

Eighth KfW International Financial Sector Symposium

Co- sponsored by the German Federal Ministry of Economic Cooperation and Development and FMO of the Netherlands

Session 2: Preserving Access to Finance – Financial Institutions and its Clients

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Keynote: Impact of the Crisis on Poverty and Access to Finance in Developing Countries (Ishrat Husain)

Transmission channels through which global economic downturn influenced Emerging and Developing Countries (EDEs) are remittances, aid disbursements, bank lending, private capital flows and international trade. Each channel had different effects and consequently the impact of this financial crisis differed across countries and regions. The following generalizations can be made:

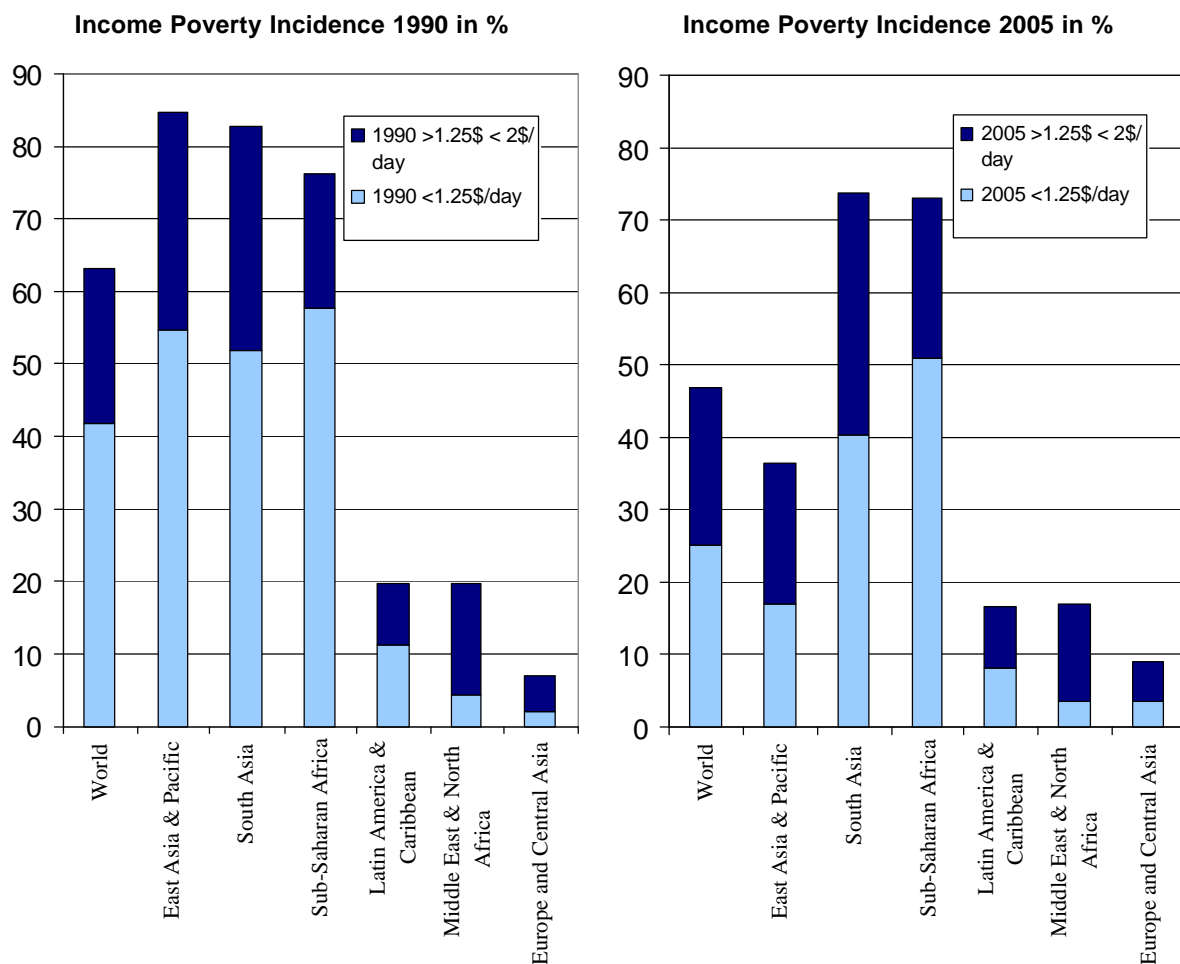
- **Correlation exists between EDE and advanced economies (AE) mainly through the real economy** (foreign direct investment, international capital flows and trade) and also through the financial sector for some countries especially in Eastern Europe.
- **Prudent fiscal, monetary and regulatory policies put many EDEs in a strong position at the onset of the crisis.** EDEs fared well who responded quickly to the crisis and had (i) reduced indebtedness, (ii) accumulated foreign exchange reserves, (iii) strong macro-economic policy frameworks and management in place. Advanced financial integration, capital account convertibility, and foreign ownership of domestic banks proved a double edged sword that caused high damage.

