



# Working Paper

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## A Note on Microfinance in Ghana

Research Department

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**BANK OF GHANA**

# **Working Paper**

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### **Abstract**

**The views expressed in this Paper are those of the author(s) and do not necessarily represent those of the Bank of Ghana. Working Papers describe research in progress by the author(s) and are published to elicit comments and to promote further debate.**

**This note reviews the microfinance sector in Ghana within the context of its potential for growth and development. The paper argues that microfinance, when properly harnessed can make significant contributions through several channels. Microfinance can promote higher investment leading to economic empowerment, which in turn promotes confidence and self-esteem, particularly for the vulnerable. In other words, micro- finance creates access to productive capital for the poor, which together with human (addressed through education and training) and social capital (achieved through local organization building), enables people to move out of poverty. The study recommends that, efforts must be geared towards the improvement of the institutional capacity as well as the regulatory framework of the microfinance sector in Ghana.**

**JEL Classification:**

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## **1. Evolution of the Microfinance Sub-Sector in Ghana<sup>1</sup>**

Certainly, microfinance is not a new concept in Ghana. It has always been common practice for people to save and/or take small loans from individuals and groups within the context of self-help in order to engage in small retail businesses or farming ventures. Anecdotal evidence suggests that the first credit union in Africa was probably established in Northern Ghana in 1955 by the Canadian Catholic missionaries that were there at the time. However, Susu, which is one of the current microfinance schemes in Ghana, is thought to have originated in Nigeria and spread to Ghana from the early 1900s. Over the years, the microfinance sector has thrived and evolved into its current state thanks to various financial sector policies and programmes such as the provision of subsidized credits, establishment of rural and community banks (RCBs), the liberalization of the financial sector and the promulgation of PNDC Law 328 of 1991, that allowed the establishment of different types of non-bank financial institutions, including savings and loans companies, finance houses, and credit unions etc.

Currently, there are three broad types of microfinance institutions operating in Ghana<sup>2</sup>. These include:

- Formal suppliers of microfinance (i.e. rural and community banks, savings and loans companies, commercial banks)
- Semi-formal suppliers of microfinance (i.e. credit unions, financial non-governmental organizations (FNGOs), and cooperatives;
- Informal suppliers of microfinance (e.g. susu collectors and clubs, rotating and accumulating savings and credit associations (ROSCAs and ASCAs), traders, moneylenders and other individuals).

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<sup>1</sup> The paper draws on some of the issues raised in the Ghana Microfinance Policy (GHAMP)

<sup>2</sup> See Ghana Microfinance Policy Document

### **Box 1: Structure and Key Stakeholders of Microfinance in Ghana**

The key microfinance stakeholders comprise:

**(i) Microfinance Institutions, including:**

- The Rural and Community Banks,
- Savings and Loans Companies
- Financial NGOs
- Primary Societies of CUA
- Susu Collectors Association of GCSCA
- Development and commercial banks with microfinance programs and linkages
- Micro-insurance and micro-leasing services.

**(ii) Microfinance Apex Bodies, namely;**

- Association of Rural Banks (ARB)
- ARB Apex Bank
- Association of Financial NGOs (ASSFIN)
- Ghana Cooperative Credit Unions Association (CUA)
- Ghana Cooperative Susu Collectors Association (GCSCA)

**(iii) End Users**

- Economically active poor who are clients of microfinance products and services.

**(iv) Technical Service Providers**

- Business Development Service Providers to MFIs and their clients.

**(v) Supporting Institutions**

- Microfinance and Small Loans Center (MASLOC);
- The Ghana Microfinance Institutions Network (GHAMFIN);
- Development partners and international non-governmental organisations
- Universities, training and research institutions.

**(vi) Government Institutions**

- Ministry of Finance and Economic Planning
- Ministries, Departments, Agencies (MDAs) and Metropolitan, Municipal and District Assemblies (MMDAs)

Source: Ghana Microfinance Policy

In terms of the regulatory framework, rural and community banks are currently regulated under the Banking Act 2004 (Act 673), while the Savings and Loans Companies are currently regulated<sup>3</sup> under the Non-Bank Financial Institutions (NBFIs) Law 1993 (PNDCL 328). On the other hand, the regulatory framework for credit unions is still being developed to reflect their dual nature as cooperatives and financial institutions. The rest of the players such as FNGOs, ROSCAS, and

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<sup>3</sup> Work on an amendment of this Act is however underway.

