RURAL FINANCE

Position paper

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HELVETAS
Swiss Intercooperation

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1. Introduction

A position paper for whom?

This position paper on Rural Finance is primarily addressed at project staff of HELVETAS Swiss Intercooperation in the field, as well as program coordinators and staff from the Advisory Services Departments involved in supervision, implementation or advice of projects where access to financial services is an issue. Moreover, the paper should also help inform colleagues from communications and fundraising department.

Why a position paper? What is the context?

Financial services are needed everywhere: women and men of all ages need a wide range of financial services – savings, credit, money transfer, Automatic Teller Machines (ATM), insurance – in order to manage their business or private finances. The poorer people are, the more these services are needed, since incomes are more irregular and uncertain, production and assets are not ensured. The booming microfinance industry all over the world has responded to these needs since more than 40 years.

However, HELVETAS Swiss Intercooperation is still regularly challenged by the difficult access to financial services of its target population, in particular in rural economy projects. Indeed, reality shows that in remote rural areas, particularly in Sub-Saharan Africa, the offer of financial services is limited and/or of low quality. Even in more densely populated and "microfinance pioneer" countries like Bangladesh, the target groups of HELVETAS Swiss Intercooperation's projects seem to struggle with access to financial services adapted to their production systems, because products are badly designed, too expensive, too inaccessible, too complex, etc.

While HELVETAS Swiss Intercooperation does not directly provide financial services to its target groups, the organization has cumulated a vast experience on rural finance. For almost 20 years, based on its long term international experience in the promotion of rural economies, private sector, value chains, organic and fair trade, and market systems, the institution is active in rural finance through the provision of technical advice and trainings, development of tools, applied research and knowledge management.

The position paper has been elaborated by the Rural Economy team and is part of the Rural Economy Strategy 2013-2017. It provides information on:

- **Definitions**: What is meant by microfinance, financial inclusion, rural finance, value chain finance.
- **Where does HELVETAS Swiss Intercooperation stand today:** Past and current experiences and future perspectives.
- **Thematic recommendations and guidelines:** Dos and Don'ts, how to chose partners?

2. Definitions / Explanations

What is meant by microfinance or financial inclusion?

The widely used term of **microfinance** means the provision of financial services to the poor and low income population which involves small amounts of savings, credit, insurance, remittances, and money transfer services. Nowadays, the donor and investor community of microfinance, represented by the Consultative Group to Assist the Poor (CGAP), does not talk about microfinance anymore. The term **financial inclusion** is more suited, since the objective of the community has shifted from "building microfinance institutions which serve the poor" to "shaping financial markets in a way that they reach down to the poor". For financial inclusion, you do not need only microfinance institutions, but also commercial banks, postal banks, cooperatives, insurance companies, informal savings groups, mobile phone operators, etc.

Multiple studies show that access to financial services can have a positive impact on household welfare and enterprise activities. Poor families are both producers and consumers. In both roles, they need access to a wide range of financial services that are reliable and flexible, because they have far less regular income and expense streams and less of an economic cushion as compared to regular income earners. As entrepreneurs, they need financial services to invest, generate income, and build assets; as households they need financial services to smooth consumption, meet savings objectives, and manage risks.

Can we reach the poorest of the poor with financial services?

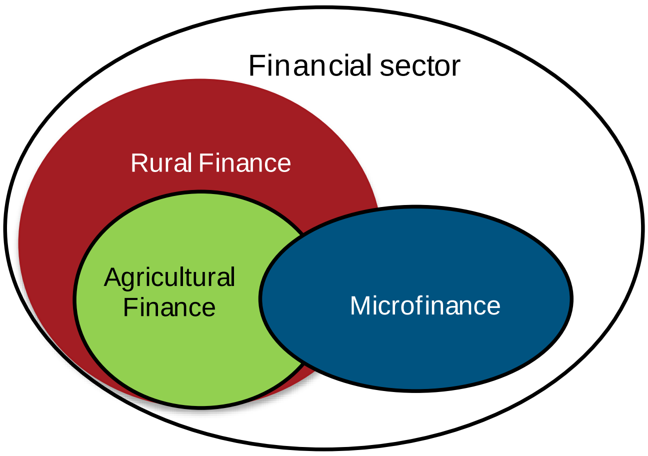
As mentioned above, financial inclusion has a positive impact on poor households' welfare and enterprise activity. However, there is indeed no evidence that loans can help poor people lift themselves out of poverty. Worse, the microfinance crisis in Andhra Pradesh, India, or Bosnia has shown that credit can lead poor people to over indebtedness and thereby worsen their economic situation. It has been widely recognized that for very poor and vulnerable people, more than credit is needed: skills training, asset transfer, savings, insurance, and eventually credit.[1]

