



WORKING PAPER

Market Facilitation to Advance Financial Inclusion

USAID in the Philippines (1996/2012): A Case Study

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ABSTRACT

CGAP's [guidelines for funders](#) encourage funders to adopt a systemic approach in their financial inclusion programs. Systemic approaches have been applied in various sectors, notably agriculture and enterprise development, for many years. In financial inclusion, systemic approaches are still rare, and there is a limited body of knowledge on how to operationalize a systemic approach in this sector.

This case study aims to contribute toward closing this knowledge gap, and shares an example of how a funder stimulated systemic change. It reviews how USAID, through two programs and in partnership with a series of market actors, helped change the microfinance market dynamics in the Philippines—from a specialized activity with limited outreach and highly dependent on subsidized credit, to a more inclusive and robust market-driven segment of the financial sector.

This study is not a comprehensive assessment of USAID's CPIP and MABS program. It focuses on CPIP components that impacted the microfinance sector, MABS capacity building for rural banks and support to regulators, and select product innovations. The case study is based on information gathered through publications and interviews with key stakeholders in Manila in May 2016.

TABLE OF CONTENTS

INTRODUCTION	1
USAID in the Philippines.....	1
Focus of this case study	3
1. ENCOURAGING EVIDENCE-BASED, COLLABORATIVE REFORM PROCESSES TO REMOVE REGULATORY CONSTRAINTS	4
The Story.....	4
USAID Interventions	5
Leading to Systemic Change	8
Lessons Learned for Funders.....	9
2. ALIGNING INCENTIVES AND CAPACITY TO ATTRACT NEW PLAYERS INTO THE MARKET	10
The Story.....	10
USAID Interventions	11
Reconstructed Theory of Change	15
Lessons Learned for Funders.....	15
3. PROMOTING MARKET COORDINATION TO ENABLE PRODUCT INNOVATION	19
The Story.....	19
USAID Intervention	20
Lessons Learned for Funders.....	21
SOURCES	23
ACKNOWLEDGMENTS	23
FIGURES, TABLE, BOXES	
Figure 1. Theory of Change for Financial Inclusion Programs.....	1
Figure 2. Systemic Change or AAER Framework	8
Figure 3. The MABSters T-shirt	14
Figure 4. Reconstructed ToC Summarizing How MABS Attracted New Actors to Boost the Supply of Inclusive Financial Products in the Philippines (1996 to 2012)	16
Table 1. Philippines Rural Banks Landscape	3
Box 1. USAID’s Programs: CPIP and MABS	2
Box 2. Efficient Evidence-Based Advocacy: Data Collection and Dissemination	6
Box 3. Putting Regulatory Sandboxes in Place	7

INTRODUCTION

Facilitating Financial Inclusion: A Systemic Approach for Funders

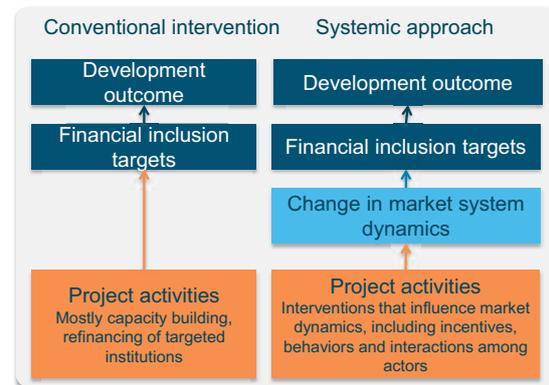
Significant progress has been made worldwide in connecting poor and low-income populations to financial services. Yet there are still large gaps in access, use, and quality of services. Funders long assumed that access to capital and lack of capacity at the retail level were the main barriers to scaling financial inclusion. However, over time, financial inclusion advocates realized that the situation was much more complex. Not only do financial inclusion barriers exist beyond the retail level (in the market infrastructure and within the policy and regulatory environment), but they also extend beyond capacity and funding issues as they are often deeply rooted in market dynamics: established practices, behaviors, and incentives of interdependent market actors. Market dynamics determine how suppliers react to demand, how consumers react to changes in supply, and how other actors, such as regulators or capacity building providers, react to financial inclusion barriers.

In this context, to improve the way markets work for the poor in the long term, funders are encouraged to adopt a new approach to influence market dynamics: nudge market actors to perform the missing or weak functions and, thereby, facilitate systemic change (see Figure 1).

USAID in the Philippines

In the 1990s, financial outreach in the Philippines remained frustratingly low despite the presence of hundreds of small-scale rural banks, cooperatives, and nongovernment organizations (NGOs) engaged in microfinance. In 1994, only 6 percent

FIGURE 1. Theory of Change for Financial Inclusion Programs



of adults had a deposit account at a bank and only 2 percent had a bank loan;¹ microfinance institutions were estimated to reach less than 1 percent of the potential market (Daley and Badiola 2003). Microfinance growth through NGOs plateaued and the sector relied heavily on subsidies. Credit cooperatives boasted an impressive network, but they lagged in internal standards, measures of self-sufficiency, and taken individually, scalability.

At that time, USAID was supporting approximately 50 microfinance NGOs with technical assistance and refinancing. But regulations prevented NGOs from collecting savings, which constrained their ability to diversify product offerings and balance scale with self-sufficiency. USAID identified a need to reconsider the microfinance market dynamics to attract viable retailers while extending the reach of services to still underserved communities.

USAID's shift in perspective coincided with a change in the Philippine government's approach toward financial sector development, as the government started undertaking major reforms to promote market-led financial sector and private sector participation. Considering this attitude as a possible driver of change, USAID seized the opportunity and joined

¹ Estimates based on Agabin and Daly (1996).

government officials and other funders in an effort to advance financial inclusion.

Based on previous work in the country, USAID realized that the government would need support to reconcile opposing views among policy makers regarding the country’s financial sector strategy, as well as support to effectively carry out the reforms. The Credit Policy Improvement Program (CPIP) (see Box 1) was launched in 1996 to provide such support at the policy level. Two additional programs were launched in 1997 to help develop the infrastructure needed to implement the reforms: the Microenterprise Access to Banking Services program (MABS), which focused on rural banks, and the Credit Union Empowerment and Strengthening program (CUES), which focused on credit cooperatives.

Through CPIP and MABS, USAID helped to remove several barriers that prevented private-sector actors from reaching out to low-income customers in a responsible and sustainable way. The programs first worked on raising awareness and changing attitudes toward the bottom

of the pyramid. By the end of the programs, regulators were more inclined to rely on private actors to reach out to the low-income population, and rural banks became more interested in this market segment. The door had been opened to addressing policy, regulation, and capacity challenges. Through direct technical assistance to policy makers, regulators, and rural banks, the programs increased the capacity of market actors to advance financial inclusion.

From close to zero rural banks involved in cash-based microlending in the late 1990s, 187 rural banks had become involved in microfinance by the end of the USAID programs in 2012, and 170 of them continue to serve 2.6 million microcustomers as of 2016 (Table 1). As two respondents summarized, “CPIP promoted a paradigm shift, toward greater reliance on market based principles,” and, “MABS opened the door to a sustained private-sector interest in the base of the pyramid.”

