative in microfinance markets and apply strict transparency standards in its own operations in order to strengthen its brand and improve its efficacy.

[1] Thanks are due to my colleagues – Dr Alok Misra, Ms Frances Sinha and Prof Malcolm Harper – for their helpful comments. Any remaining shortcomings are my own responsibility.

1 Introduction

International microfinance is at a critical juncture in 2010. As a sub-sector of the financial services industry, microfinance has evolved from the slow moving tortoise of the 1990s to the nimble hare of the early “noughties” (2000-05) and, since then, into an overcharged bull growing at 70-100% per annum in some markets (**Figure 1**), wildly chasing down the temptation of high MFI valuations put forth by the Compartamos IPO in 2007 and the private equity sales of some of the major Indian MFIs. In the dust of its wildly kicking hind legs, the charging bull has raised all manner of dangers – internal control failures, multiple lending leading to significant risk of over-indebtedness, increasing rather than declining interest rates with the growth of the sector and, partly as a result, the looming threat of government intervention as the ills of its over-charged operations become better known and politicians spot the opportunity to earn popularity at the expense of microfinance promoters.

Figure 1
Growth rates of MFIs



Source: M-CRIL research and MIX data

Added into this melee is a changing of the leadership at the Consultative Group to Assist the Poor (CGAP), the international technical agency responsible for supporting microfinance and financial access for the poor, worldwide. This imminent change opens up an opportunity for CGAP’s financial access agenda: the opportunity to reconsider its technical messages in the context of developments in the sector in recent years.

The purpose of this note is to examine some of the key messages propagated by CGAP over the past decade and to propose a substantially modified agenda designed to address the critical challenges faced by the sector today so that the charging bull of the past few years can be transformed into a more serviceable creature in the decade of the “teenies” that lies ahead. The aim is to propagate a commercially successful sector, with a better managed approach to growth, that meets the needs of its clients by facilitating their financial lives with responsible systems that are fair to all stakeholders, including the community it seeks to serve, at the same time as being economically efficient.

2 Conventional wisdom in the tortoise phase

CGAP started life in the late 1990s, with the then daunting responsibility of transforming a tortoise-like sector run by a set of welfarist NGO leaders with a concern for the poor but limited knowledge or understanding of the principles of effective delivery of financial services. In this environment, the organization set about developing a set of working norms and practices with the aim of building strong financial systems in the sector and fulfilling its mandate of maximizing financial access for the poor by promoting the growth of microfinance institutions (MFIs). Some of the earliest principles developed for this purpose and aggressively publicized through technical seminars and training programmes during the tortoise and hare phases were

1. Zero tolerance of delinquency
2. No restructuring or refinancing of client loans
3. Clear awareness of sustainability performance
4. Microfinance services provided by separate, exclusively focused teams with no other responsibilities.

Thus, came to be established the conventional wisdoms of microfinance. Specifically,

2.1 Zero tolerance of delinquency

In a tortoise environment where grant-funded NGO microfinance providers regarded the welfare of the poor as their primary responsibility, the common concern was that microfinance service providers were too tolerant of delinquency by individual clients (or client groups). Such tolerance vitiated the credit environment by conveying the message that the lender would take a soft approach to late payments and may even write-off loans if reasonably convinced that repayment would put an onerous burden on the borrower. CGAP, therefore, propagated the idea of "zero tolerance" in the hope of tightening credit discipline and ensuring that microfinance service providers would do a better job of recovering their portfolio than was the case at the time; non-performing loans of the order of 10-20% were common.

On the principle that "we value – and can manage - what we measure", CGAP established a criterion of "overdue for more than 30 days" for determining that a loan was delinquent. Based on this, a new expression hitherto unknown in the financial lexicon was coined: portfolio at risk more than thirty days (or PAR_{30}). The PAR terminology implied that the entire principal amount in any loan that was more than 30 days overdue was "at risk" and should, therefore, be subject to both more intensive follow up than loans being paid on time and to loan loss provisioning in case of default.