What is Rural Finance?

Rural finance refers to financial services offered and used in rural areas by people of all income levels (see figure 1). **Agricultural finance** is a sub-set of rural finance dedicated to financing agricultural related activities, such as loans to buy fertilizer or for marketing crops, or insurance products designed to meet the specific needs of farmers and agricultural workers. **Microfinance** encompasses (among others) the lower end of both rural and agricultural finance.

Value chain finance is the provision of financial products and services flowing to and/or through a value chain to address the needs of those involved in that chain, be it a need for finance, a need to secure sales,

Figure 1: The place of rural finance



Source: CGAP Donor Brief no. 15

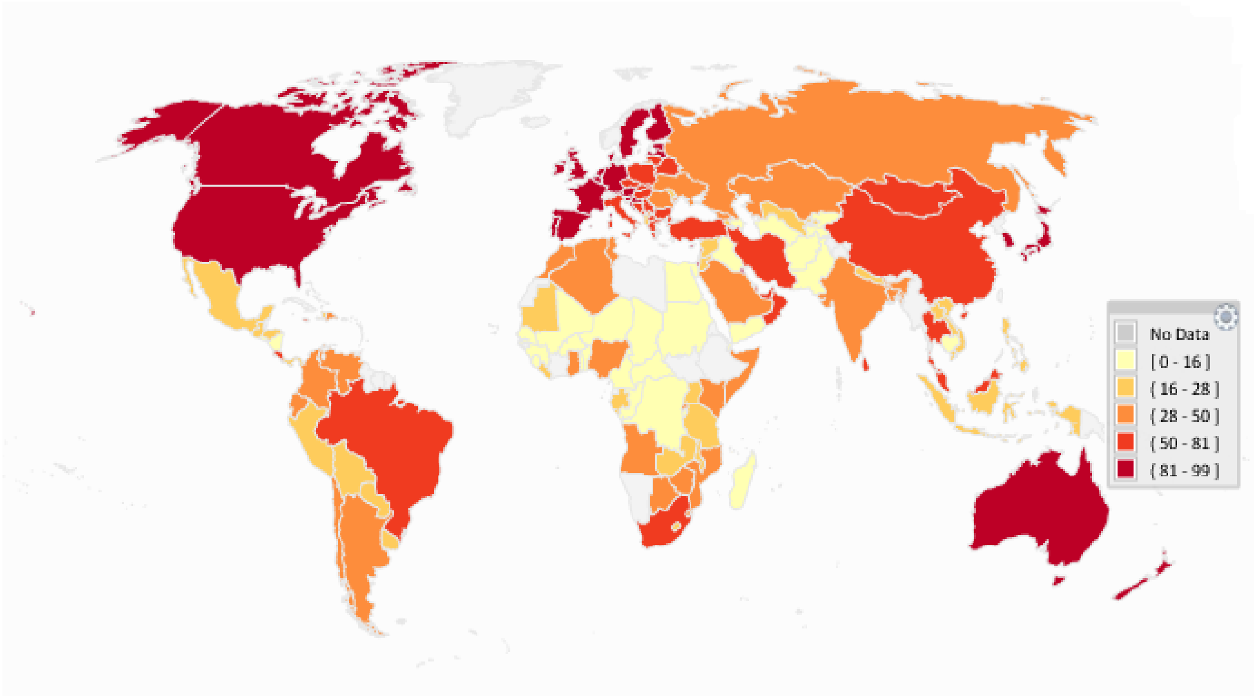
[1] See Savings and Credit Forum on Graduation Models: Graduating the Poorest into Microfinance and CGAP-Ford Foundation's graduation program.

procure products, reduce risk and/or improve efficiency within the chain.