Although CPIP and MABS cannot claim full credit for all these changes, the changes in awareness, attitude, and capacity of market actors brought about

BOX 1. USAID’s Programs: CPIP and MABS

CPIP and MABS are a “contract” according to USAID terminology: implementers, selected through a call for proposal, deliver on a set of objectives as set forward in their contract with USAID. It requires the detailed involvement of USAID mission staff, and certain terms can be changed over time. The implementer sets up a team locally, led by a chief of party. A management committee, comprising USAID, local government counterparts, and the implementer, meets on a monthly or quarterly basis to check on the project’s progress.

	CPIP	MABS
Dates	1996–2006	1997–2012
Budget	US\$4 million	< US\$30 million
Staff	4 local staff	10 to 30 local staff
Chief of Party	Local	International
Implementer	IMCC	Chemonics

TABLE 1. Philippines Rural Banks Landscape

	1997	2002	2012	2015
# Rural banks involved in microfinance ^a	~0	119	187	170 ^b
Microfinance loan portfolio (current millions US\$)		54	175	236
# microborrowers (thousands)		391	1,138	1,472
# deposit accounts (millions)	—	—	—	2.6

a. Rural, thrift, and cooperative banks. Source: Central Bank.

b. 41% of these 170 were MABS partners.

by these programs led to lasting change in the way the market functioned.

USAID is still actively involved in the financial sector of the Philippines. Its current flagship project, E-PESO, builds on the successes of its predecessors while focusing on electronic payments.

Focus of this case study

This study focuses on three key components of CPIP and MABS and highlights

how USAID's interventions generated systemic change by doing the following:

1. Encouraging evidence-based, collaborative reform processes to remove regulatory constraints.
2. Aligning incentives and capacities to attract new players into the market.
3. Promoting market coordination to enable product innovation.

1. ENCOURAGING EVIDENCE-BASED, COLLABORATIVE REFORM PROCESSES TO REMOVE REGULATORY CONSTRAINTS

USAID supported a paradigm shift away from the heavy involvement of the state in the provision of credit and toward policies and regulations that promoted private sector-led credit.

The Story

The Philippines set out on a path toward market liberalization after the 1986 People Power Revolution, which overthrew the 21-year authoritarian rule of President Ferdinand E. Marcos. Subsequent presidents, Aquino and Ramos, launched economic reforms intended to open up the national economy, encourage private enterprise, and reduce corruption. In 1993, the creation of a new Central Bank (BSP or “the Central Bank”), which was expressly prohibited from engaging in development banking, and the creation of the National Credit Council (NCC or “the Council”), a multi-stakeholder policy council, signaled the government’s intent to provide a new framework for financial sector development.

However, by 1996, the government’s main instruments to promote access to finance were still government-sponsored directed credit programs (DCPs). More than 100 DCPs were active in the country, whereby several government agencies indirectly provided subsidized credit to specific segments of the population (mostly in agriculture) (Agabin and Daly 1996). Based on international literature and the country’s persistently low levels of financial outreach, many, including in the government, believed DCPs were unsuccessful in reaching their access to finance and poverty reduction objectives. However, the government’s first attempts to reform these

programs faced strong opposition, and interest groups eventually impeded such reforms.

To move the reform process forward, the Central Bank and the Council needed to address opposing views regarding financial sector development. Through CPIP, USAID offered to support the Council in its efforts to elaborate a new financial sector strategy and policy.

In 1997, within one year of CPIP’s existence, after years of obstruction, the government was able to approve an innovative National Microfinance Strategy that formalized microfinance as a private sector-led segment of the financial sector. Simultaneously, the Council established itself as the governmental interagency body in charge of credit policy formulation and monitoring. In 2001, the new General Banking Act (GBA) directed the Central Bank to formulate microfinance specific regulations. Between 1997 and 2012, the Central Bank issued more than 40 such regulations,² enabling banks to provide microfinance services in a safe and sustainable manner.

This strategy and attendant regulations were the starting point for what became a regional success story, with rural banks serving 2.6 million microfinance customers in 2016 compared with fewer than 400,000 in 2002, and microfinance NGOs serving close to 2.5 million customers.³ Subsidized directed

² Regulations on microdeposit, microagriloans, microbanking offices, electronic money issuers, microinsurance, price transparency on loans, etc.

³ Credit cooperatives also serve low-income customers.

credit programs were terminated or transferred to government financial institutions. Today, regulators and rural banks continue to adapt, innovate, and respond to inevitable market changes. New policy formulation practices initiated by CPIP became a standard for financial sector reforms and were used to design the 2010 National Strategy for Microinsurance and the 2015 National Strategy for Financial Inclusion, without USAID support.

USAID Interventions

A standard funder intervention at the regulation level usually entails technical assistance to the regulator to draft strategies, policies, decrees, circulars, and guidelines. USAID provided this support, but it was only part of a more thorough program aimed at improving regulatory practices over the long term.

Understanding market barriers beyond the obvious gaps. Because of previous projects in the country and frequent interactions with various market players, including regulators, USAID mission staff realized that reforms were stalling because of three key issues related to incentives, information, and capacity. First, reform proposals lacked strong champions who could shepherd them through the policy-making process. Second, interest groups strongly opposed the removal of market-distorting policies (as later research work revealed, these interest groups were those actually benefiting from DCPs). Finally, several relevant reforms that were eventually adopted failed to be implemented because of a lack of capacity among the government agencies involved. The government removed the first obstacle by creating a new Central Bank and

mandating the Council to revisit the credit delivery framework. USAID thus decided to help address the two remaining obstacles by raising awareness among policy makers and developing the Central Bank's and the Council's capacities.

“Data vs. Dogma”: Using data to inform regulation. CPIP first hired and managed independent local and international consultants to conduct several policy studies to assess the efficiency of direct credit programs.⁴ For years, proponents of these programs believed that targeted lending would ensure funds reached low-income populations. CPIP's empirical analysis demonstrated that these programs not only failed to reach the target populations, but also prevented other actors, including microfinance institutions, from reaching them (Llanto, Geron, and Tang 1997). These programs actually resulted in credit rationing for small borrowers, the capture of credit subsidies by large borrowers, high default rates that increased the overall costs of intermediation, and a lack of deposit mobilization. The studies convinced legislators that the country needed a new strategy for financial inclusion. They also provided useful guidance for formulating a policy reform agenda. CPIP widely shared these results through various media and direct advocacy (Box 2). In addition to these studies, CPIP organized study tours with high-level participants, including policy makers, so they could see first-hand how other countries (Indonesia and several Latin American countries) implemented market-led policies and observe their effectiveness. MABS also organized exposure visits to rural banks for central bankers. The visits were focused on understanding market needs and rural

⁴ The studies covered the following topics: issues and framework for reform; assessment of the performance of government financial institutions and nongovernment financial institutions in implementing DCPs; policy frameworks for rationalizing DCPs; interest rates, subsidies, and DCPs.