ASCAs do not have explicit legal and regulatory frameworks, and are largely unregulated.

In terms of current policy programmes that affect the Microfinance sub-sector, a number of on-going projects can be cited. These include - the Financial Sector Improvement Project, Financial Sector Strategic Plan (FINSSP), the Rural Financial Services Project (RFSP), the United Nations Development Programme (UNDP) Microfinance Project, the Social Investment Fund (SIF), the Community Based Rural Development Programme (CBRDP), Rural Enterprise Project (REP), and Agricultural Services Investment Project (ASSIP).

## **2. Microfinance and Development**

Generally, microfinance encompasses the provision of financial services and the management of small amounts of money through a range of products and a system of intermediary functions that are targeted at low income clients<sup>4</sup>. It includes loans, savings, insurance, transfer services and other financial products and services. Microcredit is thus one of the critical dimensions of the broad range of financial tools for the poor, and its increasing role in development has emanated from a number of key factors that include<sup>5</sup>:

- The fact that the poor need access to productive resources, with financial services being a key resource, if they are to be able to improve their conditions of life;
- The realization that the poor have the capacity to use loans effectively for income-generation, to save and re-pay loans;

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<sup>4</sup> United Nations, Concept Paper: *Building Inclusive Financial Sectors to Achieve the Millennium Development Goals* (International Year of Microcredit, United Nations, 2005)

<sup>5</sup> United Nations, Microfinance and Poverty Eradication: *Strengthening Africa's Microfinance Institutions* (New York, United Nations, 2000)

- The observation that the formal financial sector has provided very little or no services to low-income people, creating a high demand for credit and savings services amongst the poor;
- The view that microfinance is viable and can become sustainable and achieve full cost recovery;
- The recognition that microfinance can have significant impact on cross cutting issues such as women's empowerment, reducing the spread of HIV/AIDS and environmental degradation as well as improving social indicators such as education, housing and health.

Indeed, empirical studies have shown that micro-finance helps very poor households to meet basic needs and protects against risks, and is thus associated with improvements in household economic welfare. Gender activists also argue that microfinance helps in empowering women by supporting women's economic participation and so promotes gender equity.

Other strands of the literature suggest that micro-finance creates access to productive capital for the poor, which together with human capital, addressed through education and training, and social capital, achieved through local organization building, enables people to move out of poverty. By providing material capital to a poor person, their sense of dignity is strengthened and this can help to empower the person to participate in the economy and society (Otero, 1999).

The aim of micro-finance according to Otero (1999) is not just about providing capital to the poor to combat poverty on an individual level, it also has a role at an institutional level. It seeks to create institutions that deliver financial services to the poor, who are continuously ignored by the formal banking sector. Littlefield and Rosenberg (2004) argue that the poor are generally excluded from the

financial services sector of the economy so MFIs have emerged to address this market failure. By addressing this gap in the market in a financially sustainable manner, an MFI can become part of the formal financial system of a country and so can access capital markets to fund their lending portfolios, allowing them to dramatically increase the number of poor people they can reach (Otero, 1999). More recently, commentators such as Littlefield, Murdugh and Hashemi (2003), Simanowitz and Brody (2004) and the IMF (2005) have commented on the critical role of micro-credit in achieving the Millennium Development Goals.

According to Simanowitz and Brody (2004, p.1), micro-credit is a key strategy in reaching the MDGs and in building global financial systems that meet the needs of the most poor people.+Littlefield, Murdugh and Hashemi (2003) state,

*Micro-credit is a critical contextual factor with strong impact on the achievements of the MDGs. Micro-credit is unique among development interventions: it can deliver social benefits on an ongoing, permanent basis and on a large scale.*

However, some schools of thought remain skeptical about the role of micro-credit in development. For example, while acknowledging the role micro-credit can play in helping to reduce poverty, Hulme and Mosley (1996) concluded from their research on micro-credit that most contemporary schemes are less effective than they might be+(1996, p.134). The authors argued that micro-credit is not a panacea for poverty-alleviation and that in some cases the poorest people have been made worse-off.