Where does "financial inclusion" stand today?

The microfinance industry has made significant progress since its beginnings in the 70'ies, evolving from "micro credit" towards "financial inclusion". Nowadays, the industry strives to the integration of microfinance into the formal financial system, so that all people have the same possibilities to access financial services. Although significant progress have been made all over the world, today still only 23% of poor people have a bank account and there is a strong correlation between the level of development of a country and access to financial services (see figure 2).

Figure 2: Percentage of adults with accounts at formal financial institutions



Source: Global Findex Database, World Bank (2012)

The **microfinance crisis** of 2010 has shown how commercialization and aggressive growth of microfinance institutions in certain parts of the world have led to undesired results on the client's (over-indebtedness) and the institutional side.

However, if financial institutions targeting the poor have a responsible behaviour, adhere to client protection principles, offer a wide range of financial services, not only credit, and are properly supervised, HELVETAS Swiss Intercooperation believes that they can make a big difference to their clients.

Taking into consideration recent debates and past learning, HELVETAS Swiss Intercooperation is strongly committed to **international good practices** and **standards of responsible finance**.

- **International good practices on financial inclusion**

Sustainable microfinance is a key element in creating solid financial markets in developing countries. Therefore, CGAP's donor members developed and endorsed the **Key Principles of Microfinance**, which were later also endorsed by the G8 countries. HELVETAS Swiss Intercooperation adheres to these principles (see Annex 2).

- **Standards of responsible finance**

Responsible finance is a set of guiding principles, elaborated by the financial services industry, for how financial services should be delivered to live up to the challenge of promoting sustainable development. Socially and morally appropriate behavior is becoming increasingly important. Responsible finance, refers to coordinated public and private sector interventions that encourage and assist financial services providers and their clients in improving their understanding and approaches, practices, and behaviors that can eventually contribute to creating more transparent, inclusive, and equitable financial markets.

Achieving this vision in any market requires action by a variety of stakeholders, with three key stakeholder groups, (i) the **financial services industry** (through a variety of actions, including compliance with laws and regulations, adherence to industry codes of conduct, standards, good practices, and institutional commitments to transparency and fairness in their operations) (ii) **governments** (through policy and consumer protection regulation, commitments to increase attention to financial literacy at the national level); and (iii) **consumers and their organizations** (through enhanced consumer awareness and capability). Areas of action are:

- **Consumer Protection**: A regulatory framework for financial consumer protection, at both national and international levels.
- **Responsible Providers:** Voluntary commitments, practices, standards, and initiatives in the financial sector (individually and at industry level, nationally and internationally).[2]
- **Financial Capability:** Interventions aimed to build and enhance financial capability of financial institutions' clients – the consumers of financial products and services.

HELVETAS Swiss Intercooperation's projects and programs incorporate social, economic, and environmental dimensions. One of the most important aspects of its financial sector responsibility is fair treatment of clients and acting in ways that protect client's social and economic welfare.

[2] Voluntary commitments are adhering to the Smart Campaign as a global effort to unite microfinance leaders around a common goal: to keep clients as the driving force of the industry and the Social Performance Task Force which has developed Universal Standards for Social Performance Management.

3. Where do we stand today?

What are our past and current experiences?

HELVETAS Swiss Intercooperation has over the years developed manifold experience in rural finance. Thematic specialists advise its project staff and partner institutions on how to facilitate access to credit, savings, and other financial services. Table 1 provides a list of activities performed by the institution and the table in annexe 1 shows specific examples.