The message of zero tolerance was simple: no microfinance loan should be allowed to become overdue and if, perforce, such an eventuality arose, the problem should be forcefully addressed both with the client and through prudential financial measures such as provisioning and write offs.

2.2 No restructuring or refinancing of microfinance loans

The tendency of NGO promoters to view clients as beneficiaries and microfinance loans as subventions to be repaid if possible was tackled not only by inculcating a zero delinquency culture but also by ensuring that the delinquency issue could not be by-passed through either restructuring (extending the loan term to facilitate repayment) or refinancing (disbursing a new loan to enable the client to complete payment on the overdue one and make a fresh start on repayments). The microfinance sector was firmly warned that neither a restructured nor a refinanced loan was any better than an overdue one and the practice should, therefore, be strictly avoided if not banned altogether. If there were any exceptions to this, such loans should be reported separately and all the financial provisioning rules applicable to delinquent loans should apply to restructured/refinanced loans as well.

2.3 Clear awareness of sustainability performance

NGOs providing microfinance services were typically grant-supported at this time though some borrowing from donors (as returnable grants) and commercial banks was also starting to appear. However, in keeping with conventional NGO accounting, grants and income earned from the microfinance portfolio appeared as revenue items in the NGO's financial statements and expenses were deducted from the sum of these to obtain a financial surplus for the year. Accounting practices varied and grants could even be received directly through the balance sheet and incorporated in equity. Such practices made it difficult, if not impossible, to establish the level of subsidy received by such organizations. Many such NGOs had no idea to what extent their microfinance operations were subsidized; what's more their funders didn't either. Transparency was an issue.

CGAP's response to this situation was to establish clearly the practices appropriate to accounting for grants as separate clearly stated line items on the balance sheet and "below the line" additions to the income statement after calculating the surplus earned or deficit incurred from operations. To emphasise the importance of this on the "we value what we measure" principle, CGAP developed and propagated the use of two new indicators, operational self-sufficiency (OSS) and financial self-sufficiency (FSS). These were defined as

Operational self-sufficiency = <u>Income earned</u> from microfinance operations (including interest on loans given, loan processing fees and any other charges associated with the microfinance activity) *divided by* <u>expenses incurred</u> on microfinance operations (including interest paid on loans taken for microfinance portfolio financing, staff expenses, other operating expenses, depreciation and loan loss provisioning)

Financial self-sufficiency = <u>OSS adjusted for subsidies</u> such as below market rate borrowing for portfolio, in kind subsidies and an adjustment for the depreciating effect on the value of the institution's own funds (or equity). The effect of the subsidies and income necessary for maintaining the value of equity had to be removed from the OSS calculation in order to establish the financial self-sufficiency (also often referred to as the financial sustainability) of the microfinance operation.

2.4 Microfinance services provided by separate, exclusively focused teams with no other responsibilities in the field

At this time the typical NGO undertook a range of activities including health, gender, education/literacy, social mobilization and livelihood support as well as the provision of microfinance services. As a result, it was often the responsibility of the community worker to dispense malaria tablets, hygiene information and gender relevant social messages along with the delivery of microfinance services, particularly loans (and occasionally the collection of deposits). As a result the community interface of the NGO entailed a combination of the distribution of grant funded commodities (or even grants as cash for the purchase of treated mosquito nets, for instance) at the same time as the disbursement of new loans and the collection of repayments on existing loans. The community worker was thus cast in the role of benevolent giver, on the one hand, and hard-nosed collector of zero delinquency loans, on the other. Not surprisingly, the roles did not mix and, more often than not, the benevolent orientation of the NGO prevailed over the strict disciplinarian role of the lender both in the minds of the clients (or beneficiaries) and in the behavior of the NGO staff.