- Food and fuel prices that escalated between 2007 and mid 2008 had more adverse impacts on low income countries than the financial crisis.
- EDEs with large domestic markets and export diversification such as China, India, Indonesia, and Brazil proved crisis resilient and recovered quickly. Low income countries that have more diversified export earnings seem to have borne the shock well.
- Policy response to the recession by governments, the IMF and other multilateral organizations was rapid, better coordinated, and much larger compared with previous crises in EDEs.

Impact on Poverty in EDEs

Income poverty has impressively declined across the world over the past two decades. However, progress has been uneven.

Chart 1: Incidence of Income Poverty by Region 1990- 2005

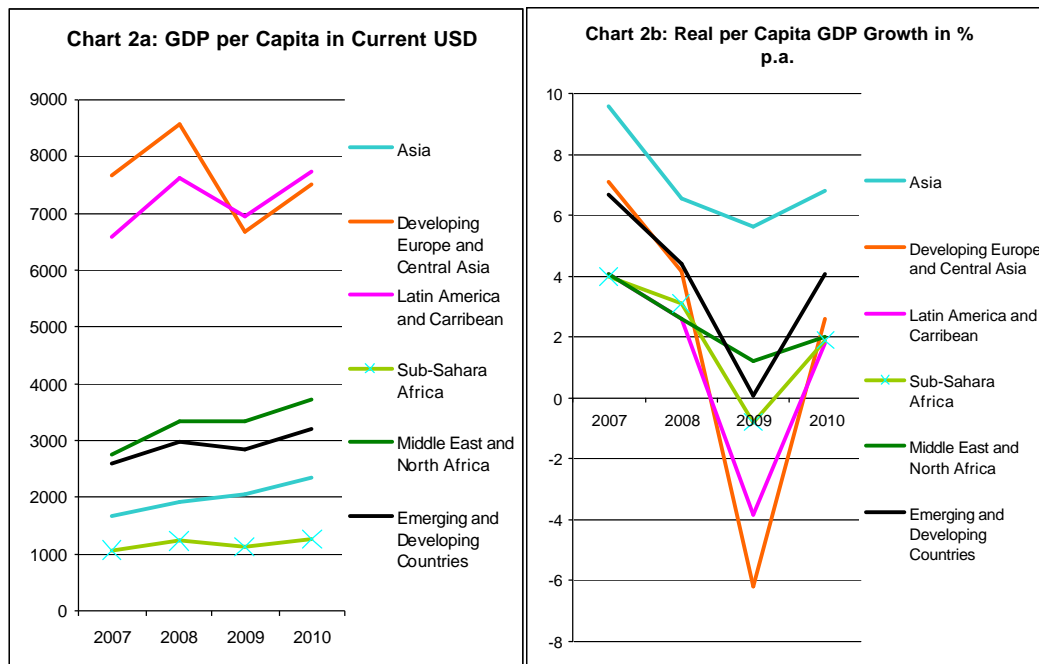


Source: World Bank Global Economic Prospects, January 2010 database accessed 24 February 2010

Most impressive is the progress in East Asia thanks to the large growth of China and other East Asian economies, whereas progress in South Asia, especially India has been steady but more subdued. Africa's decline of poverty is expected to continue on a much slower pace compared to other developing regions. Middle income regions still display significant levels of poverty which showed moderate decline over the past decades. Another important observation is that the reduction on poverty is largely attributed to the most vulnerable groups (defined with per capita incomes of up to USD 1.25 per day) while those less vulnerable (between USD 1.25 and USD 2 per capita per day) remained more stable. The World Bank estimates that an additional 64 million people will move into poverty in 2010 after about 50 million in 2009. While the secular trend of poverty reduction has in some regions come to a standstill, the robust growth, especially in Asia suggests that the overall trend of decline in income poverty will continue.