Table 1: Activities performed by HELVETAS Swiss Intercooperation in the area of rural finance

Type of activity	Description
Feasibility studies and planning missions	Organisation and carrying-out of comprehensive studies and participatory planning processes in order to identify potential areas of intervention in rural finance and plan projects
Strategy development	Review of existing rural finance mechanisms and adaptation or development of new strategies in rural finance, savings & credit activities, financial sector development
Monitoring and evaluation systems	Development and/or introduction of a monitoring system for microfinance institutions, rural financial intermediaries and / or banks Development of project cycle management handbook for donors active in financial sector development Development of social performance indicators
External evaluations and mid-term reviews	External evaluations and reviews of microfinance institutions and projects on behalf of different donors in order to improve the performance of these institutions and projects
Impact assessment	Elaboration of impact assessment surveys and analysis of data
Backstopping, technical advice	Advice to staff of own projects in the area of rural on facilitating access to financial services for our target groups; this includes non-formal financing mechanisms by input suppliers/traders in value chains. Advice on remittance management and financial literacy trainings in migration project Advice to financial sector programs or institutions with the aim of improving their efficiency and effectiveness in access to refinancing, financial and social performance monitoring, accounting, governance, etc. Advice to producer organisations on how to get access to financial services (value chain finance, agricultural loans, etc.)
Training and capacity development	Provision of short term basic general trainings and workshops on microfinance and rural finance
Knowledge management and publications	Capitalisation of experiences, lessons learned, case studies, short notes on specific topics and publications.

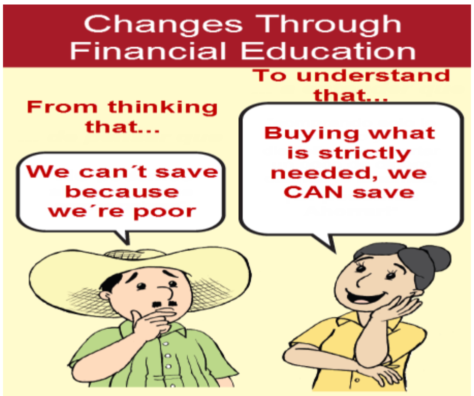
Our presence in networks

HELVETAS Swiss Intercooperation shares experience and collaborates with national, international and multilateral institutions active in the areas of financial sector development such as the Swiss Agency for Development and Cooperation (SDC), responsAbility, the Deutsche Gesellschaft für Internationale Zusammenarbeit (GiZ), Women World Banking (WWB), the Consultative Group to assist the Poor (CGAP) and many others.

What about future perspectives?

- HELVETAS Swiss Intercooperation will have a more systematic analysis of access to finance issues in its current projects and programs and ensure that the principles and standards of financial inclusion are respected. The Rural Economy Team will help project managers and project staff design their programs according to best practices for sustainable access to financial services for the target group.

- HELVETAS Swiss Intercooperation will continue to focus on the following topics:
  - Savings mobilization
  - Remittance management
  - Consumer Protection
  - Financial Literacy
  - Women & microfinance
  - Value chain finance



- HELVETAS Swiss Intercooperation will acquire new projects and mandates where its long-term experience can be capitalized.

- HELVETAS Swiss Intercooperation will partner with specialized national and international financial institutions (including insurance companies) in order to contribute to increased financial access of its target groups.

4. Thematic Recommendations and Guiding Principles on HELVETAS Swiss Intercooperation's interventions in Rural Finance

What can HELVETAS Swiss Intercooperation do more? ☺ DO's ☺

The activities listed in table 1 are very much (but not exclusively) oriented towards external clients. Very often, HELVETAS Swiss Intercooperation projects in the field face difficulties with facilitating access to financial services for their target groups. For example, in projects dealing with skills development and access to jobs for young people, access to loans is problematic, because microfinance institutions are reluctant to lend money to young people with little professional track record. Access to value chain finance for producer cooperatives is often a bottle neck in value chain projects, and so on and so forth.

HELVETAS Swiss Intercooperation provides the following services in order to improve the access to financial services to its target groups:

☺ **Advice and backstopping to projects from different working areas**, mainly rural economy, skills development, water and infrastructure, environment and climate change.

- Elaboration of an access to finance strategy
- Supply and demand analysis for financial services
- Needs assessment with respect to financial literacy and product development
- Negotiations with national and international financial institutions and value chain actors
- Elaboration of memorandum of understanding and partnership agreements.

