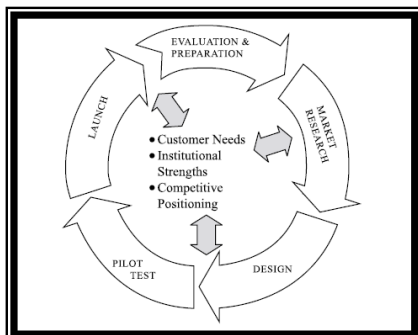


MicroSave Briefing Note # 65

Costs and Benefits of Pilot Testing for Product Development

Cheryl Frankiewicz (Summarised by Corrinne Ngurukie)

Studies of and discussions with microfinance institutions demonstrate that pilot testing is a significant component of a new product development process as shown in the figure below. Properly executed, pilot testing resulted in



more viable products and a stronger, more profitable institution.

Unfortunately, this step, as in the case of market research, is frequently ignored by MFIs.

There are many

reasons for this; one in particular (the focus of this note) is the concern or belief that the costs incurred in pilot testing new products far outweigh the gains derived from conducting a pilot test.

The Dilemma

Pilot testing demands investment in time and resources to allow the measurement of a product's worth on a limited scale and scope, so that the results of the test guide management decision making about a broader rollout of the product. However, top of the agenda, especially for MFIs operating in highly competitive environments, is to stay ahead of the pack and to safe guard the 'secret product concept', hence a delay to offering the product to the public is seen as a significant opportunity cost.

The question then asked is, "Why bother with pilot testing if the costs incurred appear to potentially outweigh the benefits generated from the process?" or "What pre-requisites or conditions must be fulfilled in order to make pilot testing worthwhile?"

A study¹ conducted through ten case study MFIs revealed interesting findings that explored the costs incurred, the benefits received and the lessons learned as these MFIs implemented the pilot testing process.

The Costs of a Pilot Test

Practitioners and theorists generally agree that new product development is a costly undertaking, with pilot testing being the most expensive of the steps in the process especially if not properly planned or prepared for. Yet it is an investment that an increasing number of MFIs are willing to take up because of the anticipated perceived gains. However the concern of whether the returns generated are worth going through the process

¹ The study, conducted by Cheryl Frankiewicz, builds on concrete experiences of four research partners and their member MFIs: *MicroSave*, Microfinance centre for Central and Eastern Europe and the New Independent States (MFC), Micro-finance Consulting Group (MCG) and Women's World Banking (WWB) all of whom have played lead roles in development of new products and services. The full document accessible through www.MicroSave.net

still remains. The question really is, "What really are the costs of conducting a pilot test?"

Financial Costs

A Virtual Conference on Pilot Testing hosted in March 2005 by *MicroSave* generated a long list of costs (Box 1) commonly associated with pilot testing. However, a quick look through reveals that there are only three or four in the list that are costs specific to pilot testing – the cost of meeting to agree on a pilot test protocol, monitoring and tracking performance against protocol targets, documentation of lessons learned and evaluation of the pilot and deciding whether to roll out or not.

Box 1: Costs Commonly Associated with Pilot Testing

- Building the product concept
- Pricing the product
- Documenting policies and procedures
- Preparing systems (especially the MIS)
- Training (staff, clients, pilot test team)
- Marketing (product launch, promotional materials, incentives)
- Feedback and follow up sessions and activities
- Product modifications
- Gathering performance data
- Analysing performance data
- Cost of monitoring and evaluation
- Loss of confidence, morale and money if the product fails
- Developing and maintaining a system to track product profitability
- Sensitisation and negotiation
- Meeting regulatory requirements

With their pilot tests lasting between one month and 33 months, case study MFIs estimated that 40-80 days of management time was required for an average one year testing phase. Elsewhere, the MBP Guide to New Product Development estimates a level of effort of 75 to 135 days for pilot tests running between 6 to 12 months.

In addition, the study revealed that a pilot testing exercise may require between US\$5,757 and \$32,520 per new product developed with the cost of labour and the extensive involvement of consultants, accounting for most of the costs.