Unemployment has soared from 5.6% in 2007 to a high since the Second World War reaching 8.5 % in 30 high income OECD countries. Job losses have particularly affected young people, low skilled workers, immigrants, ethnic minorities and temporary staff. Rising job losses can depress real sector demand posing a threat to recovery. The loss of migrant workers jobs in high income countries adversely affected labor exporting EDEs. The aggregate number of unemployed will rise from 190 million to 210 million.

Volatility of GDP per capita was high before and after the crisis in middle income regions of Eastern Europe and Central Asia and to a lesser extent Latin America. Low income developing countries' GDP per capita showed an upward moving pre-crisis and stable trend during the crisis, whereas Asia showed an almost unabated upward moving trend. Real per capita GDP growth in all developing regions had tumbled in 2008 and 2009 however differentiated sharply between Asia at the high end, and middle income and oil exporting developing regions of Europe and Central Asia, Latin America and Middle East and North Africa at the lower end. Sub-Saharan Africa also declined significantly however from more moderate levels.



Source: World Bank Global Economic Prospects, January 2010 database accessed 24 February 2010

Asia. Governments in East Asia cushioned the impact on the most vulnerable citizens through cash transfers. Nevertheless 10 million more people are projected to remain in poverty. Despite buoyant growth in China, an estimated 25 million migrant workers were laid off lowering remittance flows to rural China. India's social safety nets and social transfers did play an important role in protecting the poor. Recent estimates do not show serious increases in the number of the poor in India. Bangladesh's and Pakistan's low income groups are protected through overseas workers' remittances. But low growth and high inflation will increase the incidence of absolute poverty in Pakistan.

Africa and the Middle East. As the Governments are forced to reduce public expenditure, households are pushed into poverty, health conditions deteriorate and school attendance declines. Similar effects were observed from declining remittances from overseas workers. In thin domestic credit markets Government borrowing crowds out the private sector as the domestic banks prefer less risky assets. Poverty should increase significantly in Sub-Saharan Africa as real GDP contracted in 2008 and 2009 the first decline in a decade. Unemployment has risen and the region lacks extensive social safety nets.

In **Eastern and Central Europe**, forecasts suggest that unemployment will remain high for some time and some of the increase in unemployment will become structural. Labor market policies continue to focus on protecting other groups that are mostly at risk. Unemployment in the Middle East is quite high and youth unemployment is of concern as it may cause social and human crisis.

Impact on EDEs' Financial Sector

Access to finance is much determined by country specific conditions. The crisis has provided some useful general insights:

- Regulation of banks was well focused with commercial banks and standard banking products forming the bulk of financial intermediation. The weight of non-bank entities such as investment banks, hedge funds, private equity firms, insurance companies, off-balance sheet exposures and special purpose vehicles that triggered the crisis was negligible.
- Except for Eastern Europe and a few other countries regulators insisted that credit expansion should be mainly funded by domestic deposits. This policy stance supported bank system resilience in many EDEs.
- Excessive risk taking by the banks was kept under active vigilance by the regulators. Although resented at the time as too much intrusion and micro-management this approach proved to be an ultimate savior of the system.
- Adequate liquidity support by the central banks proved decisive in boosting market confidence.
- In most EDE markets the share of large foreign financial conglomerates was limited and therefore direct exposure of the significantly important financial institutions to global financial markets was low. The damage to EDEs' domestic financial systems except for Eastern European and some Latin American countries was consequently not significant.
- Capital Controls and limited capital convertibility in China, India, Pakistan, and Bangladesh effectively reduced exposure to foreign currency assets.

