

Conversations with Practitioners

The Challenges of Market-Led Microfinance

Conversations with Practitioners

The Challenges of Market-Led Microfinance

Guy Winship

Intermediate Technology Publications Ltd
trading as Practical Action Publishing
Schumacher Centre for Technology and Development
Bourton on Dunsmore, Rugby,
Warwickshire CV23 9QZ, UK
www.practicalactionpublishing.org

© MicroSave, 2007

First published in 2007

ISBN 978 1 85339 623 6

All rights reserved. No part of this publication may be reprinted or reproduced or utilized in any form or by any electronic, mechanical, or other means, now known or hereafter invented, including photocopying and recording, or in any information storage or retrieval system, without the written permission of the publishers.

A catalogue record for this book is available from the British Library.

The author has asserted his right under the Copyright Designs and Patents Act 1988 to be identified as author of this work.

Since 1974, Practical Action Publishing has published and disseminated books and information in support of international development work throughout the world. Practical Action Publishing (formerly ITDG Publishing) is a trading name of Intermediate Technology Publications Ltd (Company Reg. No. 1159018), the wholly owned publishing company of Intermediate Technology Development Group Ltd (working name Practical Action). Practical Action Publishing trades only in support of its parent charity objectives and any profits are covenanted back to Practical Action (Charity Reg. No. 247257, Group VAT Registration No. 880 9924 76).

Printed by Information Press, United Kingdom

Contents

Abbreviations and Acronyms	iv
Acknowledgements	v
1. <i>Introduction</i> The Shift to Market-Led Microfinance	1
2. <i>Meeting</i> The Practitioners, their Organizations and the Experts	9
3. <i>In Conversation</i> The Concept of Market-Led	21
4. <i>Knowing Your Market</i>	29
5. <i>The Product Development Process</i>	36
6. <i>Pricing and Costing</i>	52
7. <i>Client Satisfaction</i>	61
8. <i>Human Resource</i> Development and Management	75
9. <i>The Institution</i> Capacity, Structure, and Governance	87
10. <i>The Environment</i>	99
11. <i>Critical Issues</i>	109
12. <i>Conclusion</i>	115
About MicroSave	127

Abbreviations and Acronyms

CGAP – Consultative Group to Assist the Poor

DFID – Department for International Development

FINCA – Foundation for International Community Assistance

MESP – Micro Enterprise Support Programme

MFI – Microfinance Institution

MFRC – Micro Finance Regulatory Council

MIS – Management Information System

NGO – Non-Governmental Organization

OECD – Organization for Economic Co-operation and Development

PAR – Portfolio at Risk

PRA – Participatory Rural Appraisal

TEBA – The Employment Bureau of Africa

TPB – Tanzania Postal Bank

UMU – Uganda Microfinance Union

UNDP – United Nations Development Programme

Acknowledgements

This book has been a rewarding experience, and I hope offers something to everyone who reads it. The conversations I held with both practitioners and experts revealed their unflagging passion for microfinance and an inspiring commitment to fighting poverty, despite the considerable challenges they face. These dedicated practitioners have re-ignited my own belief in the need to provide savings, credit, and other financial services in poor communities.

Many thanks are extended to all the participants for generously giving their time; I know the conversational interviews often took place at busy moments and appreciate the great thought that the practitioners and experts put into their responses. Allowing me to take some licence with the transcripts to assist with the conversational flow of the book is also appreciated.

Many other people have aided in getting 'Conversations with Practitioners' to publication. The encouragement, support and patience of Graham Wright and the MicroSave team is much appreciated. Graham granted me total independence to develop and guide this project as I thought best, and therefore, any biases it contains are mine alone. Roseanne Petters invested significant time and effort in making sense from hours of often indistinguishable recordings; this book could not have been written without her dedication to, and good humour during the transcribing process. Recognition is given to Candace Nelson for the great editing job and to Shane Nichols, Edward Pearson and Jacqui Winship for the informal editing and other support. A special thank you to Jacqui for keeping the home fires burning while I was travelling and for enduring those late night telephone calls. The long discussions with microfinance colleagues in various countries contributed to the issues raised and questions and discussion; while there are simply too many of you to acknowledge individually, I do recognise the many microfinance practitioners trying their best to overcome the great misery of poverty.