BOX 2. Efficient Evidence-Based Advocacy: Data Collection and Dissemination

CPIP studies were not obscure documents sitting on a funder's shelves. On the contrary, they were widely disseminated under various forms and through various channels. The Council working groups were involved in designing the studies and reviewing results. Along with the full versions, available online, CPIP also published abridged versions of these studies in the form of policy notes that were used by the Council as advocacy tools. CPIP also directly disseminated results beyond the working groups through various activities aimed at addressing potential lack of interest and misinformation, from talking to legislators or appearing in a congressional hearing to more resource-intensive activities like holding a regional consultation with stakeholders.

banks' constraints. These visits were instrumental in changing the mindset of legislators, including the chairman of the Banking Committee in the lower house of the Congress who would later advocate for inserting a provision in the 2000 GBA mandating the Central Bank to adapt regulations to microfinance specificities.

Changing practices vs. drafting policy. CPIP recommended that the Council adopt a collaborative approach to formulating policies. As a multi-stakeholder council, the Council built on its various private and public sector constituencies to create working groups that reviewed studies and added insights. The working group outputs were then used in regional workshops to prompt public discussion. A more

standard regulatory process would have had the Council draft policies and request comments from market actors. Instead, the groups served as a venue for the Council and CPIP to learn from members, discuss the merits of proposed policy reforms, and play a critical role in reaching a truly shared vision for the sector. Working group members then served as champions in their fields of influence to push for necessary reforms. Coordination with other donor agencies also helped ensure that donor-funded programs were aligned with the Council-initiated credit policy reforms. This collaborative process, based on solid analysis and incorporating public and private sector perspectives, managed to get one of the major financial sector reforms approved and implemented. Later, in the early 2000s, the second USAID program, MABS, also influenced the way the Central Bank designs regulations, over the long term and beyond microfinance by developing what later became known as a regulatory sandbox (Box 3).

Beyond the mandate: Support to policy implementation. Policy formulation and its formal adoption only set the tone for the implementation of these policies. To truly change the environment, policy implementation often involves several interrelated activities. Failure to undertake one of them could lead to the failure of the entire policy reform. Several of these activities, like enacting a law, were beyond the control of the Council. The Council formally requested USAID to extend CPIP technical assistance to support these additional activities. USAID agreed and subsequently effected a contract modification to extend project duration, adjust metrics, and provide additional resources. CPIP then supported the Council in coordinating with other government agencies and reviewing how the new strategy affected their

BOX 3. Putting Regulatory Sandboxes in Place

Obstacles in the licensing process for rural banks to be microinsurance agents were considered insurmountable at first: the process required the approval of two regulators (Insurance Commission and Central Bank) but each of them wanted the other to preapprove the application before it would consider it itself. In addition, rural banks were required to change their by-laws before they could apply for a license; this burdensome process discouraged banks from entering the insurance space altogether.

To resolve these difficulties, MABS, the Central Bank, and the Insurance Commission became forerunners in developing what later became known as a regulatory sandbox: a safe space where banks were authorized, under clear limits, to test innovative services or business models that did not conform to the current regulation.

The Central Bank authorized banks to test the product and their interest for one year before they were required to update their bylaws; meanwhile, rather than an approval, the Central Bank would provide a “no-objection” stamp to rural banks that comply with other regulatory requirements; the Insurance Commission agreed to use this “no-objection” approach rather than full approval in its own application process. This “test and learn” approach has been essential to promoting microinsurance through the agent-partner model in the Philippines.

regulations.⁵ This support required significant financial resources, time, and expertise, and is where a major part of CPIP’s technical assistance was deployed. In the early 2000s, MABS also supported the Central Bank to develop rules and regulations for supervising bank microfinance operations.⁶

Balance market representation. MABS played a role in improving the regulatory process by strengthening the capacity of the private sector to contribute constructively. MABS worked with the Bankers Association to help bankers understand proposed regulations and articulate their written responses. This short-term

support strengthened the Bankers Association as an effective policy advocate on behalf of its constituency. The Bankers Association and MABS together won the Central Bank’s Outstanding Financial Inclusion Partner Award in 2012, in recognition of the tangible results of their engagement regarding policy inputs on microagrifinance, housing microfinance, microinsurance, and electronic money. MABS helped to develop the Bankers Association’s awareness and capacity to constructively participate in designing inclusive financial regulations: even if its contribution is not as detailed and proactive as it was with MABS technical support, the Bankers Association is

⁵ CPIP supported the Council in drafting amendments to the cooperative code and the Regulatory Framework for Microfinance in the Philippines issued in July 2002, and in designing implementing tools, such as a standard chart of accounts for credit cooperatives. CPIP also provided expertise to the following regulations: the Agricultural Fisheries Modernization Act in 1997; EO 138 (1999), which directs government agencies implementing credit programs to adopt the Council Credit Policy Guidelines; the 2000 General Banking Act; Central Bank Circular 272 in 2001 implementing the microfinance provisions of the General Banking Act.

⁶ USAID directly supported the Central Bank by funding an international expert to help it develop a Manual for Rules and Regulations for supervising the microfinance operations of banks. USAID also supported the initial training courses for Central Bank examiners to understand the basic principles of microfinance.

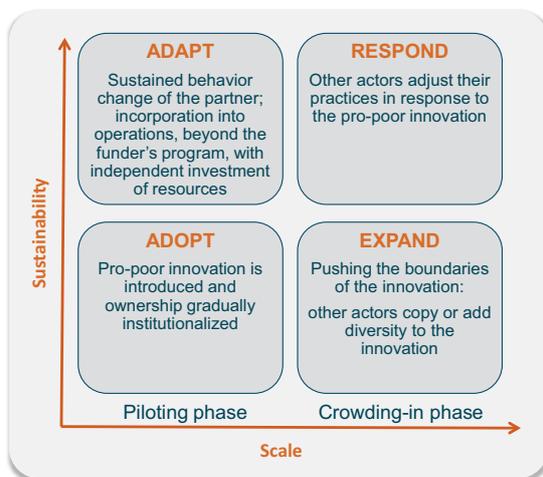
still the main communication channel between rural banks and regulators on microfinance matters.

Leading to Systemic Change

These various interventions not only helped design the new national strategy and the subsequent policies and regulations, but also promoted a true paradigm shift by changing behaviors and practices of policy makers and regulators in the long term. In brief, they generated **systemic change**, modifying how financial markets work for the benefit of the poor and low-income groups. The Springfield Centre’s “Adopt, Adapt, Expand, Respond” (AAER) framework or “Systemic Change Framework” (Figure 2) helps illuminate the various dimensions of this systemic change.

In what can be considered the **Adopt** phase, CPIP supported the adoption of an innovative evidence-based policy reform process for the financial sector. The “data vs. dogma” activities and the collaborative working group process helped convince policy makers of the benefit of changing their initial views and practices. The flagship result was the adoption of a new national microfinance strategy.