☺ **Technical Assistance** to on-going projects or partner institutions (e.g. banks, microfinance institutions) in terms of capacity building. For example, HELVETAS Swiss Intercooperation can finance trainings, on-the-job-training, consultancies for the elaboration of management tools and instruments, process design, product development, business planning, financial literacy trainings. This technical assistance provided or funded by HELVETAS Swiss Intercooperation should be targeted towards providing financial services to the target groups of our projects.

☺ **Promotion of self-managed Savings and Credit Groups.** Self-managed savings and credit groups build on the self-help capacity of the target group. They are organized at the grassroots level, helping very poor people without access to financial services to organize and finance their own informal financial system. HELVETAS Swiss Intercooperation supports such savings and credit initiatives by facilitating capacity building and training to self-help groups involving local service providers.

☺ **Promotion of value chain finance** provided by financial institutions or value chain actors who are not specialised in the provision of financial services. HELVETAS Swiss Intercooperation facilitates the negotiations between different actors of the value chain in order to ensure that funding is available in the value chain where necessary (e.g. for pre-financing the production cycle, storage of crops, etc.).

☺ **Partnerships** are encouraged with NGOs, donors, commercial banks, cooperatives or microfinance institutions when access to finance is a prerequisite for the target group to move forward.

For new projects in the area of rural economy, such strategic partnerships are useful, where access to financial services is not yet available.

☺ **Cooperation and / or investments** into global initiatives such as Fair Trade Funds, Technical Assistance Funds or Social Investment Funds are encouraged if HELVETAS Swiss Intercooperation clients directly and indirectly profit from better access to financial services.

What should HELVETAS Swiss Intercooperation not do? ☹ DON'Ts ☹ :

In certain projects, e.g. when our target groups have no chance to access a formal financial institution, project staff tends to develop its own in-built solution. The position of the Rural Economy team is that projects should not engage into the provision of financial services. Where no alternative is seen, we advise to seek support from the Rural Economy team. Hereafter, we list a series of actions that projects should definitively refrain from doing:

☹ **Creation of financial institutions:** HELVETAS Swiss Intercooperation does not create new financial institutions but rather seek to partner with existing ones and promote their expansion. In all our partner countries, microfinance institutions or banks provide financial services to low income clients. The issue is to find the one which could develop more suitable products or locations.

☹ **Provision of financial services:** HELVETAS Swiss Intercooperation does not give loans directly to the target group. It also cannot collect savings or administrate them. These services should be provided by banks or specialized institutions operating within the legal framework.

☹ **Promotion of revolving funds:** numerous past experiences have shown that revolving funds are not sustainable beyond the end of a project. HELVETAS Swiss Intercooperation should thus refrain from promoting them.[3] Revolving funds differ from savings and credit groups: the former are based on an initial capital put at the disposal of a group (usually formed of project beneficiaries) by a project; the latter are based on group members' initiative to save for a common goal.

☹ **Subsidization of interest rates:** HELVETAS Swiss Intercooperation should not subsidize interest rates. The provision of subsidies to reduce interest rates does not set the right incentives in terms of efficiency of the financial service provider and is difficult to phase out.

☹ **Financing of operational costs of financial institutions:** HELVETAS Swiss Intercooperation cannot contribute to these costs on the long term, e.g. salaries, office rent, gasoline, etc. These have to be covered by the institutions themselves.

☹ **Promote credit targeting:** HELVETAS Swiss Intercooperation is not imposing targeted credit. Experiences have shown that financial institutions need to be autonomous in their loan decisions and HELVETAS Swiss Intercooperation should promote a universal access to financial services. Nevertheless, HELVETAS Swiss Intercooperation can promote the development of financial products addressed to a specific target group.

[3] see "11 reasons for the possible failure of revolving funds" in "References".

☹ **Provide credit lines** to financial institutions serving our target group. This should be done by specialized re-financing institutions. However, HELVETAS Swiss Intercooperation can facilitate the access to such institutions and support its project target groups with access to information and negotiation.

What are the criteria for the selection of partner institutions in Rural Finance?