This notwithstanding, microfinance has emerged globally as a leading and effective strategy for poverty reduction with the potential for far-reaching impact in transforming the lives of poor people. It is argued that microfinance can facilitate the achievement of the Millennium Development Goals (MDGs) as well as National Policies that target poverty reduction, empowering women, assisting vulnerable groups, and improving standards of living. As pointed out by the

former UN Secretary General Kofi Annan during the launch of the International Year of Micro Credit (2005),

*“Sustainable access to microfinance helps alleviate poverty by generating income, creating jobs, allowing children to go to school, enabling families to obtain health care, and empowering people to make the choices that best serve their needs.” (Kofi Annan, December 2003).*

Clearly, there is broad consensus among academia and policymakers that although microfinance is not a panacea for poverty reduction and its related development challenges, when properly harnessed it can indeed make sustainable contributions through financial investment leading to the empowerment of people, which in turn promotes confidence and self-esteem, particularly for women.

### **3. Microfinance and Poverty Reduction in Ghana**

The main objective of Ghana's Growth and Poverty Reduction Strategy (GPRS II) is to ensure “...*sustainable equitable growth, accelerated poverty reduction and the protection of the vulnerable and excluded within a decentralized, democratic environment*”. The task is to eliminate widespread poverty and growing income inequality, especially among the productive poor who constitute the majority of the working population. According to the 2000 Population and Housing Census, 80% of the working population is found in the private informal sector. This group is characterized by lack of access to credit, which constrains the development and growth of that sector of the economy. Clearly, access to financial services is imperative for the development of the informal sector and also helps to mop up excess liquidity through savings that can be made available as investment capital for national development<sup>6</sup>. Unfortunately, in spite of the obvious roles that microfinance institutions have been playing in the economy

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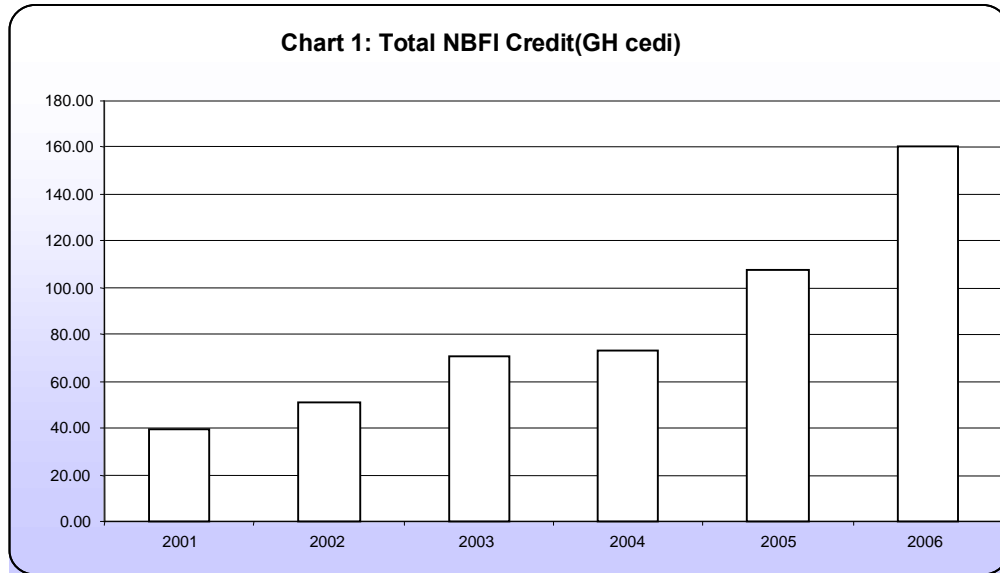
<sup>6</sup> World Bank-Africa Region, Studies in Rural and Micro Finance: *Financial Services for Women Entrepreneurs in the Informal Sector of Ghana*. World Bank, New York, (1999)