These many efforts from around the globe have come together in one book that I hope will make a small contribution towards the huge goal to provide quality financial services to the millions of poor people who need them.

Last but not the least, the gracious and timely support of UNCDF/UNOPS towards publication of this book is gratefully acknowledged.

Guy Winship

CHAPTER 1

Introduction

The Shift to Market-Led Microfinance

The term microfinance is quite simply, the provision of much-needed financial services to the poor. The terms most dominant in recent discussions of microfinance trace the fascinating history of its evolution – from the very early realizations that the poor, in fact, can repay loans, to the widespread endorsement of sustainable microfinance. With sustainability as a driving force, the industry homed in on the elements that were necessary for its achievement – growth, market pricing, quality portfolios, efficient systems, and professional management. While ‘sustainability’ has far from disappeared from our lexicon, new terms like ‘transformation’ and ‘commercialization’ capture the industry’s forward movement towards full financial intermediation and access to local and international capital markets.

Most recently, the term ‘market-led’ has crept into conversations about microfinance. Encompassing the principles of sustainable and commercial microfinance, the concept of being ‘market-led’ adds a dimension too-long ignored: the clients. Rather than going to the market with that which they have to sell, market-led institutions are trying to provide what the market – i.e. poor clients – want. That these market-led institutions are investing in understanding and responding to market demand indicates another major shift in the way the business of microfinance is done.

Market-led microfinance exemplifies the convergence of business and social objectives. Increasingly, microfinance practitioners are realizing that in order to maintain market share *and* grow, their institutions must actively seek to determine and meet their clients’ financial needs. They must invest in their relationship with clients through customer service, better delivery systems, and appropriate products. Institutions that offer a more diverse range of products tailored to real needs will have greater impact, leading to yet another case in which doing good is good business. And since bringing about improvements in the lives of the poor is the stated aim of most microfinance institutions, the poor themselves play a central role in the dialogue on how this is best achieved.

Presented as a set of conversations among practitioners, this book contains a set of edited interviews with the chief executive officers (CEOs) and product champions of some of the leading microfinance institutions in sub-Saharan Africa, as well as some of the leading thinkers and writers on commercial

microfinance internationally. The conversations focus upon why and how microfinance institutions should and can become market-led institutions. With the support of MicroSave¹, these conversations were undertaken in 2003 and 2004 in part as a follow-on to a similar effort undertaken five years earlier. *Microfinance: Conversations with the Experts*² reflected the cutting-edge issues for the industry at that time, many of which remain relevant even today. The challenges that microfinance institutions are currently grappling with – market research, product development, client retention – are inherent in the relationship between the institution and its clients; a relationship that is emerging as a critical element in sustainable microfinance.

Conversations with Practitioners offers a decidedly institutional and anecdotal perspective on MFIs' attempts to become more client focused. Many of the interviews were held at two conferences co-ordinated by MicroSave, one near Johannesburg in South Africa in February 2003 and one in the Aberdare mountains of Kenya in October 2003. By offering a rare insight into the issues practitioners face and the practical strategies they are using, this book facilitates the sharing of current experiences and lessons learned. While the focus is on experiences in Africa, these relate to areas of microfinance practice that are universal in nature.

The need for a range of financial services

It is widely recognised today that poor people need – and can pay for – appropriate access to financial services at different times in their lives. Their needs for services and products vary depending upon a range of individual and environmental factors that include:

- personal desires (thrift, increased independence, entrepreneurial vision);
- stage of life (paying for children's education, marriage, raising a family);
- cultural influences (that govern expected expenditures on life cycle events, access to financial services);
- climate (exposure to drought, flooding, violent storms, etc.); and
- governmental factors (the degree to which governments assist in times of emergencies).