FIGURE 2. Systemic Change or AAER Framework



Adapted from Springfield.

In the **Adapt** phase, this change in reform practices was institutionalized, as evidence by policy formulation that took place without CPIP support. The evidence-based policy-making used in the Adopt phase became a standard for financial sector reform agendas (see the 2010 microinsurance strategy and 2015 national financial inclusion strategy).

To increase and stabilize the impact of the innovations beyond their initial partners, CPIP and MABS proactively supported the crowding-in of other market actors. In the **Expand** phase, both programs aimed at supporting other government agencies and the Central Bank to react to the 1997 strategy and adapt their practices as needed. With CPIP, USAID went beyond its initial mandate to accompany the Council in supporting changes in related regulatory environments (cooperatives, agriculture, credit programs, GBA, etc.). As a result, other government agencies reacted to the new policy: for instance, the state revisited the DCPs, cancelling most of them and transferring the remaining ones to government agencies dedicated to promoting the financial sector; the Cooperative Development Authority, which initially did not support the proposal to reform the cooperative sector, eventually took the lead in the reform process. Through MABS, USAID also worked with the Central Bank to design new microfinance regulation.

In the **Respond** phase, to sustain the impact, MABS worked with the private sector (rural banks) to help them adjust their practices to the new policy-making process. MABS strengthened the capacity of its association to efficiently participate in the collaborative policy-making process.

Lessons Learned for Funders

Evidence-based advocacy and consultation facilitate decision-making and implementation. CPIP encouraged the

Council to base reforms on unbiased data. This “data versus dogma” approach offered an objective assessment, effectively disarming conflicting opinions that had derailed previous reform efforts. The 2015 Financial Inclusion Strategy is also based on significant data gathering (BSP 2015). The intensive level of consultation within the Council was crucial in bringing different actors together around a common vision. This fact-based, collaborative process was very successful in getting buy-in from various government agencies, maximizing chances that the strategy would be implemented.

Changing regulatory practices enables longer-term systemic impact, as opposed to an isolated intervention such as drafting a new policy. USAID’s actions were not intended to directly provide the missing functions (in this case, a new strategy and regulations) but to incentivize and enable market actors to provide these functions in the long term (systemic approach): rather than delivering outputs, the program improved the ***process*** for market actors to produce these outputs. This change in market dynamics led to the development of new pro-poor regulations, during the programs and beyond.

Remaining in the background promotes local ownership. The Council took the lead in formulating policies, tackling obstacles to policy implementation, and monitoring implementation, while CPIP stayed in the background, providing the necessary technical support and knowledge of international good practices. The Council and the Bankers Association spoke directly to Congress and the Central Bank, respectively, with CPIP and MABS teams participating only upon formal request. The CPIP local staff team relied on short-term foreign technical assistance and involved many local researchers and consultants, who remained active in influencing policy long after CPIP ended.

Accompanying initial change until it is mainstreamed might be necessary to stabilize market change. CPIP supported the incorporation of the microfinance strategy principles within the regulatory framework and banking practices—even those not under the direct responsibility of the Council. This support was important for mainstreaming changes in mindset and practices underpinning reform, translating them into changes at the provider level.

2. ALIGNING INCENTIVES AND CAPACITY TO ATTRACT NEW PLAYERS INTO THE MARKET

USAID encouraged rural banks to initiate and expand microfinance operations. MABS first demonstrated the viability of microfinance by increasing knowledge among the banks, then supported capacity-building efforts.

The Story

The 1997 Philippines' National Microfinance Strategy promoted an approach in which the private sector would play a major role. However, USAID was aware that the private sector would not spontaneously make use of the opportunities provided by the new framework. In 1997, the USAID mission took part in a diagnostic, organized by another funder, of cooperative rural banks in the Mindanao region. During this field visit, USAID found that rural banks operated with low fixed costs, boasted a wide network of 2,100 branches throughout the country, and possessed a great deal of the local knowledge that would be necessary to be an effective microfinance lender. Unlike NGOs, they could mobilize savings and access private capital to support their expansion. Rural banks were, in theory, well-positioned to serve microentrepreneurs.

However, in practice, their business models relied on collateral-based lending and directed credit programs underwritten by the government.⁷ As the MABS deputy chief of party summarized, "Banks were allergic to small lending." Rural bank staff sat in branches, waiting for clients to come in to apply for a collateral-based loan or to qualify for one of the government's directed credit programs. Banks offered basic savings products,

but provided no encouragement for clients to save; they themselves relied on government funds for on-lending, rather than on deposits. In addition, rural banks faced considerable operating challenges, as demonstrated by frequent closures, limited capitalization, poor governance, low staff capacity, and inefficient operations (Agabin and Daly 1996).

Building on its knowledge of international microfinance good practices, USAID designed MABS to demonstrate to rural banks that microfinance could be a profitable business if done correctly and implemented as a regular part of operations.

Starting with a pilot of four banks in the Mindanao region, MABS attracted 28 banks in the same region after four years, exceeding its initial target of 20. By the end of the program in 2012, MABS had national coverage; 332 rural banks had solicited the services of MABS and benefited from its technical assistance in microfinance.⁸ From 1997 to 2012, these banks reached over 1 million borrowers and disbursed more than 3.2 million loans, totaling more than US\$960 million. They also managed more than 1.4 million microdeposit accounts, with balances of US\$48 million in 2012. Augmented by the rural banks' equity, these microdeposits provided banks with nearly all their required loan funding.

⁷ With the exception of some rural banks that began to experiment with group lending with support from Asian Development Bank and IFAD to mainstream a Grameen-type methodology in the Philippines.

⁸ MABS Evaluation (2013). MABS trained many more banks than those active in microfinance today. Several banks sought training to better understand microfinance but realized it represented an investment they were not ready to make. Other banks were trained but subsequently changed their priorities or their status changed due to consolidation, closure, or being sold or merged.

In 2016, despite new challenges (tightened regulation, increased regional integration, bank consolidations, and increased competition brought on by branch location liberalization) and some banks ceasing their microfinance operations, 170 rural banks continue to provide microfinance services, and the leading rural banks are former MABS partners. The ability to adjust to changes is a good measure of market resilience and sustainability. These banks offer services to an increasing number of customers, serving nearly 1.5 million borrowers and managing 2.6 million microdeposit accounts at the end of 2015 (see Table 1). Microenterprise loans are their most common loan type, with 1.26 million borrowers, followed by housing microfinance loans (85,000 borrowers), and microagri loans (34,000 borrowers). Around 40 banks offer microinsurance to nearly 2 million clients. Furthermore, interest rates on microcredit declined from 5 percent to about 2–3 percent per month in the past 20 years,⁹ and rural and cooperative banks with microfinance operations outperform the rural and cooperative banking industry standards on nonperforming loan (NPL) ratios, return on assets, and return on equity.

Beyond the outreach figures, MABS also contributed to changing rural banks' attitudes toward their clients and improving their overall processes and operations. MABS demonstrated the importance of listening to market needs and the value of collecting and mobilizing client savings. It instilled procedural discipline and improved banks' operations monitoring. MABS achieved these outcomes with a relatively modest budget and high participation from the private sector.