Asia. Asia's banking system came out largely unscathed as the banks were by and large sound, well capitalized and liquid. The weight of non-banking activity in the financial sector and its systemic risk is insignificant. Asian financial institutions' share in the global financial meltdown since July 2007 was limited so far at USD \$39 billion or only about 2.7 % of global losses.

Eastern and Central Europe. In Eastern and Central Europe, financial institutions were vulnerable to deterioration in asset quality because losses in the corporate sector had risen while capitalization remained low. Large cross-border exposures by advanced countries' banks added to the risk of the portfolios held by the domestic banking system. Credit conditions therefore remained tight while public support was not commensurate with the gravity of the problem. The existence of distressed assets and the quality of assets did impair the capacity for external financial intermediation. Stress tests have revealed the need for bank recapitalization.

Latin America. In Latin America, financial systems have endured the global crisis well. In particular, the banking systems generally remained sound, reflecting important regulatory and supervisory enhancements introduced before the crisis. Accumulation of large foreign exchange reserves by the leading developing countries also shielded against financial market contagion. However, the foreign investors' and parent banks' flight to quality and liquidity away from the developing countries equity and debt markets and to cover losses elsewhere left a significant financing gap. As credit growth in the private sector slowed, public banks increased their lending to the private sector.

Middle East and Africa. The Middle East was hit hard by global recession and growth has decelerated sharply through the collapse in oil prices, and sharp contraction in foreign direct investment. The banking systems of oil exporting countries could come under stress, however sovereign wealth funds can come to their rescue.

In Africa the effect of the global recession was initially felt most strongly in middle income economies such as South Africa which is highly integrated into global markets. The impact then extended to oil and commodity exporters as global trade collapsed. This includes countries like Nigeria and Angola, bestowed with sufficient fiscal balances to use as shock absorbers for stimulating domestic demand. Other countries that depend on commodity exports were adversely affected by falling prices. Most African countries had limited access to international financing and as such were not much affected.

Conclusion

EDEs that relied on domestic savings for investment proved more resilient than those that relied more on foreign capital. Short-term foreign inflows seem to increase the volatility and adverse consequences of boom-bust cycles magnifying the risk of destabilization.

International trade remains an important channel for expanding EDEs and raising its peoples' living standard. The best example is China which has now overtaken Germany as the world's largest exporting nation. As the global economy contracted world trade fell more sharply.

Financial sectors in EDEs have not been particularly responsive to the credit needs of small farmers, small scale entrepreneurs, low income housing and micro-enterprises. Tighter borrowing conditions, rising borrowing costs and increased risk aversion have further reduced the funds to the poor and vulnerable groups. Finance has traditionally remained limited to the corporate sector, large size businesses export-

import trade and high net worth individuals. Microfinance started to penetrate in some countries but it remained peripheral to the mainstream financial sector.

Outlook. Prospects for the EDEs will depend on whether the world economy will return to its pre-crisis pace of growth or will grow at much lower rates. The room for policy maneuvers for the advanced countries is limited. Budget deficits and Indebtedness of advanced G20 countries has already reached alarming levels. Fiscal retrenchment will likely slow down economic growth of G-20 countries below the pre-2007 period resulting in subdued global recovery over a longer period. The outstanding challenge for financial sector policies in other EDEs is the resumption of credit growth.

The impact of the financial crisis on South Asia's excluded segments of the financial market including the poor (Haroon Sharif)

Observations refer to experience in large South Asian countries of India, Pakistan and Bangladesh, which may be seen as representative for the region.

Impact of the crisis – loss of confidence in the financial sector

Although South Asia was relatively less hit by the financial crisis the mistrust in financial markets has risen, not only by the general public but also on different segments of the society, analysts, media and policy makers.

The decline public trust has resulted in a squeeze of liquidity. The financial sector witnessed a massive reduction of deposits and investments. Concurrently the banking sector has become extremely conservative especially in financing the lower end of the market. Liquidity was not squeezed because of bank failures but other factors.

Credit risk has risen sharply and NPL ratios at the lower end of the market, which increased up to 5-10% where they used to be 2-3%.