These factors that influence a person's need for financial services can be grouped into three categories:

- general life cycle events;
- investment opportunities; and
- the need to cope with unforeseen crises including illness and natural disasters.³

Such a diversity of life situations generates the need for a similar diversity of financial products, from savings and loans to insurance and money transfers.

Despite the obvious and compelling rationale for product diversity, its implications in terms of the need to identify and understand clients' needs have yet to be widely embraced by microfinance institutions. The industry is still dominated by a few loan products, regardless of potential demand for greater variation. Market-led microfinance, defined as the provision of client-focused and responsive financial services in an ever-changing market, is a new

frontier. In order to understand how some microfinance institutions have reached this frontier, it is helpful to examine where they have come from.

Historical antecedents to market-led microfinance

Perhaps the primary reason behind the apparent lack of attention paid to identifying, and then meeting, client needs is the historical assumption that microfinance institutions are the major – if not the only – source of financial services within their targeted low-income communities. As the ‘only game in town’, microfinance institutions could subjugate clients’ needs to their own growth and institutional performance, both cornerstones of sustainability. That growth has been facilitated by rapid replication of standardized operations essentially built around one or two credit products. With few other alternatives in the marketplace, robust client demand for these limited offerings provided little incentive to develop others. In addition, the use of donor funding, the inability to obtain regulatory approval to intermediate funds, and a fairly common focus on small business development (especially from American agencies) also contributed to this focus on the asset side of the balance sheet. Cost reduction, achieved through improvements in operational efficiency, management and risk assessment has been another important sustainability strategy. More often than has generally been acknowledged, institutions improved their financial sustainability by passing inefficiencies on to their poor clients through high interest rates and fees, a strategy that is

Expert Box 1.1

Success will come to those organizations that best determine the perceptions, needs, and wants of target markets, and satisfy them through the design, communication, pricing, and delivery of appropriate and competitively viable offerings.

From Philip Kotler and Alan R. Andreasen, *Strategic Marketing for Non-profit Organizations* (Revised Fourth Edition), Prentice Hall, 1996.

only possible in a context of minimal competition.

Yet, by the late 1990s, an important phenomena began to chip away at the monopolistic armour of microfinance. Clients were leaving credit programs in large numbers. In Africa, client retention rates were – and remain – as low as 40% per annum. That clients are voting with their feet is indicative of two very important developments exerting huge influence on the industry: first, existing clients are not satisfied with the services they have received; and secondly, they have someplace else to go to meet their financial needs. With more options available, clients are learning how to compare them and make their own choices. In those countries where competition has arrived, it is changing how the business of microfinance is conducted, as the conversations in this book will attest. Whatever the reasons for client turnover, low client retention rates negatively affect institutions’ financial performance and compromise their ability to achieve sustainability. The need to compensate for the loss of existing clients (and loss of market share) with aggressive recruitment of new clients has multiple direct and indirect cost

implications. Direct costs include those related to outreach and promotion, while indirect costs are associated mainly with a decreased ability to assess client risk. Both contribute to increasing difficulty in ensuring on-going cost recovery. One microfinance institution estimated, for example, that the costs of attracting a new client to a specific loan product were between 6 and 11 times higher than the costs of retaining an existing client.⁴

The need to attract and retain clients against a backdrop of growing competition engendered change within the microfinance industry. Some microfinance institutions began to focus on how to improve their delivery of existing products (an *internal* or *production focus*); others are concentrating on new ways to attract or retain customers to existing products (a *sales focus*).

The Production Focus – In the early days of microfinance, both international programs and local initiatives ascribed to the logic that tried and tested products from one country could well work in another. Products and delivery models that were successful in some parts of the world have commonly been replicated in whole or in part with little consideration for local economic, social, regulatory or institutional factors. Believing that lower costs and more efficient delivery were key to improved performance, these ‘production-oriented’ institutions focussed on the supply side of the operation. Cost-to-income, clients-to-credit officer, and operating expense ratios are some of the internal indicators they focussed their attention on. Rather than invest in tools to better understand client needs or in new product development, they remained focused on one or two loan products in order to achieve economies of scale with a minimalist ‘one-size-fits-all’ approach.