USAID Interventions

Unlike most traditional microfinance programs at the time, MABS was designed as a capacity-building program and did not provide any loan funds or guarantees. Rather than attract rural banks with subsidized funding, MABS intended to unveil the business potential of this new target market. MABS' success is based on a sequenced approach, beginning with an initial, focused phase followed by a crowding-in phase.

The initial phase

During the first two periods of the program, from 1997 to 2003, MABS convinced 110 rural banks to explore a new market and test innovative products and processes (adopt phase), and instilled a new procedural discipline to listen to market needs and develop and offer new products in the long run (adapt phase). The following activities helped achieve these results.

Partnering with the Bankers Association and influential individuals. To quickly gain access to rural banks, MABS partnered with the Bankers Association and its influential chairman. At the time, the government was reforming its direct credit programs, which represented the main business activities for many rural banks. Recognizing the need for rural banks to explore new markets and diversify their offerings, the Bankers Association started opening doors for MABS to meet with rural bank executives.

Initial grant for operating expenses. MABS offered “carrots” to entice the first 20 banks to participate: computers, servers, two-way radios, and small grants to cover one to two microfinance employees (at 100 percent for six months and

⁹ CGAP ISIP Interviews.

50 percent for the next 12 months). This budget remained small (under \$10,000 per bank), as MABS aimed to have banks invest their own resources to offer microfinance services. Rural banks that later joined the program not only self-funded their portfolio but even paid for technical assistance at the market rate.

Involving banks in market research.

Once banks joined the program, MABS trained them on conducting market surveys to inform their product design, rather than directly providing technical assistance to design new products. These market surveys provided evidence that convinced rural banks to change the way they worked. Although they considered themselves “community banks,” most banks realized that their neighboring communities did not know them nor did they find the banking services relevant to their needs. The market surveys revealed a disconnect between how the banks perceived themselves and how the market actually interacted with them—which came as a surprise for both rural banks and MABS. The market surveys also provided data to support MABS’ hypothesis that a market for microfinance products existed. The information motivated banks to work with MABS and revisit their organizational set-up and product offerings.

Coaching rural banks. MABS was then able to start building the capacity of the pilot rural banks, to manage quality services while covering their expenses. The initial program design included both classroom training and six months of coaching by MABS staff to develop, offer, and monitor microfinance services. This comprehensive approach overcame typical classroom training limits (such as passive learning, lack of hands-on experience, ready-made rather than tailor-made guidance). Instead, trainees applied new learning directly after the course, and MABS coaches scheduled

several follow-up visits to supervise and operationalize what trainees had learned in the classroom. Rural banks mentioned that this ongoing coaching was crucial in creating a new discipline in how banks’ staff applied procedures. This “personal touch” was identified in the final MABS evaluation as a key facilitating factor: “MABS’ strategies on monitoring, coordination, and hands-on guidance to the partner bank, sometimes even to the extent of going to the client’s field, conducting focus group discussions to draw lessons on how to ensure successful implementation of the product are unique personalized approaches.”

The crowding-in phase: Scaling up and sustaining the impact

To generate systemic change, MABS had to scale up the results of this initial phase and attract rural banks beyond the initial champions. During the expand phase, the program expanded to more than 300 banks that directly or indirectly benefited from MABS assistance. Approximately 100 additional banks developed cash-based microfinance loans without MABS assistance.

Promoting the results of the initial phase. To attract additional rural banks, MABS used the success stories of the initial phase to generate interest among other rural banks. MABS created “[learning centers](#)”: rural banks served as hosts to other banks that were interested in learning how to effectively target the microfinance segment. These banks, which were designated as learning centers, were trained and equipped to showcase their microfinance operations. MABS provided them with a standard visit agenda, sample PowerPoint presentations, a standard budget, and a list of handouts (loan forms, rapid market appraisals, etc.). As part of its mandate, the Bankers Association organized

conferences twice a year, which served as a venue to promote results and address potential concerns. MABS organized technical presentations and showcased success stories, while participating banks would share the results of their involvement. Several bankers remember these conferences as the most useful technical contributions in the Bankers Association's history.

Leveraging incentives. MABS also leveraged interpersonal incentives and social motivations. MABS tried to groom bank owners and presidents into microfinance champions by promoting their work and helping them gain social and industry recognition. As family businesses, rural bank owners are often concerned with their bank's image in the community. MABS assisted rural banks in obtaining press coverage in the Philippines and abroad, using extensive online communications, including videos and interviews. MABS also developed the EAGLE scoring system, based on simple performance indicators (e.g., outreach, portfolio quality), promoting competition among banks and leading to formal recognition during the Bankers Association's conferences. This scoring was efficient in the first years, proving to be an additional incentive for rural banks to perform better than others, but was dropped later on because it required significant work, and the Association's independence in continuing it was questioned because of its membership.

Creating and sharing knowledge products. The first phase highlighted that the initial diagnostic had overestimated the capacity of rural banks. The banks required assistance beyond product development to tackle various

issues from governance to information systems and operational set-up. They also had a much poorer knowledge of their client base than anticipated. MABS soon realized that its limited resources would not allow it to scale up the program with the initial approach. Hence, MABS changed its operating model and started standardizing tools to enable easier replication. It created toolkits that included procedure manuals and other tools that cover specific topics in microfinance (e.g., loan management, savings mobilization, product development) and broader topics (e.g., governance, information systems, reporting, market research, operations review). MABS disseminated these knowledge products widely—including through [a public website](#), which is still online today, although it is not updated. Anyone could access the material and start using and adapting the standard procedures.¹⁰

Several program participants also highlighted that MABS had opened a “window to the world” by bringing external knowledge to rural banks and spotlighting the Philippines' rural banks on the global microfinance stage (which later helped them attract foreign investors). While not necessarily an explicit goal of MABS, linking the rural banks with the international microfinance community helped legitimize the business model and helped local champions feel part of a larger movement.

Strengthen the capacity-building market using a “franchise model.” To maintain each bank's enhanced capacities in the long term, MABS realized that the market would need an independent and sustainable capacity-building function. MABS first envisioned the

¹⁰ Although the toolkit standardized the content, it also promoted a “step-by-step” customization rather than a full copy-and-paste. Rural banks could pilot test the standardized manuals and then customize them with the coaching provided by MABS staff and consultants over several months. This test-and-learn process, with transparent reporting and analysis of results, gave rural banks the confidence over time to invest their own resources to scale up.

Bankers Association as a training and consulting platform to its members, and began training 10 of its staff. However, this initiative did not reach expected results mostly due to an underestimation of the governance issues facing the Bankers Association: the recurrent change in leadership (the president has only a one-year term) led to frequent changes in agendas and high staff turnover that prevented the development of their internal capacity. MABS then tested training and certifying staff within participating rural banks to deliver MABS training over the long term (the MABS Technical Resource Specialists, or “MABSters”). MABS even designed t-shirts so that these staff could be easily identified by others (Figure 3). However, this strategy did not fully succeed either. Staff turnover and reassignment undermined the strategy’s sustainability, and because of the demands of their regular work, MABSters were for the most part able to share their knowledge only within their own banks.