Microfinance institutions and banks

The Client Protection Principles[4] are the minimum standards that clients should expect to receive when doing business with a microfinance institution or a bank, and include:

Appropriate product design and delivery

- Prevention of over-indebtedness
- Transparency
- Responsible pricing
- Fair and respectful treatment of clients
- Privacy of client data
- Mechanisms for complaint resolution

HELVETAS Swiss Intercooperation is committed to the above principles and wants that any partner institution is adopting them. Therefore, potential partner institutions should be appraised in view of the above criteria, simply because clients should expect an appropriate treatment. If the above criteria are satisfactory, further criteria for potential partner institutions include:

- Be a registered and supervised financial institution
- Professionalism in its operations: well trained staff, up-to-date financial statements, knowledge of accounting principles, solid governance structure
- Internal and external control mechanisms in place (audit)
- Positive social and financial rating from recognised rating agencies (e.g. M-Cril, Micro Rate, Planet Finance, Microfinanzas)

The rural economy team assists you in the assessment and choice of the suitable institution. The intenseness of appraisal depends on the degree of collaboration and how much funds are involved.

NGOs & Self Help Groups providing financial services or related services

NGOs can be competent partners for the training and capacity building component of Self Help Groups. Minimum criteria:

- Professionalism in their operations
- Sound track record and stable conditions
- Good local knowledge and proximity to the target group

[4] From Smart Campaign (see footnote 2).

Non specialized financial service providers (e.g. input suppliers, wholesalers, etc.)

In many Rural Economy projects, in particular those related to market systems and value chain development, different actors (cooperatives, input suppliers, advisory service providers, retailers and wholesalers, processors, etc.) provide loans (in-kind or in cash) to producers. These “informal” financing mechanisms appear when formal financial institutions fail to provide the right products to the right actors at the right time and at an affordable price. When these financing mechanisms apply in projects, HELVETAS Swiss Intercooperation should make sure that the terms of contracts are equitable for our target groups, that credit takers are well informed about prices and conditions, and that the financial relationship does not create dependency or risks of over indebtedness.

5. References

Links:

SDC's platform for employment and income practitioners (e+i): www.sdc-employment-income.ch
Part of it is dedicated to Financial Sector Development (FSD)- the REC-team is mandated by SDC to work on this shareweb:

> General information under FSD main topics and resources and also FSD Savings and Credit Forum. The presentations, minutes and list of references of the different Fora give a concise overview of the respective themes.
Since 1996 the Savings and Credit Forum is organized twice a year by HELVETAS Swiss Intercooperation on behalf of SDC. It is a training and exchange event with participants from SDC, Swiss NGOs, consultants and academics. They are given the opportunity to get experts' views on themes related to savings and credit institutions and financial sector development.

> SDC's Policy for Financial Sector Development (English, French, Spanish),
SDC's financial sector policy describes the strategic orientation, operational principles and instruments of SDC's activities in financial sector development. A must for everybody working in an SDC financial sector project!

> SDC's PCM: A Manual on Managing Cooperation in Financial Sector Development (English)

This manual provides a practice-oriented guide for development practitioners in financial sector development, which integrates the general methodology of Project Cycle Management (PCM) and the technical aspects of FSD. By linking the essential elements of PCM with the requirements of FSD, it aims at a comprehensive approach to improve the quality of the design, monitoring and evaluation of FSD-projects. This should distinguish this manual from similar manuals which exist, but which either explain the methodology of PCM or the technicalities of FSD.

Consultative Group to Assist the Poor (CGAP): www.cgap.org
CGAP is an independent policy and research centre dedicated to advancing financial access for the world's poor.

Microfinance Gateway (English): www.microfinancegateway.org **or**
Portail de Microfinance (French): www.lamicrofinance.org **or**
Portal de Microfinanzas (Spanish): www.portalmicrofinanzas.org
The Microfinance Gateway and its affiliate language sites (content not identical) is the most comprehensive online resource for the microfinance community.