Non-Financial Costs

The already cited *opportunity cost* of delaying introduction of a product to the market is a valid one, especially because it is seen as giving the competition

the opportunity to ‘steal’ the product idea, develop it further before launching hence giving them a “first mover” advantage over the MFI doing the testing.

Closely linked are the *psychological costs*. The pilot test team, for instance, focus a great degree of their effort on the test and this could result in weaker performance in their other areas of responsibility. They risk burn out.

Reputation risk might arise especially when clients’ hopes of new product being introduced does not materialise or is delayed. Furthermore, clients in non pilot locations may feel they are being denied an opportunity to access the new product and thus become upset. Experience demonstrates that communication is the key to help manage both client and staff expectations during the testing process.

The Value of Pilot Tests

None of the new products launched by case study MFIs after pilot testing failed. Praise for pilot testing was evident when these institutions articulated the following benefits derived from it:

- Very useful for gauging real demand for a product.
- Provides a better understanding of internal capacity, for instance the efficiency of systems and procedures.
- Fewer and less expensive mistakes due to the limited scale in which the product is being experimented. Fixing problem areas during pilot testing is less costly than if the product was rolled out first:
 - Contains costs by minimising the time that it takes to identify and respond to problems.
 - Monitoring is more intense and reaction time even faster than during roll out.
 - Institutions that move straight to roll out spend much of their resources fighting fires than preventing them and are less likely to deal with minor problems when they are still small.
- Pilot testing is a tool for managing change – staff are trained on the process whilst lessons are documented.
- Promotes organisational buy in through sharing positive experiences.

- Product roll out is faster, smoother and cheaper. MFIs are able to more accurately predict and plan for resources for a wider implementation; new products can be introduced in new locations with systems, procedures and policies that have already been tested and have had major problems resolved in advance.
- Ensures that the product being rolled out is attractive to clients, and that it is delivered right first time.

The Cost of Failure

New products fail for various reasons including the failure to identify and respond to the needs of target market, and poor estimates of the total cost of delivering the product. The results: a tainted institutional image, high costs in repairing that broken image and high costs required to fix the problem areas.

“Tackling the problem when it is small is one thing: solving it when you already have a portfolio of 60,000 clients is another”.
~ James Mwangi, CEO Equity Bank

Conclusion

Two things to keep in mind on lowering costs for a pilot: (a) reduce the scale by limiting the testing to few locations and reducing length of test and (b) narrow the focus by having clear targets.

Realistically, however, the question that many MFIs struggle with is the trade off between speed and risk particularly in highly competitive markets; or in areas where the demand for financial services exceeds supply; or when an institution hires staff with expertise in delivering a particular product; or when the product itself is low risk or has become commonplace. Is pilot testing really necessary then? A general rule of thumb determined during the aforementioned virtual conference suggested, and rightly so, *“A pilot test should be done only if the outcome of the test is going to decide or will at least substantially influence what will be done after the test.”*

The Cost of Failure – Equity Bank’s Painful Lesson

Equity Bank was, and still is, a strong proponent of the market-led approach that embraces pilot testing as a core step to developing successful financial products. Its exponential growth in 2003-2004 and its transformation from a building society to a bank challenged management to find ways of giving adequate attention to all the changes taking place. With the potential of 100,000 customers per year, the bank decided, during this time, to roll out an apparently straight forward salary-based loan product without testing. In the words of the CEO James Mwangi, *“We thought it would be a quick win”*.

There was enormous demand for this product. It was easy to administer at low volume, so the bank scaled up reaching a portfolio of US\$3.75 million in 9 months. Then the trouble started. The amount of staff time required to complete an employer assessment and manage employer relationships daily had been underestimated. Soon one Equity employee was managing a portfolio of 5,000 clients.

Post transformation, it took more than 3 months for the bank to get into the central payment system and it had not built a grace period into the product’s design, so several months of arrears quickly piled up as customers’ loan payments fell due and salaries were yet to be credited. PAR-30 days rose (from 7% to 18% in 3 months) and there were instances of internal and external fraud. Equity quickly reviewed and re-engineered the product, identified and mitigated risks, purchased and installed a robust MIS system and launched a major collections effort. By November 2005 they reported 90% recovery. From this, Mwangi counselled, *“If you want to manage the risk of new product development effectively, pilot test!”*