Eventually, MABS tried building a service market, by training and certifying two external service providers. This strategy helped increase the number of bank units accessing training from 204 to 643 (in this paper, bank units are considered to be banks’ headquarters and branches offering microfinance services). MABS provided the firms with a list of rural banks, and the firms managed their own



FIGURE 3. The MABSters T-shirt

marketing. Rural banks paid service providers directly, with MABS covering around 30 percent of the consulting fees for the first group of banks. In the following years, consultants reduced their fees so that rural banks could cover 100 percent of the fees. For the consulting firms, training rural banks represented a new revenue stream and a tremendous learning opportunity as MABS provided guidance not only on technical content (e.g., cash flow projections, loan collection) but also on training techniques (e.g., experiential learning).

This enabled the trainers to effectively spread good microfinance practices during the life of the project. However, MABS’ attempt to strengthen local technical service providers has not proved very successful in the long term, given that only one service provider remains involved today, and to a very limited extent. This firm reported that demand was low and that the firm could earn more working with other subsidized programs. Incentives were also lacking for firms to join and remain in the program; three of the initial five selected firms dropped out before achieving final accreditation. Interviewees cited lack of initial promotion (they were not aware MABS was offering to train and certify them) and significant upfront investment as two deterrents for other service providers to join the program (the consulting firms selected for the pilot received free training but had to cover costs for staff time during the six-month training). Rural banks also noted that the accreditation from the Bankers Association to the service provider was not a sufficient quality assurance stamp to ensure trust in the long term. The trainers were not able to update their knowledge and keep up with the rapidly evolving field. Strengthening the capacity-building market is not an easy task, as highlighted in El-Zoghbi and Lauer (2014). MABS did address issues at the demand and supply levels, but more was needed around the

supporting functions and norms for this capacity-building market. For instance, MABS' exit strategy could have benefited from introducing a more formal and regularly updated accreditation process and an information and research function to enable trainers to remain technically relevant.

Create a capacity-building function focused on microinsurance. MABS' microinsurance assistance is an exception to the unsuccessful attempt to turn the Bankers Association into a training center, as the Association continues today to provide its members assistance on microinsurance. Several factors help explain this. First, the Bankers Association recruited and dedicated staff to work on microinsurance with MABS early on, association staff were not involved in designing the general microfinance training. Second, the Association's executive director was involved from the start and actively monitored results. Third, demand for microfinance training was guaranteed given that training was mandatory for rural banks to obtain their license as microinsurance agents—the incentive to receive the training was embedded in the system, while broader microfinance training was voluntary. Moreover, the regulator had recognized the Bankers Association as a trusted training partner. Fourth, the microinsurance training was a one-time, very technical and focused course, and was easier to deliver compared to the broader microfinance training that required on-going monitoring for several months. With one part-time staff (compared to the 10 staff initially trained to deliver the microfinance course), the Bankers Association has been able to meet demand.

MABS produced another somewhat unplanned outcome: a cadre of individuals trained on microfinance good practices. First, MABS staff themselves (most of whom were locally hired) benefitted

from the training. Second, employees of the rural banks received technical training, either directly from MABS staff or as part of the MABSters program. Several of these individuals now have leadership roles in rural banks, other financial service providers, insurance companies, and international consultancies. MABS generated a pool of around 100 well-trained individuals.

Reconstructed Theory of Change

A systemic approach involves developing a strategy that first clarifies how interventions sustainably alter the market, and then spells out how these alterations translate into gains in access and use of financial services (Figure 1).

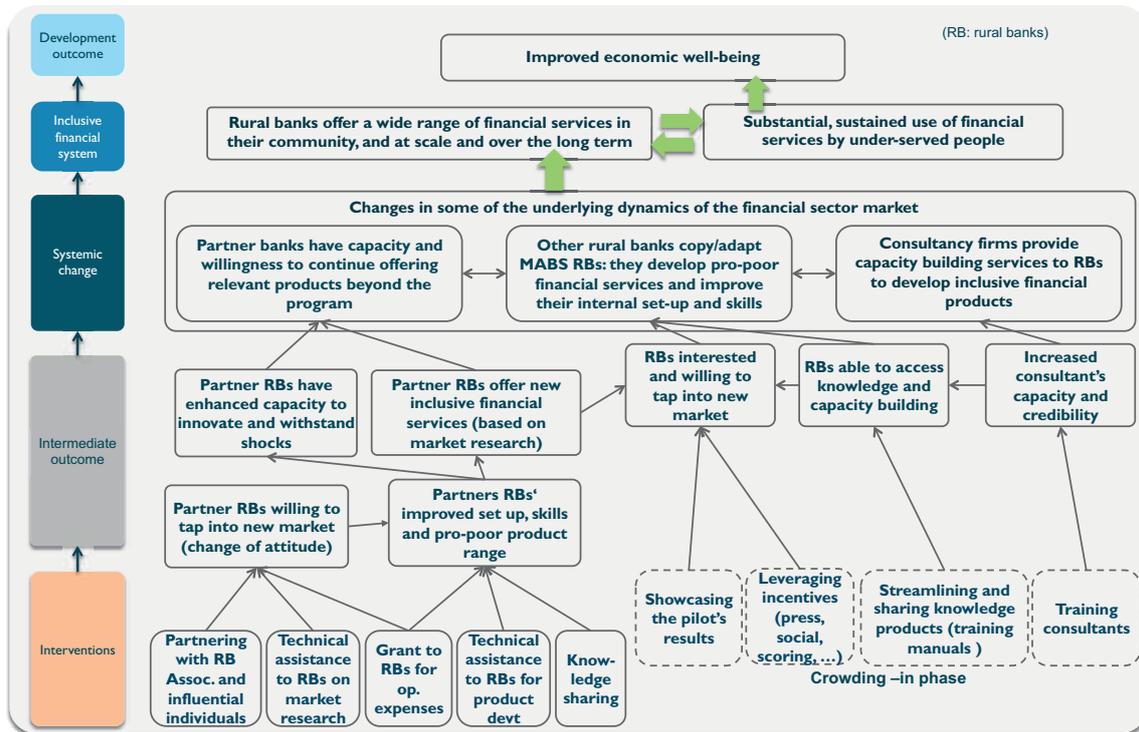
A theory of change (ToC) helps summarize the strategy. The ToC in Figure 4 illustrated how MABS' actual results were achieved. If ToCs were being used in the late 1990s, this is what USAID would have drafted for the capacity-building component of MABS.

A meaningful ToC is the foundation of a successful systemic development intervention. It is valuable for program formulation, measurement, and communication among program partners and wider audiences.