The Sales Approach – Despite the best attempts to improve internal systems and controls, the persistence of high levels of client turnover gradually motivated many MFIs to pay more attention to their relationship with clients. This initially resulted in more aggressive marketing and improved sales techniques. After all, they needed to continually bring in new clients to replace those who were leaving. They also made improvements in market assessment techniques in order to facilitate entry into new, untapped markets.

Microfinance institutions experimented with a range of sales methods, using both visible and non-visible strategies (the so-called ‘above’ and ‘below the line’ strategies). New resources were invested in enhancing institutional image through advertising, logos, coordinated company colours and spruced-up branch offices. Front-line staff was offered new training or re-training with courses such as “Managing Customer Relations” and “How to Sell Services”. They learned that “the client is king”. In many cases microfinance institutions interpreted this mantra as a mandate to improve client retention with stronger marketing, and indeed, in some instances client satisfaction improved as institutions did a better job of selling their products.

While the sales approach generally did not incorporate responding to clients’ needs with a wider choice of products, it did assist in bringing the client back into the equation. The move to embrace sales led to an appreciation of the unique nature of the relationship between financial products and their consumers. Financial services are *intangible*; that they cannot be seen or touched or tasted means that a client’s decision to purchase is heavily dependent

upon personal experience, word of mouth, the institution's image and its reputation within the community. Direct selling, with sales being dependent on direct contact with clients is the only practical distribution channel for microfinance services, and it is therefore impossible to separate the service from the front-line staff selling or providing them. The importance of the personal touch that front-line staff provide in promoting and providing these services cannot be over emphasised. Microfinance institutions conscious of the need to cultivate clients with appropriate products and good service are now beginning to appreciate that the prevailing emphasis on productivity and cost containment puts pressure on staff to generate loans that may well be incompatible with an approach that truly places clients first.

Defining the new frontier: market-led microfinance

Thus, some of the leading microfinance institutions have started to fight back by – (re)focusing on clients. They are increasingly interested in a *client-centred* or *market-led* approach that investigates client needs on an on-going basis, and mobilises the entire institution to meet these needs to the greatest extent possible. The emergence of market-led microfinance is the next phase of the move towards commercialisation, in which business principles are increasingly being harnessed to ensure that microfinance institutions can appropriately serve the needs of clients while at the same time improving their bottom line.

But what is market-led microfinance and how is it different from the microfinance the world has known to date? Market-led microfinance is the opposite of the previously dominant *supply-led* approach that was based on what the microfinance institution had to offer rather than what the client needed. Market-led microfinance places the clients' needs first and foremost. It conducts market research to determine these needs, identify gaps in the marketplace and assesses the competition. Such market intelligence serves as the foundation for a process of conceptualising, designing and testing the best product or products in response to identified needs. As a result, innovative products such as mechanisms to safely, cheaply and quickly transfer small amounts of money, and insurance products to help clients manage risk, are now appearing in the marketplace. But market-led microfinance is not only characterised by the number or diversity of products. In putting the client first, practitioners also embrace customer service and seek to minimize all the transaction costs that clients incur when accessing services.

Such practices are standard for any successful business. Indeed, a central and recurring theme espoused by industry leaders is that microfinance is a business enterprise like any other, albeit aimed at a poor and historically underserved clientele. Given increased competition, greater exposure to the formal financial sector, new regulatory requirements with specific prudential norms, and reductions in donor support, the environment facing microfinance institutions in many countries increasingly reflects the "regular" business sector. The framing of microfinance as a business is dramatically changing how products and services are designed and delivered since attracting and keeping clients – capturing market share – is key to commercial success. As in any other