Naturally, the only response to this situation was to recommend the separation of not only social activities (health, education, drinking water, social mobilization, et al) but also livelihood support programmes from the pure financial services function. Despite the clear role of financial services in enabling the pursuit of livelihoods a combination of the delivery of the two types of activities was seen not to work; at the time, livelihoods programmes still entailed substantial grant distribution and pursuit of the two together was incompatible for the reason indicated above. In addition, the dilemma of a team providing support services for livelihoods expecting to collect microfinance loans at times when the support livelihood was not delivering adequate income for seasonal or cyclical reasons was obvious. Hence, CGAP promoted the full separation of microfinance teams from the other activities of such organizations and recommended the establishment of separate institutions, if possible, for the provision of financial services.

3 The successful evolution of the nimble hare…warts and all

The early years of the twenty-first century (2000-05) were heady days for microfinance and a tribute to CGAP's success in gaining acceptance for its principles of good practice. Not only did the financial practice principles of zero delinquency and no restructuring come to be overwhelmingly accepted and applied but PAR_{30}, OSS and FSS amongst other monitoring parameters promoted by CGAP became standard ratios for benchmarking performance. The principle of separation between microfinance service provision and other development activities undertaken by an organization became fully accepted. Most organizations either established separate institutions for microfinance (which came to be known as MFIs) or, in the case of the older established organizations like BRAC in Bangladesh, ensured that financial services were provided by a distinct team not identified with the livelihoods and other interventions of the organization. As a result, the growth of microfinance accelerated to a healthy 30-50% as illustrated in **Figure 1**. While Latin America went through this evolution somewhat earlier, in most microfinance markets of Asia, Africa and Eastern Europe, market penetration remained limited at 20-30% with only Bangladesh of the major markets approaching saturation in some geographical clusters.

3.1 Transparency initiatives…was the MIX really necessary?

In order to contribute to and reinforce the process of monitoring and benchmarking, as well as to improve transparency to funders and governments, a new support services segment of the sector developed at this time. Support institutions such as MFI networks/associations and training organizations had already started to enable the growth of the sector by the late 1990s; the hare phase saw the widespread use of specialized microfinance rating agencies for better due diligence and greater transparency of MFIs resulting in strengthening the flow of funds to fuel their growth. Across the world, funders (donors as well as a growing legion of domestic as well as international commercial lenders) increasingly used microfinance ratings as a key due diligence tool for identifying opportunities to place their funds. Financial performance rating came to be established during this period as an essential facilitator of funds for microfinance. In India, the world's largest microfinance market, microfinance ratings (mainly by M-CRIL), an eager development bank (SIDBI) that took the lead in providing debt funds to MFIs and the preferential "priority sector" lending requirement for commercial banks combined to create a situation where an analysis of MFI balance sheets for the 2005-07 period showed that as much as 80% of MFI funds were sourced as debt from (mainly) commercial banks.[2]

CGAP's major contribution during this phase was the establishment of the Microfinance Information Exchange (MIX) in 2002 for strengthening the transparency that had already started to happen with microfinance ratings. As its database of reporting MFIs grew, the MIX helped to establish benchmarks based on information from a wider range of MFIs than any of the rating agencies was individually able to do. During this early stage of its work, however, the MIX benchmarks suffered from being based on information self-reported by the MFIs, sometimes with their own interpretation of the calculation of indicators like PAR

[2] M-CRIL & MIX, 2007. India Microfinance Review 2007. Gurgaon, India.

and FSS[3] and often with conflicts of interest in reporting vis-à-vis competition. Whether better results might have been achieved by persuading the specialized rating agencies to pool the data from MFIs they had rated is a question to be considered.