Lessons Learned for Funders

Market knowledge and a thorough initial *diagnostic* are critical elements for success. USAID carried out a thorough diagnostic before designing the project, which enabled USAID to change its focus in the country. Although USAID staff were already quite knowledgeable about the Philippines' financial sector, their participation in a mission to visit rural areas broadened their perspective. The tacit knowledge they gained extended beyond data points and numbers, to understanding barriers in terms

FIGURE 4. Reconstructed ToC Summarizing How MABS Attracted New Actors to Boost the Supply of Inclusive Financial Products in the Philippines (1996 to 2012)



Note: This reconstructed ToC aims to explain how change happened. It is a mix of a program ToC (upper levels of the diagrams) and a project results chain (lower levels of the diagram). A prospective program ToC would be less specific at the lower levels (interventions and expected intermediate outcomes), to give projects the flexibility to adapt to the market. For more information, refer to the forthcoming CGAP Measurement Handbook.

of incentives of rural banks to reach this segment and their capacity to do so. The diagnostic also enabled USAID staff to meet with knowledgeable and influential individuals, at the Bankers Association and within local government, who later became MABS proponents. Because USAID staff managed the diagnostic themselves rather than fully outsourcing it to external consultants, they ensured that the findings would feed directly into program design.

Funders need to give themselves (and their implementing partners) the flexibility to adapt. This requires a test-learn-improve approach and an enhanced monitoring system with short feedback loops. The MABS team and USAID recognized that their understanding of the sector changed substantially in the first years of the

project. Their comprehensive monitoring system, using both formal reporting and very frequent meetings with several market actors, enabled the MABS team to identify what worked and what did not. As they learned more, they updated their underlying assumptions about what it would take to change the perspectives and behavior of rural banks, as well as the activities they planned to deliver. **MABS changed its approach several times, correcting hypotheses that proved to be wrong and adapting to a changing environment.** Due to USAID’s “limited commodity assistance,” MABS was able to add small grant funding to attract the first participant rural banks. Because to USAID’s flexibility on indicators and targets, MABS had the freedom to experiment, as long as the experiments started on a small scale and generated learning.

MABS was able to start and drop some activities (e.g., conflict-affected areas), adjust targets in terms of units to be reached (e.g., bank branches rather than banks), and experiment with several exit strategies. With USAID project evaluations beginning a full year before the end of each phase, MABS staff could also leverage the information from the evaluation and incorporate it into their designs for the subsequent phase of MABS. Overall, the project benefitted from an openness to change, which was built into its organizational structure. In programs aiming for systemic change, this level of flexibility is critical. *Information on monitoring and measurement frameworks for systemic interventions can be found in the CGAP Measurement Handbook (forthcoming).*

Incentives need to be aligned. A market functions according to its actors' behaviors. Behaviors are driven by incentives. Therefore, programs must work on aligning incentives. Incentives operate at various levels: for and among individuals, within and among groups or organizations. Incentives are dynamic; aiming for sustainable impact means considering not just the existing alignment of market functions but also how they will evolve in the future. At different times and to different actors, MABS provided three incentive types: (1) materially oriented (in this case, small grants, increased profits and sustainability), (2) socially oriented (partnering with influential individuals and organizations, peer pressure, and social motivation), and (3) purpose oriented (for some socially oriented banks). MABS also overcame negative incentives such as rural borrowers' distrust of rural banks.

Funders should provide an appropriate level of support that market actors can realistically fulfill after the funder's support ends. MABS did not pay for expensive international consultants to assist rural banks. If it had, it would be nearly impossible for the banks to continue accessing such services without the support of USAID funding. Instead, MABS trained local consultants who could offer affordably priced services without subsidies. Technical assistance was also replicable at low cost, given that MABS had standardized and streamlined the training content. MABS provided the right-size support to increase prospects of sustainability.¹¹ MABS always kept in mind that market actors would have to "do" and "pay" for the services after the program is gone, and for the microinsurance training program, it had a realistic plan for who these actors would be.

Integrating a portfolio of tactics and solutions into program design increases the chances of a successful exit. One of the shortcomings of the MABS exit was that MABS relied too heavily on a single partner, the Bankers Association, to continue the activities. Due to the Association's changing priorities and high staff turnover, MABS has not been able to train the association sufficiently for its staff to continue offering capacity building to rural banks in the long term (except for microinsurance as discussed). But the Association successfully continued its advocacy role, remaining the main communication and advocacy platform between the rural banks and their regulators. It is important for funders to clearly separate functions from players. Focusing on players led MABS to work with the Association

¹¹ "Right-size support," as identified by Springfield in the FSDA 2016 FSD Kenya case study: "'Right size' support to increase prospects of sustainability: development agencies are often able to deploy a level of resources that exceeds prevailing norms within the systems in which they intervene. Consequently, their actions can be so intensive (in terms of money, expertise or effort) that they cannot be replicate by players within the system. By carefully assessing cost-effectiveness and feasibility, FSD Kenya's approach to savings group training and support was matched to local conditions, making take up by local service providers possible."

on various functions (e.g., advocacy, capacity building), other partners might have been more appropriate for functions such as training. Funders and implementers need to test various strategies and regularly revise them in light of results and market systems dynamics.

It all takes *time*. MABS ran for significantly longer than most other projects by

USAID or other development agencies. Although it began as a four-year program, it was extended three times and lasted for 15 years. MABS also benefited from the longevity of its management staff, who steered the project on a stable but adaptive path. The fact that MABS' chief of party, a financial sector specialist with strong facilitation and networking skills, remained in place for more than 10 years was an additional asset of the program.

3. PROMOTING MARKET COORDINATION TO ENABLE PRODUCT INNOVATION

By convening market actors and organizing partnerships, MABS helped develop micro-insurance offerings.

The Story

Banking regulations in the early 2000s did not permit rural banks to sell insurance products. The concept of microinsurance was new even to most insurance companies, and none of them had thought about partnering with rural banks. From 2007 to 2012, MABS capitalized on the government's growing recognition of microinsurance as a financial risk mitigation measure for the poor and built on its strong relationship with rural banks, the Bankers Association, and the overall sector to develop the partner-agent model, whereby rural banks became a new microinsurance distribution channel for poor rural people.