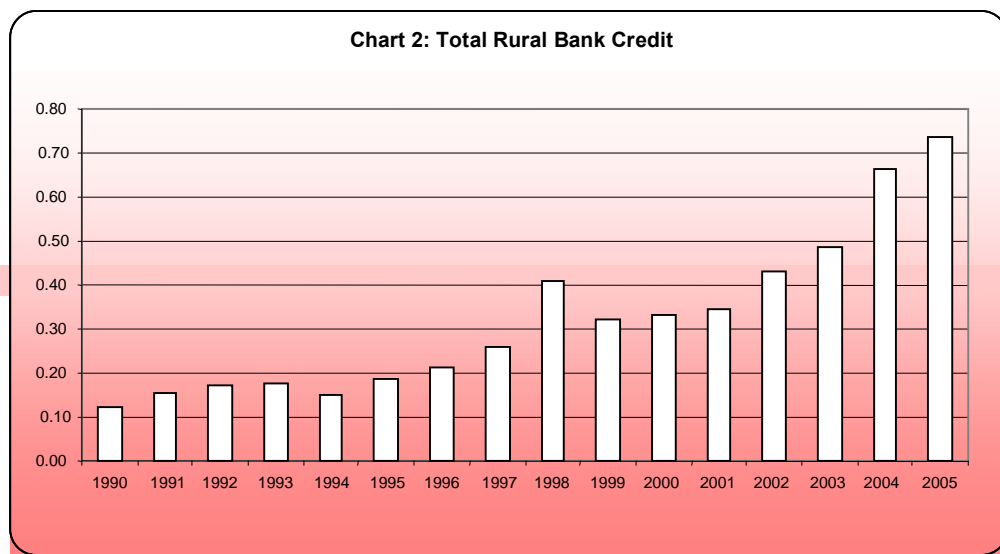
particularly over the last twenty years, there is pervasive lack of data on their operations.

It is known that loans advanced by microfinance institutions are normally for purposes such as housing, petty trade, and as start up loans for farmers to buy inputs for farming and this includes rice seeds, fertilizers and other agricultural tools; Some of the loans are used for a variety of non-crop activities such as: dairy cow raising, cattle fattening, poultry farming, weaving, basket making, leasing farm and other capital machinery and woodworking. Of course, funds may be used for a number of other activities, such as crop and animal trading, cloth trading and pottery manufacture.

There are other instances where credit is given to groups consisting of a number of borrowers for collective enterprises, such as: irrigation pumps, building sanitary latrines, power looms, leasing markets or leasing land for cooperative farming. For example, trends in loans and advances extended to small businesses, individuals and groups by the Non-Bank Financial Institutions(NBFIs) in Ghana amounted to GH¢50.97 million in 2002 as against GH¢39.64 million in 2001, indicating about 28.6 per cent growth. The amount of loans extended by NBFIs further increased from GH¢70.63 million in 2003 to GH¢72.85 million in 2004, suggesting 3.1 per cent growth. In 2006 alone, total of GH¢160.47 million was extended to clients, which represents 48.8 per cent higher than the previous year's total loans and advances granted by these microfinance institutions(see Chart). The upward- trending NBFIs' credit to individuals, small businesses, groups and others indicates marked improvements in level of microfinance in the country.



The Rural and Community banks also play very important roles in microfinance in the country. These banks were established specifically to advance loans to small enterprises, farmers, individuals and others within their catchment areas. Total loans advanced to clients by all community and rural banks in Ghana was GH¢20.68 million in 2002 compared to GH¢13.12 million in 2001, suggesting an increase of 28.6 per cent. The amount of loans further increased from GH¢71.63 million in 2005 to GH¢115.10 million in 2006, thus indicating 35.4 per cent respectively (see chart).



#### 4. The Role of Bank of Ghana and other Government Programs

The Bank of Ghana's history of promoting the financing of Micro, Small and Medium Enterprises (MSME) began from the Credit Guarantee for Small Borrowers scheme in 1969 that was administered through the Development Finance Department of the Bank. The Bank was further instrumental in administering the IDA-financed Fund for Small and Medium Enterprise Development (FUSMED) Project, and also with the Private Enterprise and Export Development (PEED) Project, as well as other direct projects that were ended after BOG decided to focus on its core areas of operation. Currently, BoG is actively participating in the Rural Financial Services Project (RFSP).