3.2 The suitability of the PAR_{30} criterion…is a variable criterion more appropriate?

Another issue that emerged at this time was the suitability of the 30 day criterion for determining delinquency. It is a criterion devised from the experience of the flourishing, urban oriented microfinance sector in some Latin American countries in the mid-1990s. The average loan term there was four months (120 days) for which a 30 day overdue criterion made sense in determining delinquency. In the one year loan terms of predominantly rural microfinance in Asia and much of Africa, the suitability of this criterion could be questioned. In Asia as much as 40-50% of rural microfinance loan portfolios are deployed in animal husbandry activities which have irregular revenues necessitating the repayment of micro-loans out of the borrowers' family cash flows rather than directly from income from the investment enabled by the loan. The 30 day criterion applied to such loans, represents less than 8.5% of an annual loan term and just two payments in a monthly payment cycle; conversely 30 days in a four month loan cycle represents 25% of the loan term and is suitable for the mainly trading activities (with daily cash flows) pursued by typical microfinance clients in urban Latin America. A variable criterion, depending on regional conditions, would have been less convenient but probably more appropriate.

3.3 The lessons of the Grameen Bank experience of "no refinancing"

Finally, problems with the "zero delinquency, no refinancing" principle were also starting to emerge. Around this time managers of far flung branches of the celebrated Grameen Bank were found to be extensively refinancing loans of delinquent clients, protecting their own standing with the bank's management if not necessarily safeguarding its portfolio. The Grameen Bank's response to the potential hole in its balance sheet should, in fact, have sounded the death knell of the principle. Grameen 2 allows widespread restructuring and refinancing in the sense that clients may repay varying amounts so long as interest payments and a small amount of principal are covered and it also allows top-up loans. In conjunction with a flexible deposit scheme, Grameen 2 has become a highly successful programme and the Grameen Bank has become a revitalized force for financial inclusion in Bangladesh. Yet, few MFIs outside Bangladesh have applied the lessons of Grameen 2 and CGAP's principles remain the overwhelming mantra of MFIs throughout the world.

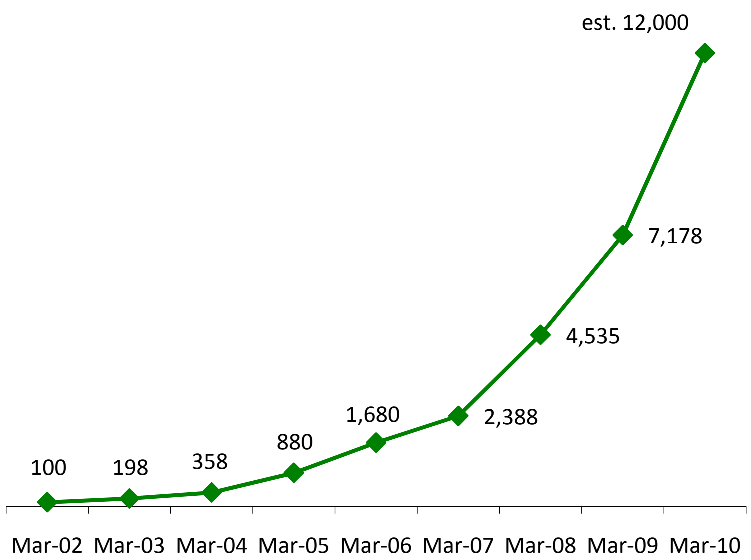
The discussion in this section has pointed to the emergence of some issues in the microfinance sector even as it started to grow strongly under the (largely) appropriate technical stewardship of CGAP. The increased growth and improved performance of the sector during the hare phase was so successful, however, that such concerns as arose at this time were quickly swept aside and even those who dared to raise them were perhaps less assertive than they might have been.

[3] PAR was often confused with amount overdue during this phase; some MFIs still do this. FSS has never been calculated accurately by MFIs.