Periodically populist political interference was witnessed in Pakistan where ministers announced loan write-offs to relieve the poor. Although the government provided aid, there was no fundamental justification for the aid.

Central banks have acted immediately to restore market confidence. The central banks in Pakistan and Bangladesh provided guarantees to comfort commercial banks to continue financing the lower end of the market. In Pakistan donors, DFIs and private investors are working on a larger Microfinance Fund to address the liquidity squeeze.

Financial Inclusion

Even before the crisis financial exclusion was high, where less than 18% percent of the people in India, Pakistan and Bangladesh had access to formal financial services. In Pakistan, only about 13% of the people have access to formal financial services. Bringing low income people under the ambit of the formal financial sector has become a key policy focus for governments and regulators.

Financial inclusion has a much wider perspective beyond microenterprise finance. Financial inclusion does not just capture microenterprise finance. It includes the financing of small and medium sized enterprises (SME), low income housing and rural activities.

There is now agreement that the reliance on subsidized credit has to vanish. The market still believes that a partnership with government is needed to provide incentives and infrastructure support.

India, Pakistan and Bangladesh follow different approaches in pursuing the goal of inclusion. India for instance has taken a more conservative approach, directing banks to lend to the lower end and the agriculture sector. Pakistan has taken more market based approach by creating incentives. Bangladesh is in the middle focusing much more focus on microfinance, and only recently there are signs of support to the SME sector. The size of loans in microfinance is less than 300 USD equivalent and mostly focused on consumption smoothing.

Moving from Micro to SME. The creation of productive assets has now become a concern of policy makers. Linked with this is the need to increase the size of loans and investments beyond the microenterprises since SMEs have a much higher growth potential. Microfinance remained essential during the crisis for financing people and households investment and consumption needs. However, Microfinance is not contributing to the creation of productive assets.

Regulators response to the market segmentation

Central banks in India, Pakistan and Bangladesh have taken the lead on financial inclusion and changed policies over the past 5 years accordingly. However, regulators are struggling how to deal with conglomerates who own several financial institutions, banking, non banking, and MFI. Currently the coordination between political offices, regulators, and the market segments involved in the policy and regulatory process remains weak and erratic. The result is a trend to market segmentation. Market participants do not differentiate between the SMEs, Microenterprises, and cash transfers and rather focus on creating NGOs to tap large deposit markets and reaching out to people in a more systematic way. Despite cultural similarities there is little dialogue within South Asia among the private sector, regulators and policy makers.

Even the top tier commercial banks now focus on the lower end of the market. Particularly in Bangladesh where donors and DFIs are partners. But **there remains lack of attention to a huge missing middle**, the SMEs and agriculture, which is the engine of growth and coming into focus with the food crisis respectively.

Policy makers and regulators are thinking on how to **address financial segmentation** where the rural areas are being used for deposit taking, where investment is siphoned off into urban areas. This is complicated particularly in Pakistan on the western borders where new ways to deal with the post conflict financing needs are needed.

Innovation in technology and outreach. There is a hype that technology can actually increase access to finance. However, evidence shows that basic services technology is good for payments including cash transfers, remittances, settlement of utility bills, and social cash transfers, or even pensions. However, the expansion of credit and the financial advice can not be done through technology. The direction of South Asia policy makers now emphasizes that the state and donors should not intervene in the financial sector but partner with the private sector, and achieve financial inclusion through the market.

The financial crisis in South Asia – from the perspective of financing Micro, Small and Medium Sized Enterprise, and Rural Economic Activity (Ashok Sharma)

Micro Small and Medium Sized Enterprises (MSMEs). Most of South Asian governments adopted fiscal stimulus packages that emphasized more lending through MSMEs to stabilize employment and economic growth. It proved critical for ADB to channel the flow of funds during the crisis in a moderate way to avoid stress on banks and intermediaries that were not in the best health. The challenge was to identify channels that benefit MSMEs in a timely manner in a context where formal institutions do not reach more than 25% of the target clientele in South Asia. This issue of access predates the crisis and remains throughout and after the crisis.