This project was supported by donors such as the International Development Agency (IDA) of the World Bank, the International Fund for Agricultural Development (IFAD), and the African Development Bank (AfDB). It is aimed at broadening and deepening financial intermediation in rural areas through measures such as; Capacity Building of the Informal Financial Sector, Capacity Building of Rural and Community Banks, and the establishment of an Apex Bank for Rural Banks in Ghana. Generally, the range of players in providing financing facilities for the MSME sector is shown in Table 1 below.

**Table 1: Credit Flow to Micro Enterprises and SMEs in Ghana**

Source	Examples of Schemes
1. Financial Institutions	Major Banks, Rural banks, Community banks, non-bank financial Institutions, etc.
2. Donor/Government Credit Schemes	GRATIS, FUSMED, NBSSI schemes
3. Donor-Assisted SME Loan Projects	IFAD, DANIDA, CIDA, FAO, USAID etc.
4. Informal Financial NGOs, Credit Unions	Sinapi Aba Trust, CARE International etc.
5. Government Schemes	BAF, SIF (Micro-Finance Capitalisation), Poverty Alleviation Fund (PAF), EDIF, MPSD and PSI schemes, MOTI, MASLOC,

Source: Compiled from various sources

From 1990, support for micro, small and medium enterprises was intensified with the establishment of the National Board for Small-Scale Industries (NBSSI). In 1991, the NBSSI was merged with the Ghanaian Enterprises Development Commission (GEDC) and this made the NBSSI to take over the functions of the latter . in particular the delivery of credit to small scale entrepreneurs.

**Table 2: Examples of facilities for MSMEs administered by the NBSSI**

Facility	Target Beneficiary/Sector	Clients	Interest Rate	Repayment Performance
1. PAMSCAD Credit Line	Small Scale Entrepreneurs operating in the rural areas, poor urban areas, women entrepreneurs	1200	20% p.a	87%
2. Revolving Fund Loans Scheme	Small Enterprises in the productive, export and service sectors, but excluding enterprises engaged in trading, primary agric, and real estate	250	20% p.a	69%
3. NBSSI/NFED Devt Assistance Programme	Literacy groups of the Non-Formal Education Division of the Ministry of Education.	<200	20% p.a	<70%
3. UNDP /ILO/DRHC Micro Concrete Tile Credit Scheme	Micro Concrete Tile Producers under a UNDP/ILO Project arranged for the erstwhile Department of Rural Housing and Cottage Industries.	<200	20% p.a	<70%
4. ENOWID Revolving Loan Fund	Women in development. It was operated largely in the Brong Ahafo, Volta and Western Regions for the Department of Community Development (National Commission for Women and Development)	3,500	20% p.a	96%
5. NBSSI/DED Credit Scheme	Micro and Small enterprises in the Northern, Brong Ahafo and Eastern Regions through the Business Advisory Centres.	<200	20% p.a	75 %
6. Small and Micro Enterprise Promotion Fund (SMEPF)	Micro and small Enterprise sector in general.	<200	20% p.a	<70%

Source: Compiled from records obtained from the NBSSI

Its main financing window was a USD30 million Fund for Small and Medium Enterprise Development (FUSMED), which was provided under the World Bank's small and medium enterprises project and managed at the Bank of Ghana. The fund offered credit to enterprises in all sectors of the economy except primary

agriculture, real estate and trading. However the repayment performance turned out to be less than satisfactory.

Currently, the projects that are on-going for the MSME sector include the Financial Sector Improvement Project, Financial Sector Strategic Plan (FINSSP), the Rural Financial Services Project (RFSP), the United Nations Development Programme (UNDP) Microfinance Project, the Social Investment Fund (SIF), the Community Based Rural Development Programme (CBRDP), Rural Enterprise Project (REP), and Agricultural Services Investment Project (ASSIP). A recent impact assessment<sup>7</sup> of the plethora of MSME financing programs that have been implemented across the country suggests that significant challenges remain in ensuring the effectiveness of MSME programs. The study found that access to finance was a significant problem for MSMEs, even though other problems such as low cash flow, energy, high cost of non-labour inputs, increasing competition, and high cost of credit were also cited. The next section outlines some of the remaining challenges facing the microfinance sector in Ghana.