4 The onset of the charging bull…

In the early part of the past decade, the process of microfinance NGOs transforming into partially or fully regulated microfinance companies had begun. By the middle of the decade, some of the early movers had already registered high growth rates and had been successful in mobilizing private sector equity funds. This success infused significant momentum into the transformation process and the pursuit of MFI valuations led to growth (with zero delinquency) becoming the guiding principle determining MFI performance. Inevitably, it was the markets with highest potential that registered the highest levels of growth. In India, M-CRIL's India Growth Index climbed to the level 7,178 by March 2009 (and estimated to reach 12,000 by March 2010)[4] – registering an annual growth rate of 65% during 2006-2010. Elsewhere in Asia, an already large microfinance sector in Bangladesh doubled its number of clients from 9.5 million in 2003 to around 20 million in 2008 and M-CRIL's composite index of microfinance for the rest of Asia increased from 100 to 367 during the same period. Worldwide, growth of the typical MFI was of the order of 25% per year during this period (slowing to 15% with some drying up of onlending funds during 2008).[5] This will have resulted in a typical MFI serving around three times as many low income borrowers in 2008 as in 2003. The average compound annual growth rate indicated by the MIX data was even higher at 43% for the period 2004-08 .[6] This translates to a four-fold increase in the number of borrowers over this period. The charging bull of microfinance had truly been unleashed.

Figure 2
M-CRIL India Growth Index



4.1 …leaves a trail of destruction as "zero delinquency/no restructuring" fundamentalism causes heartburn

In spite of a slowdown in 2009 due to reduced fund flows resulting from the financial crisis, the numbers served in many microfinance markets have now reached 50-70% of the potential. The rest of this contemporary story is well known

4 March 2002=100. The M-CRIL India Growth Index (**Figure 2)** is a composite measure of growth of the 14 leading Indian MFIs combining information on the number of borrowers and portfolio size of the MFIs.
5 Stephens, Blaine, 2009. Operating Efficiency: Victim to the Crisis? MicroBanking Bulletin, Issue 19.
6 Chen G, Rasmussen S and Reille X, 2010. Growth and Vulnerabilities in Microfinance. CGAP Focus Note 61.

- On account of rigidities in microfinance outreach, 50-70% overall market coverage has resulted in significant pockets of local market saturation
- Saturation has led to multiple lending in many places in the microfinance world
- Managements have been unable to ensure that controls keep pace with the growth of outreach and portfolio
- All of the above have caused vulnerability (and sometimes over-indebtedness) in a number of microfinance markets – most notably in Bosnia, India, Morocco, Nicaragua and Pakistan.[7] Other markets, notably Cambodia, Nepal and various regional clusters in India (apart from southern Karnataka) are lining up for similar problems.

More particularly, the zero delinquency, no restructuring principles adopted by managements rigidly following the CGAP principle have sometimes led to overbearing collection practices at the loan officer-client interface, raising concerns about client protection. MFIs are now courting reputation risk and are increasingly regarded as no different from the conventional view of moneylenders: collecting willy-nilly whatever the circumstances of the client. Indeed, in southern Karnataka state (in India) this phenomenon has been the cause rather than the result of a delinquency crisis.[8]

4.2 Without necessarily "assisting the poor" or improving their livelihoods

Impact studies over the years and, more recently, surveys using practical tools for poverty assessment, such as the Progress out of Poverty Index (euphemistically named) and the Poverty Assessment Tool, have virtually established that while MFIs work almost exclusively with the financially excluded, this does not necessarily translate to working with the poor. The financially excluded population in most countries with active microfinance sectors amounts to 60-80% of the total while poverty rates range from 10-40%. Since MFIs cover, usually, no more than 20-40% of income earners (as opposed to the microfinance market), the research surveys referred to above have now established that MFIs work largely with the upper strata of poor households along with the vulnerable non-poor just above the appropriate poverty line[9] as well as the non-poor. By and large studies by M-CRIL and its parent organization (EDA) in Asia and Africa have shown that MFI coverage of the poor (below the national poverty line) is often no more than the proportionate occurrence of poverty in the community as a whole. Thus, at a time when the national poverty line indicated 25-30% of the population of India as having below poverty line incomes, just 29% of clients across 20 MFIs were found to have incomes below that level.[10]

Further, a series of impact studies with and without randomized controls have failed to establish any direct causal link between better availability of financial (more particularly credit) services from MFIs and increasing client incomes.[11] Indeed, CGAP having successfully

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7 Documented and discussed in the CGAP Focus Note cited above for four countries and by EDA in India.