Disbursing large amounts is a short term measure justifiable as a crisis response. It is essential to bear in mind the underlying larger long term constraints while undertaking the short-term actions. Across Asia most of the banks remain extremely prudent and reluctant of lending to MSMEs because of the scarcity of reliable information and lack of understanding of MSMEs. MSMEs are also viewed to be highly vulnerable to economic shocks.

Within the Asian banks, there is a huge discrepancy of systems and skills. While a head office may be capable to well serve clients with cash flow based lending based on modern modelling and scoring techniques, a branch at a rural district may just have the skills and systems to do the classical collateral based lending. Since most MSMEs have no documented collateral lending does not happen as needed. In many countries, legal frameworks for securing the mobile assets are missing. While ADB is addressing these bottlenecks with its development partners the success has been mixed. During the crisis ADB observed that most governments were using market based mechanisms such as guarantees to encourage lending to MSMEs and political directives to banks were the exception. It is also important to note that interest rates came down during the crisis, but the MSMEs never benefited from this because of the banks' risk aversion. The governments and DFIs realize that credit alone is not a solution and that broader constraints need to be addressed.

Rural Finance. Nearly three quarters of Asia's population live in rural areas. However, exclusion of is high at about 80% of the rural population. Currently the major players in rural finance are cooperatives and government DFIs. They were not affected by the crisis but continue to be exposed to endemic institutional policy and governance issues that undermine broader access to finance.

Because of the crisis governments were alarmed that the high urban to rural migration may lead to social unrest, which prompted them to inject funds into weak banks and massive loan waiver schemes. There is a risk that these funds may never be used productively and that borrower discipline is undermined further keep access to rural finance low. However the measures were financed out of government budgets and banks were not burdened as previously with the consequences of government schemes.

To lift access to rural finance in a significant way it is necessary that strong political action is taken to reform the rural finance institutions including closing those that cannot be reformed to ensure a higher standard of institutions in the market. Autonomy of financial institutions in financial policies and relaxation of tight branch licensing policies are essential to improve discipline and induce some competition in the market.

Experience with rural finance reform in Asia is mixed depending on the governments resolve to carry out difficult reforms. Normally progress is gradual and hampered by

many roadblocks. The overall experience in India and Nepal has been quite positive, whereas reforms in Sri Lanka and Vietnam still have a much longer way to go.

The impact of the crisis on Microfinance (Alexia Latortue)

It is important to note that there are current financial and food crises in developing countries. The poor spend between half and three quarters of their income on food. High food prices pose a tough challenge on the poor.

Impact on microfinance clients. The crisis made it much harder to access credit, because MFI portfolios of many institutions remained stagnant or were shrinking as liquidity dried. Remittances tumbled while food prices were still volatile and high in many markets adversely affecting micro businesses severely especially in rural areas. Adverse impacts included unemployment, reduced nutrition, taking children out of school, working longer and paying back loans with much delay. Some increased their indebtedness trying to manage a more vulnerable situation. Overall the impact was diversified depending on the level of vulnerability.

Impact on MFIs. A dramatic drop in portfolio growth may be viewed as a healthy correction of excessive business growth. The quality of MFI portfolios deteriorated substantially with portfolio at risk tripling or even quadrupling relative to the pre-crisis situation. Liquidity shortage remains a challenge for some MFIs. While interest rates remained stable, and the cost of capital increased for many MFIs, which was often not passed to their clients.

Understanding the new risk landscape after the crisis. The annual “Banana Skin report” looks at the risk perception facing the microfinance industry. The top 3 risks in 2008 were not even listed under the top 20 risks in 2009. The risk landscape has changed dramatically.

The first risk is now credit risk an area where microfinance used to achieve top quality results. The second risk is liquidity risk which was ranked 20th in 2008. The third risk is the macroeconomic environment, which was rated 23rd in 2008. The fourth is management quality which had been rated first in 2008. Finding good managers to manage through a crisis is critical. Fifth is refinancing which was 28th in 2008.

Overall many MFIs managed the crisis challenge well while some did not. **Business models that focused on extremely high growth rates proved did not withstand the challenge of the crisis.** There was an abundance of funding from donors, social investors, national governments that were interested in financial inclusion as well. India, Pakistan, Nicaragua, Bosnia, and Morocco had the highest microfinance growth levels and risks failed to be properly identified. For example in Morocco the portfolio quality deteriorated in 2006 masked by high growth rates.