Publications:

CGAP (2003). **Financial Services for the Rural Poor**. Donor Brief No. 15.
Available: English, French, Russian, Spanish
Download: www.cgap.org

CGAP (2006). **Access for All. Building Inclusive Financial Systems**. Author: Brigit Helms.
Available: English, French
Download: www.cgap.org

Milligan, Walter (1994). **11 Reasons for the possible failure of a revolving fund.** Nogub-cotesu.
Available: English, French, Spanish
Download: www.sdc-employment-income.ch (use the search function on the site)

Annexe 1: HELVETAS Swiss Intercooperation's experience in rural finance (selected examples)

Type of activity	Example of mandates	Client and partners	Country	Year
Feasibility studies and planning missions	Fact finding and planning missions for the set up of a pilot agricultural credit scheme in North Corea	Swiss Agency for Development and Cooperation (SDC)	North Corea	2007
Strategy development	Support to the development of SDC's Financial Sector Policy and its updating	SDC	Global	2007
	Guiding through the process of review and development of Caritas Switzerland's "Strategy and guidelines for the international Co-operation in Savings and Credit"	Caritas Switzerland	Switzerland	2001/2002
	Support to the development of Brücke-le Pont's strategy on Savings and Credit activities	Brücke Le Pont	Switzerland	2003/2004
Monitoring and evaluation systems	Participation in the elaboration of A Manual on Managing Cooperation in Financial Sector Development	SDC	Switzerland	2009/2010
	Development of a monitoring tool for microfinance institutions	SDC	Global	2000/2005
	Participation in the elaboration of Social Performance Indicators	SDC	Global	2000/2005
External evaluations and mid-term reviews	Independent mid-term evaluation of GTZ's project "support to Micro-finance Services in Rural Areas of Tajikistan"	GiZ	Tajikistan	2009
	Evaluation of Savings and Credit Approaches	Fastenopfer	India, Peru	2008
	Review of the microfinance sub-component of the Lao-German Programme "Integrated Rural Development of Mountainous Areas in Northern Laos"	GiZ	Laos	2006
	Evaluation of Caritas Switzerland's strategy on Savings and Credit	Caritas Switzerland	Switzerland	2006

Impact assessment	Development Impact Study 2009 on Agricultural Finance	European Fund for South-east Europe	Albania, Kosovo, Moldova	2010
	Impact Assessment of the Second Rural Finance Project	World Bank	Kirgizstan	2005
Backstopping and technical advice	Backstopping on remittance management and financial literacy in migration projects	HELVETAS Swiss Intercoopration	Nepal and Sri Lanka	2013
	Backstopping of Access to Finance component of the M4M project	HELVETAS Swiss Intercooperation	Armenia	2013
	Backstopping and technical advice to Swiss NGOs on Savings and Credit activities	Caritas Switzerland HEKS Brücke Le Pont	Global	2004 - 2008
	Technical advice at strategic level to the Rural Finance Fund (World Bank and SDC funded)	SDC	Albania	2002
	Backstopping Mandate on Financial Sector Development and Private Sector Development to SDC’s employment and Income network	SDC	Global	Since 1996
Training and Capacity Development	Trainings on financial sector development and microfinance, in particular rural finance, savings, financial and social performance monitoring	SDC School of Agriculture, Forest and Food Sciences, University Bern (HAFL) Caritas Switzerland	Switzerland	Since 2006
	Organisation of savings and credit fora on actual topics http://www.sdc-employment-income.ch/en/Home/Financial_Sector/Savings_Credit_Forum	SDC	Switzerland	Since 1996
	Participation in the organization of the annual Social Performance Task Force meeting in Berne, Switzerland	SDC	Switzerland	2010

Knowledge management and publications	Capitalisation of Experiences, case studies, lessons learned	SDC	Global	
	Savings mobilisation	SDC	Global	2004

Annexe 2: Key Principles of Microfinance- Consultative Group to Assist the Poor (CGAP)

CGAP

ENDORSED BY THE G8 SEA ISLAND SUMMIT 2004

Building financial systems for the poor

KEY PRINCIPLES OF MICROFINANCE

1. **The poor need a variety of financial services, not just loans.** Just like everyone else, poor people need a wide range of financial services that are convenient, flexible, and reasonably priced. Depending on their circumstances, poor people need not only credit, but also savings, cash transfers, and insurance.