8 EDA Rural Systems, 2010. Competition & the Religion Conundrum. Gurgaon, India.

9 National poverty line or $1 or $2 a day as modified by latest practice.

10 EDA Rural Systems, 2005. The maturing of Indian microfinance: Findings and policy implications from a national study. Gurgaon, India.

11 The most recent being the study of impact of the leading Indian MFI, Spandana by MIT.

promoted the growth and efficiency of MFIs partly by obtaining the separation of livelihood promotion from microfinance service delivery has also de-linked MFIs from enabling livelihoods. Thus, while there is some evidence of reduced client vulnerability on account of the availability of bridging finance, there is not any overwhelming argument or evidence for CGAP's work to "assist the poor" having reduced poverty.

Of course, CGAP does not work exclusively with the microfinance value chain – from investors to clients. In recent years (indeed during the charging bull phase), satisfied that much had been achieved in promoting microfinance, CGAP has also turned its attention to other ways of promoting financial inclusion. Thus, it has engaged with issues such as the use of mobile devices, IT systems and business correspondent programmes aimed at increasing and deepening the outreach of the banking sector to the hitherto financially excluded. This is a laudable move but has not yet delivered significant results.

4.3 Governance and social performance have also suffered…

While CGAP has excellent achievements in the fields of financial performance and the management of MFIs, it cannot claim to have done as much in some of the areas that are now emerging as the key to enabling MFIs fully to serve the needs of the poor. These include various aspects of social performance management; while CGAP has a strong initiative on client protection it has not significantly addressed other issues that have emerged as significant weaknesses of MFI operations. These include

- the (lack of) depth of outreach of MFIs to the poor
- the suitability of microfinance products to the needs of very low income clients – the typical microfinance product is too rigid to do so, yet Grameen Bank has demonstrated that it is possible in certain circumstances to be more flexible
- the employment effects of microfinance operations; is it perhaps possible to increase employment and "assist the poor" through larger loans and other financial services that facilitate the operations of SMEs (small and micro-enterprises) rather than just cash flow lending to the financially excluded
- human resource systems (incentive systems and working conditions) that affect the increasing numbers of staff employed by MFIs; in some regions there are increasing concerns about staff working conditions (in terms of the length of the working day), on the one hand, and also about the role of incentive systems designed to increase the charge of the bull (microfinance growth rates) with negative fall out in the form of multiple lending to 'excluded' households with risk of client over-indebtedness.

Most importantly, the governance of MFIs is desperately in need of strengthening. From the mission driven sector of the tortoise phase, microfinance has evolved into the equity valuation driven sector of the charging bull phase. Starting with the Compartamos IPO in Mexico in April 2007, the increase in MFI equity valuations from 1.5 times book value at the beginning of the charging bull phase to around 2.5 times book value (internationally) in 2009[12] has led many microfinance promoters to think of taking advantage of the windfall of

[12] Reille, X, et al, 2010. <u>All eyes on asset quality: Microfinance Global Valuation Survey 2010</u>. CGAP Occasional Paper 16.

personal profits. The phenomenon has been most pronounced in India, where valuations in excess of 5 times book value have become common in the past few years. Since valuations are driven by the prospect of profits in the future, the growth potential of MFIs has become the most important feature for investors; this has reinforced the charge of the bull, often at the expense of depth of outreach and responsible lending practices, negating the stated social mission of the MFI. Governance plays a crucial role in focusing an institution's commitment on social mission and values; beyond platitudes, relatively little has been done to improve MFI governance.