## **5. Challenges Facing the Microfinance Sector**

Generally, since the beginning of government involvement in microfinance in the 1950s, the sub-sector has operated without specific policy guidelines and goals. This partially accounts for the slow growth of the sub-sector, and the apparent lack of direction, fragmentation and lack of coordination. There has not been a consistent approach to dealing with the constraints facing the sub-sector. Such constraints include - inappropriate institutional arrangements, poor regulatory framework, inadequate capacities, lack of coordination and collaboration, poor institutional linkages, lack of linkages between formal and informal financial institutions, inadequate skills and professionalism, and inadequate capital etc.

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<sup>7</sup> Study conducted by Ernst & Young and ISSER for the Bank of Ghana

For example, better coordination and collaboration among key stakeholders including development partners, government and other agencies, could help to better integrate microfinance with the development of the overall financial sector.

Secondly, traditional commercial banking approaches to microfinance delivery often do not work. According to traditional commercial banking principles, the credit methodology requires documentary evidence, long-standing bank-customer relationship and collateral, which most micro and small businesses do not possess. The commercial banking system, which has about twenty-three (23) major banks, reaches only about 5% of households and captures 40% of money supply. Therefore there is room for expanding the microfinance sector in Ghana.

An example is the programme for Susu by the Barclays Bank of Ghana (BBG) Ltd. BBG launched a microbanking scheme in December 2005 which establishes a formal link between modern finance and susu (one of Africa's most ancient forms of banking) collection in an unconventional mobile initiative across the country. The scheme aims to extend microfinance to some of the least affluent in Ghana, like the small trader at the market or the micro-entrepreneur selling from road-side stalls. Though their individual income is apparently too small for high street banking, collectively it is estimated at about a \$150 million economy thriving below the traditional banking radar. Ghana's 4,000-strong Susu Collectors offer basic banking to the needy. For a small fee they personally gather the income of their clients and return it at the end of each month, providing greater security for their clients' money. In addition, with finance from Barclays the Susu Collectors are able to provide their clients with loans, helping them to establish or develop their business. In the words of the CEO of BBG Margaret Mwanakatwe,

*“What we are doing is somewhat unique. Not only are we creating an account for Susu Collectors to deposit their funds, we are also providing them with loans of their own, which they can ‘lend-on’ to their customers, helping them build their capital. In the process, we are laying the building blocks for a truly financially inclusive society. Currently, over three quarters of Ghanaian society may not have access to high street banking. We are also providing capacity building training to Susu Collectors to make sure that they do their credit risk correctly and any training needs they may need.”*

It is gratifying to note that the Government of Ghana has adopted microfinance as one of the important strategies for poverty reduction and wealth creation. Recognizing the role various institutions and individuals can play to ensure the achievement of this national vision of achieving the MDGs and also becoming a middle income country by the year 2015, there is the need to quicken the pace of reforms in the microfinance sector in order to unleash its full potential for accelerated growth and poverty reduction.

Finally, while Ghana has a reasonably diversified and supervised regulatory framework for formal financial institutions licensed by BoG, there is concern that appropriate regulation needs to be extended to other institutions operating in the microfinance sub-sector (for example the legal framework for credit unions) in order to improve the outreach, sustainability and efficiency of savings, facilitate credit delivery, and institutional arrangements.

The specific challenges facing the industry are discussed into more detail below<sup>8</sup>.

### **5.1 Institutional Framework<sup>9</sup>**

The stakeholders in the sub-sector play various roles which are expected to be complementary. Due to the lack of defined areas of operation, the roles and responsibilities of stakeholders currently overlap in some cases. The overlap is also due partly to the fact that organizational and institutional hierarchy and reporting relationships among all the stakeholders are not clearly defined. Commercial banks could play an increasing role. There is the need therefore to clearly define relationships and roles to enhance effective implementation and delivery of services.

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<sup>8</sup> Again, we draw on some of the issues discussed in the Ghana Microfinance Policy (GHAMP)

<sup>9</sup> The section also benefited from an earlier paper, "Rural and Microfinance Regulation in Ghana: Implications for Development and Performance of the Industry". William F. Steel and David O. Andah. This paper was presented at the International Conference on Ghana at the Half Century, July 2004.