2. **Microfinance is a powerful instrument against poverty.** Access to sustainable financial services enables the poor to increase incomes, build assets, and reduce their vulnerability to external shocks. Microfinance allows poor households to move from everyday survival to planning for the future, investing in better nutrition, improved living conditions, and children's health and education.

3. **Microfinance means building financial systems that serve the poor.** Poor people constitute the vast majority of the population in most developing countries. Yet, an overwhelming number of the poor continue to lack access to basic financial services. In many countries, microfinance continues to be seen as a marginal sector and primarily a development concern for donors, governments, and socially-responsible investors. In order to achieve its full potential of reaching a large number of the poor, microfinance should become an integral part of the financial sector.

4. **Financial sustainability is necessary to reach significant numbers of poor people.** Most poor people are not able to access financial services because of the lack of strong retail financial intermediaries. Building financially sustainable institutions is not an end in itself. It is the only way to reach significant scale and impact far beyond what donor agencies can fund. Sustainability is the ability of a microfinance provider to cover all of its costs. It allows the continued operation of the microfinance provider and the ongoing provision of financial services to the poor. Achieving financial sustainability means reducing transaction costs, offering better products and services that meet client needs, and finding new ways to reach the unbanked poor.

5. **Microfinance is about building permanent local financial institutions.** Building financial systems for the poor means building sound domestic financial intermediaries that can provide financial services to poor people on a permanent basis. Such institutions should be able to mobilize and recycle domestic savings, extend credit, and provide a range of services. Dependence on funding from donors and governments—including government-financed development banks—will gradually diminish as local financial institutions and private capital markets mature.

6. **Microcredit is not always the answer.** Microcredit is not appropriate for everyone or every situation. The destitute and hungry who have no income or means of repayment need other forms of support before they can make use of loans. In many cases, small grants, infrastructure improvements, employment and training programs, and other non-financial services may be more appropriate tools for poverty alleviation. Wherever possible, such non-financial services should be coupled with building savings.

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7. **Interest rate ceilings can damage poor people's access to financial services.** It costs much more to make many small loans than a few large loans. Unless microlenders can charge interest rates that are well above average bank loan rates, they cannot cover their costs, and their growth and sustainability will be limited by the scarce and uncertain supply of subsidized funding. When governments regulate interest rates, they usually set them at levels too low to permit sustainable microcredit. At the same time, microlenders should not pass on operational inefficiencies to clients in the form of prices (interest rates and other fees) that are far higher than they need to be.

8. **The government's role is as an enabler, not as a direct provider of financial services.** National governments play an important role in setting a supportive policy environment that stimulates the development of financial services while protecting poor people's savings. The key things that a government can do for microfinance are to maintain macroeconomic stability, avoid interest-rate caps, and refrain from distorting the market with unsustainable subsidized, high-delinquency loan programs. Governments can also support financial services for the poor by improving the business environment for entrepreneurs, clamping down on corruption, and improving access to markets and infrastructure. In special situations, government funding for sound and independent microfinance institutions may be warranted when other funds are lacking.

9. **Donor subsidies should complement, not compete with private sector capital.** Donors should use appropriate grant, loan, and equity instruments on a temporary basis to build the institutional capacity of financial providers, develop supporting infrastructure (like rating agencies, credit bureaus, audit capacity, etc.), and support experimental services and products. In some cases, longer-term donor subsidies may be required to reach sparsely populated and otherwise difficult-to-reach populations. To be effective, donor funding must seek to integrate financial services for the poor into local financial markets; apply specialist expertise to the design and implementation of projects; require that financial institutions and other partners meet minimum performance standards as a condition for continued support; and plan for exit from the outset.

10. **The lack of institutional and human capacity is the key constraint.** Microfinance is a specialized field that combines banking with social goals, and capacity needs to be built at all levels, from financial institutions through the regulatory and supervisory bodies and information systems, to government development entities and donor agencies. Most investments in the sector, both public and private, should focus on this capacity building.

11. **The importance of financial and outreach transparency.** Accurate, standardized, and comparable information on the financial and social performance of financial institutions providing services to the poor is imperative. Bank supervisors and regulators, donors, investors, and more importantly, the poor who are clients of microfinance need this information to adequately assess risk and returns.