4.4 While there are still questions about capacity enhancement

Whether or not establishing the MIX in its present form was strictly necessary, in the charging bull phase, its database has become widely used for the purpose of benchmarking. To this extent, what it does has a direct impact on stakeholder perceptions of the sector. Therefore, its efforts to introduce a degree of data oversight and desk verification through local or international resource institutions are welcome; though for reasons best known to its management it has now pulled back from this to establish its own regional offices. Nevertheless, analysis of the data by region, undertaken by the MIX, helps to establish regional benchmarks and to place them in a practically useful analytical framework.

However, the question remains whether there was not enough analytical capacity around the world without there being a need for the MIX to create more capacity, to the exclusion of analytical efforts within microfinance markets. Thus, CGAP and MIX donors and management need to consider whether the undoubtedly excellent MIX reports have in fact crowded out the development of analytical capacity in some of the key microfinance countries or regions. There is, of course, no bar on others doing similar work but the fact is that a well resourced, grant funded institution based in Washingtion DC has the luxury to do more and carries more immediate credibility with observers than the, initially, hesitant efforts of developing country researchers with, often, limited resources. MIX has not gone out of its way to seek the engagement of local researchers and analysts in developing countries and when it has, it has tended to be so focused on cost that high quality researchers have been by-passed.

Another issue with the MIX is its apparent lack of sensitivity to local variations and financial systems. To take just one example, its response to the issue of the off balance sheet portfolio management activities of Indian MFIs has not been encouraging. The 2008 database of the MIX adds portfolio management fees to revenues earned on the MFIs' own portfolio in order to calculate portfolio yield. This overstates the yield on owned portfolio and makes the MFIs appear to be charging more than they actually are. Yet, despite substantial discussion with MFIs and rating agencies on the matter the MIX has not made the changes necessary to present the correct ratios on its website.

An action agenda for calming the charging bull, reducing reputation and political risk as well as reinforcing the efficacy of CGAP vis-à-vis its ambition to "assist the poor" is presented on the following page.

How to calm the charging bull

– an action agenda for the current decade

1 Modify the zero delinquency message to assure MFIs that non-performing loans of the order of 2-3% of portfolio are common even in the most efficient segments of the financial services industry.

2 Reduce the emphasis on OSS and FSS measurements that serve little purpose at this stage of the sector's development; modify the PAR criterion with regional variations – in order to standardize, perhaps PAR_{30} and PAR_{90} could both be measured. Other ratios – such as standard measurements of CAR (capital adequacy ratio) and the foreign exchange risk ratio – employed by the rating agencies for some years (and recently advocated by the MIX) should be promoted extensively.

3 Similarly, modify the no restructuring, no refinancing principle to promote a more humane response to genuine delinquency issues. Encourage a wider dissemination of the lessons of the Grameen Bank so that Grameen 2 becomes the favoured microfinance methodology amongst mission driven MFIs leaving Grameen 1 to be exploited for personal enrichment by microfinance promoters.

4 In order to focus MFIs on better meeting the needs of low income clients, encourage greater product innovation to provide alternatives for different conditions and loosen the rigidity that afflicts current microfinance product offerings.

5 Enhance CGAP's engagement in strengthening the governance and social performance of MFIs as outlined in the discussion in **Section 4.3** above. Increase engagement with lenders and investors (both microfinance investment vehicles (MIVs) and private equity investors) to strengthen their commitment to improved governance and microfinance service delivery based on social values.

6 Reinforce initiatives in the wider field of financial inclusion to encourage the banking system to provide services to low income families at the lowest possible cost.

7 Expand and increase CGAP's limited engagement with programmes for graduating the extreme poor to sustainable livelihoods.

8 Redesign the MIX as a coordinator and stimulator of data collection and analysis in a manner that enhances, not crowds out, such capacity in microfinance markets.

9 Finally, **expand CGAP's mandate to include <u>technical support to livelihood promotion</u>** initiatives so that it can reinforce its ability to "assist the poor" through a wider, more holistic programme than is possible with microfinance alone. This is not to suggest that MFIs should mix livelihood promotion services with their financial activities but rather that CGAP should open a radical new channel of work to improve its ability to "assist the poor".