Delinquency is one of the biggest inherent risks in microfinance. In extremely high growth delinquency is accentuated through the erosion of the relationship between borrowers and MFI lenders. The focus on high growth, on profits, extreme efficiency has really served to disconnect the relationship between the client and institutions. Examples in India show that credit officers had 700 individual clients, whereas sound institutions in Bangladesh cap this at 500. In India some group lending systems went up from 15 - 25 members, to up to 50 numbers. A microfinance fund in Morocco studied their clients finding out that clients did not know the source of lending.

In cases of high growth MFIs encounter the challenge to add new staff at reasonable quality. In Morocco, microfinance was one of the greatest employers in the country. In Pakistan the number of staff increased from 2,500 to 9,500 during 2007. Another institutional challenge is the scarcity of appropriate management skills. When institutions are small, headquarters can manage the branches reasonably well. With rapid growth, senior management had to focus on an increasing number of external stakeholders, including investors, and regulators and lost attention to manage the branches well. Strong middle management is necessary but many institutions were unable to build up that capability. Growth has strained internal controls and management information systems were not able to keep up with the growth. Good credit underwriting was weakened because the MFI just focused on growth.

Growth led to massive competition concentrated in a few areas of the country for example in India in three of the 28 states, in Morocco in two cities. These negative developments are exceptions exposed by the crisis. However these cases will not just hurt Morocco, India and Pakistan but may hurt the reputation of microfinance globally.

More emphasis is needed to develop market infrastructure. Among the five countries studied only Nicaragua had a functioning credit bureau at the time. The rating agencies failed in microfinance in many ways by providing good ratings for doubtful institutions as seen in the case of Bosnia.

Connecting Africa's trade and investment to fast growing emerging markets (Jonathan Wood)

Innovation and long term commitment to emerging markets are critical to have a competitive edge in Africa. This entails among other things collaboration with development finance institutions, aiming to mitigate some market failures and market gaps in emerging markets and developing local capital markets by helping to improve conditions for streamlined investments.

Trade with emerging markets, especially the large countries like Brazil, Russia, India and China (BRIC) has a huge potential. For example BRIC-Africa trade surged from USD 22 billion in 2000 to USD 161 billion in 2008. Africa's share of BRIC global trade was 4% in the early 1980's rising to 19% in 2008. As a result trade with BRIC and other emerging markets is a large source of growth for Africa.

Brazil's resilience in mastering the crisis (Eduardo Rath Fingerl)

For a short time Brazil was adversely affected by the crisis associated with high volatility and uncertainty in the market. The first signs were the liquidity and credit crunch in the banking sector that affected private business. High risk aversion was the counter reaction of banks after significant exposure in toxic assets in the export sector.

However Brazil bounced back quickly. Government and monetary authorities established strong accommodating monetary and fiscal policies and the role of public banks was very important financing about 80% of loans underwritten in Brazil in the 12 months following September 2008.

Brazil has a very solid fiscal balance and had become a net creditor (USD 36 bn July 2009) lending funds to the IMF recently, and has a comfortable level of international reserves (USD 231 bn or 15% of GNP). Brazil's banking system was operating under

effective regulation and expanded lending with falling spreads. As a result private business survived the crisis well.

Discussion

How do large state owned development banks, who play a countercyclical role in supporting the economy mitigate the large incremental risk associated with the expansion of credit?

It is essential to check the fundamentals of long standing customers especially whether and how they were and likely to be affected by the crisis and adopt methodologies for evaluating companies in looking at their internal processes, strategy, marketing and alliances. Instead of just evaluating the balance sheets looking into the company's future is essential. This affects the evaluation and more importantly changes the mindset of bank staff.