## **5.2 Capacity Enhancement and Funding**

The various stakeholders in the sector often organize training programmes and activities with the view to upgrading capacity in the industry. This notwithstanding, the staffing and competency levels are still below what is desired. For example, the capacity of some key stakeholders and institutions including MASLOC, GHAMFIN, MFIs, relevant Ministries, and technical service providers etc. needs to be enhanced for microfinance operations. Also, the current microfinance Apex bodies lack an adequate cadre of in-house trainers and/or facilitators as well as in-house monitoring and evaluation units to continually measure progress of their activities consistently over time. Funding for the sub-sector has been from three sources - the institutions themselves, government, and development partners. In the first place, available funds have not been adequate, and secondly, the different sources come with their associated conditions, and thus distort the market in some cases. There is considered to be a need for a central microfinance fund to which MFIs can apply for on-lending and/or capacity building support, building on experience such as the case of the Training Fund under the Rural Financial Services Project.

## **5.3 Credit Delivery and Management**

Current strategies for credit delivery are not adequately diversified or efficient, and therefore are unable to fully meet the varying demands of the market and different categories of end-users. There is no framework for categorizing and upgrading some of the emerging microfinance institutions in the semi-formal and informal sub-sectors in accordance with their operational capacities and capabilities. The objective of microfinance is to provide resources for the poor. Nonetheless, there is yet to be adequate, reliable and acceptable methods for classifying various poverty levels to enhance the categorization of potential and actual MFI clients and other forms of support that may be more appropriate for some groups.



#### **5.4 Data/Information and Dissemination**

Generally, there is lack of information on microfinance institutions, their operations and clients in the country. Approaches to and methodology for data and information gathering at the national level are not uniform, making it difficult to centrally monitor progress of the sub-sector. There is a lack of well defined reporting system by both the government and development partners with regards to their interventions, and hence there is inadequate database for decision-making and planning. At the institutional level, data/information gathering and dissemination are weak within and between institutions. Also, the lack of common benchmarks, methods for measuring and information sharing further inhibits the performance of the sub-sector. Thus, lack of adequate and reliable information on outreach in terms of its depth and breadth remains one of the most daunting in the sub-sector. This lack of information has affected targeting of clients and ultimate poverty reduction.

#### **5.5 Regulation and Supervision**

There needs to be dialogue on the formulation, implementation and review of regulatory and supervisory policies and procedures to ensure consistency and efficient approaches to regulation across different types of microfinance institutions. There is a need to balance the need to facilitate the evolution of a variety of institutions providing microfinance products and services, with the need to protect depositors' funds, provide adequate information and protection to consumers, and coordinate expansion and regulation of different segments of the market. Microfinance institutions in this category often face rigid regulatory and supervisory systems in many countries, which often inhibit their product innovativeness, outreach and ultimately the performance of the institutions. Finally, there is a lack of well specified guidelines for operations among apex bodies namely, CUA, GCSCA, ASSFIN and the Cooperative Council. This leads to uncoordinated activities and invariably hampers the performance and outreach of their member institutions.

## **5.6 Coordination**

Currently, there is no formal body that is responsible for coordinating all activities associated with microfinance, nor is there a forum for dialogue among stakeholders on policy and programme issues<sup>10</sup>. As a result, there is fragmentation, duplication and inadequate collaboration between and among MDAs, MMDAs, development partners, service providers, practitioners and end users. In this regard, the role of GHAMFIN as an umbrella body for microfinance apex institutions, as well as their member institutions, needs to be strengthened to ensure the transfer of best practices and setting of standards for the industry. The existing institutional structure does not include all practitioners and service providers, and needs to be addressed.

## **6. Conclusion**

In conclusion, the potential economic benefits of sustainable microfinance in Ghana are compelling, and its potential effects on the development process cannot be understated. This calls for a holistic approach, as discussed to facilitate the development of the microfinance sub sector and thereby unleash its potential for accelerated growth and development.

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<sup>10</sup> GHAMFIN is playing this role presently, but needs to be given some formal clout.