By 2012, when the program ended, six insurance companies and two brokers were in contact with the Bankers Association to target poor and low-income segments through rural banks. The Bankers Association had trained 192 banks in microinsurance, and 26 of them were already authorized by the Insurance Commission as microinsurance agents.¹² By 2014, nearly 2 million individuals (principals and families) were covered by regulated microinsurance products offered through rural banks—starting from zero in 2007, according to the Bankers Association. By 2015, 50 rural banks were accredited by the Insurance

Commission and around 30 were in the process of being accredited. Sixty-three insurers active in the Philippines were engaged in some form of microinsurance, from close to none in 2010. Microinsurance represented 62 percent of all insurance coverage, contributing on average 2 percent of the total premiums.¹³

The formalization of the rural banks' insurance products led to clients receiving better and safer products that were stronger in terms of consumer protection than what was previously offered. Although microinsurance through rural banks is still mostly available to borrowers only, and automatically bundled with their loans, the number and diversity of products improved considerably over the years. Depending on the rural bank, borrowers can benefit from burial assistance, credit life insurance, life insurance, and/or accidental medical reimbursement. While most countries predominantly offer products to direct clients only, in the Philippines most rural banks covered the borrowers' family members. Several facts tend to highlight a positive trend toward the development of more flexible and responsive products: a pawnshop network with 1,800 branches nationwide started distributing voluntary microinsurance services; borrowers increasingly select their bank based on the insurance product they

¹² The difference between the number of banks trained and those actually authorized as agents is due to several factors, including the following from the 2013 survey by the Bankers Association: (i) banks sought training to better understand microinsurance and not necessarily to introduce a product, (ii) changes in the banks' priorities, and (iii) the Central Bank did not permit all applicants to introduce a product on a "no-objection" basis. Other reasons included the bank's Board of Directors is undecided; under consolidation/closed/sold; trained staff is no longer connected with the bank; not yet interested due to other concerns (i.e., Central Bank audit, concerns with the amendment of their articles of incorporation, microinsurance is not the bank's priority).

¹³ Information on the broad microinsurance sector for this entire section is from Bulos and Portula (2016).

offer with the loan; a rural bank started offering insurance on a voluntary basis; and several rural banks allow clients to keep their insurance products beyond their credit life provided that they maintain their savings account.

MABS cannot claim full credit for all the developments in the insurance market—above all given the contributions of many actors at the regulatory level. But MABS clearly contributed to a few factors identified as key to building the microinsurance market: the demonstration effect—where market leaders show that microinsurance can work; the changed perceptions of insurers, who recognized the business potential of the lower-income market segment; and the growth in distribution channels.

USAID Intervention

While some donors supported the Insurance Commission in its effort to regulate and supervise the sector, MABS focused on business model issues, supporting the Bankers Association¹⁴ in its effort to help market actors (rural banks and insurance companies) communicate with the Central Bank and devise sustainable and rapidly scalable business models. MABS' activities included (i) research and information sharing, (ii) the streamlining of the license application processes and the development a matching training curriculum for rural banks, and (iii) market coordination.

The research, information sharing, process streamlining, and training activities were key to raising awareness, unveiling incentives, and creating the capacity of market actors to develop and manage microinsurance products.

The information-sharing activity (including publications, websites, focus group discussions, and field visits) created opportunities for market actors to witness first-hand market potential and possible solutions, and changed insurance companies' perceptions of rural banks and rural clients. By streamlining the processes (including templates, standardized checklists, and training curricula),¹⁵ MABS and the Bankers Association developed a turnkey approach to all aspects of the application process for rural banks to become microinsurance agents, which made it easier for banks to apply and for regulators to quickly review dozens of applications. By training the Bankers Association to support rural banks in the application process, MABS enabled long-term coaching and easier replication of the model.

These activities are similar to those discussed in Section 2, and will not be detailed here. What makes MABS' work on microinsurance particularly interesting is its support to developing a **market coordination** function, which **improved relationships among market actors**. After contributing to increasing interest in microinsurance, MABS focused on creating understanding and relationships among the various actors involved: insurers, rural banks, regulators (Insurance Commission and Central Bank), and rural clients. Insurers and rural banks had never worked together before.

MABS developed a coordination mechanism, with the following interventions:

- **Organizing market-wide consultations.** MABS facilitated the first series of consultation meetings among

¹⁴ Actually the Rural Bankers Research and Development Foundation, Inc., but referenced herein as the Bankers Association for the sake of simplicity.

¹⁵ Formalized application process (Train, Request, Assemble, Choose, and Submit): Train rural banks in microinsurance basics and product mastery, request a no-objection notice from Central Bank, assemble a microinsurance core team, choose a partner insurance provider, submit complete requirements to the Bankers Association.

the Bankers Association, the insurance companies, and their regulators (Insurance Commission, Central Bank), during a two-year period that included quarterly discussions. As a meeting facilitator, MABS helped identify, conceptualize, and communicate the different parties' needs, constraints, and reservations, so that each party would be fully aware of challenges and incentivized to come up with solutions. Bringing neutrality and technical expertise, the Bankers Association and MABS helped move these discussions forward. Microinsurance working groups, convening private sector and regulators, are still active today, without funders' support, and the Bankers Association is an active participant.

- **Facilitating one-on-one discussions and partnerships.** By training rural banks on microinsurance, the Bankers Association and MABS lowered the risks to insurers of engaging in new relationships with rural banks. To facilitate the partnership process further, they streamlined the process for entering into partnerships. The Bankers Association, with MABS support, helped develop a standard partner-agent agreement for insurers and rural banks to start discussing practical details of their partnership. Working with both partners, they made sure the business agreements would satisfy the insurer (ensuring rural banks had the skills and systems to promote, sell, and manage the products) and the bank and its clients (ensuring simple registration and quick pay out). The Bankers Association would provide not only a template agreement (still freely available from the [MABS website](#)) but would accompany the two future partners in their negotiations. The Association still provides this service today, although

most insurance companies interested in serving rural and low-income areas no longer need detailed assistance in setting up partnerships.

Lessons Learned for Funders

Market coordination, creating understanding and relationships among market actors, help promote product innovation. MABS recognized that innovations could not be brought forward by only one actor, especially in the microinsurance field where several actors are required to work in partnership, so it convened several types of market actors to help them develop a shared vision. MABS built a market coordination function by setting up relationships among market actors. MABS' convening power and neutrality created a safe place for market actors to learn about each other, voice their needs and requirements, and together design partnerships that would satisfy all. MABS' expertise was needed in identifying, conceptualizing, and communicating the benefits each party would gain by participating in the innovation. As a market facilitator, MABS ensured all parties were well-informed, able to share their concerns and to listen to the concerns of others, and incentivized to come up with solutions. This function is still in place, where regulators regularly convene market actors to discuss regulation and product development.

A systemic approach is not just about improving regulations or market infrastructure. MABS' intervention on microinsurance generated systemic change, although it focused on building retail-level capacity. Systemic change is aided not only by whom the funder partners with but how the funder goes about generating change. MABS' intervention did not focus only on building capacity, it also included market coordination and partnership building. Beyond building

capacity, MABS changed the dynamics of the market so that this capacity could be used. On the other side of the spectrum, working on regulations or market infrastructure does not necessarily create systemic change if the work fails to set the right incentives for market actors to adapt to the changes. An intervention can change the system dynamics starting at any level of the system, provided that it clearly contributes to changing behavior and practices of market actors.

Partnerships should be flexible, yet clearly defined. One of the keys to successful market facilitation lies in the way

that interventions engage, partner with, and support market actors to help them innovate and adapt new functions. Innovation requires some level of freedom, yet it also requires different parties to act in consultation. MABS managed to clarify responsibilities while leaving some leeway by setting up partnership agreements from the beginning. The Bankers Association entered into various partnerships—with rural banks, insurance companies, and technical service providers. The partnership agreements were essential to test interest at the beginning and clarify responsibilities and expectations.

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