Countercyclical support involves very large disbursements in a short time. It is difficult to use these measures to serve microfinance. Even if the focus is on the SME segment and the Government is to disburse the large amount within six months because of the countercyclical nature the absorptive capacity of financial intermediary channels in South and Southeast Asia remain limited. Countercyclical measures in the face of the crisis worked well in countries which were prepared for hard reforms of the banking or the microfinance sector to increase capacity and technology. Supporting strong policy measurers in creating a level playing field these amounts may be sensible. But providing large loans and just asking to increase access to finance and particularly to microfinance is not a viable solution.

Is access to or quality of finance the issue facing microfinance in the crisis?

The biggest problem in 2009 in most countries appears to be over indebtedness. It is not the lack of access to finance and some countries appear to have too much access to finance especially in Eastern Europe. In certain Central American and African countries access to finance may be the biggest problem.

In the Micro segment many markets had been adversely affected by excessive consumer and microfinance lending as a whole. There was extreme pressure on fast growth and it is difficult to maintain responsible finance and underwriting standards in a market environment which emphasizes growth and quantity, and high returns, and where all believe that growth delivers a massive social impact. This requires strong institutions and a regulatory stance against this trend. Many good MFIs were forced to become less responsible, and now face the consequences of their own faults.

SME is equally difficult if you are working in an environment where you do have too much access to credit, guarantees, and reliance on collateral which is still the case in many markets. It takes time and cost to build the essential long term relationships with SME clients through understanding of their investment needs and their debt service capacity.

In Eastern Europe and Central Asia the balance sheets of the banks have all shrunk significantly and many people now do not have access to finance. But should the previous excesses be preserved?

It will be a big challenge for IFIs and DFIs since the measure so far is by volume and moving to a measure by impact will be necessary and difficult to achieve.

A controversial debate on excess of access and lack of quality in microfinance discussed whether it is generally true that microfinance growth was excessive and who is responsible.

The best MFIs in the past were growing very rapidly. What is the correlation between the crisis and risk taking? Some participants believe that regulation and supervision generates very bad players in the market. The other challenge is the ability to attract very good responsible and competent equity investors. The example in Bosnia tells that it is the right time to request authorities to recognize microfinance as an asset class that needs regulation.

The previous view that Pakistan and India's microfinance industry grew excessively is not shared by some participants since both show strong growth in relatively immature markets. There is a huge potential for growth, and this is typical for an early stage of development. While growth puts a lot of pressure on MFIs the Pakistan challenges are not a consequence of rapid growth but rather a combination of wrong choices, inappropriate technology, and political interference. In India there are five institutions which are driving the market but a number of institutions that emphasize building capacity.

Should MFIs be regulated or not and who should set the standards. Who should regulate these institutions? Phrased differently: should the poor man's deposit be sacrificed for the poor man's access to loans?

In Pakistan the central bank took responsibility over microfinance regulation and supervision, which is a very light version of banking sector regulation facilitating orderly growth of the industry. The political crisis of 2007 and 2008 did a lot of damage, but once back to normal the regulatory oversight and guidance will lead to positive outcomes. Otherwise money just would be spent in the hope that someday a social impact will emerge. The soft affection of many donors is actually money wasted without a proper regulation.

There is no unanimity whether a central bank should regulate microfinance. In India the issue remains unresolved. The days of lending growth have gone as the financial crisis reinforced this is not an option. Experience with credit lines through commercial banks show that the disbursement takes much longer than anticipated if sound lending is applied. IFIs learned that improving the policy and regulatory framework is essential to set the market right before lending is set to grow to suffice demand.

Another view reminded that one has to balance the market and the political economy. Politicians cannot wait for years that access goes up and action has to come in the meantime.

Is the increasing mismatch between deposit taking and equity investments of MFI conglomerates an issue?

In Bangladesh there are some microfinance institutions that might be classified as conglomerates, which are taking deposits, and on the other hand are investing in equities.

The Microfinance sector in Bangladesh is much larger than the commercial banking sector. Some MFIs have become conglomerates and regulatory arbitrage has been an issue because of the coexistence of commercial and philanthropic arms. Bangladesh is trying to address this issue through regulation of these non bank institutions by a regulatory agency under the ambit of the central bank. Coordination of banks and non

banks is addressed by this mechanism. However there remains legitimate concern that the conglomerates become too large as they invest in very diverse services from telephones to commercial activities to treasury functions.