

Designing Savings and Loan Products

Graham A.N. Wright
February 2010

Abstract

In “Portfolios of the Poor – How the World’s Poor Live on \$2 a Day”¹, Collins et al. note that poor people face what they call the “triple whammy”: not only are their incomes low, but they are also unpredictable, and furthermore, because they are financially excluded, poor people lack the financial instruments to help them manage what little, irregular income they have. This paper examines this in detail by looking at a typical year in the life of Pon, Melodia and their two children, using *MicroSave*’s seasonality analysis, which traces households’ income, expenditure, loans and savings over time.

As Collins et al. note, from the above, it is clear that three needs that drive much of the financial activity of the poor households:

1. *Managing basics*: cash-flow management to transform irregular income flows into a dependable resource to meet daily needs – in the case of Pon’s family to manage school fees and the lean season.
2. *Coping with risk*: dealing with the emergencies that can derail families with little in reserve – in the case of Pon’s family to manage Pon’s sickness.
3. *Raising lump sums*: seizing opportunities and paying for big-ticket expenses by accumulating usefully large sums of money – in the case of Pon’s family to manage his brother’s wedding.

To meet these needs, poor people need the following financial services

1. A *current savings account* into which they can deposit, and from which they can withdraw, conveniently.
2. An *emergency or general loan* that can be taken and repaid quickly.
3. *Recurring, commitment or contractual savings products*.
4. A *loan that can be used for a wide variety of purposes* - the need that the microfinance industry has done so much to meet.

Poor people need these products delivered in a reliable, convenient, flexible and structured manner.

The paper provides examples of organisations that have implemented such systems with great success and highlights Grameen Bank’s Grameen II system in particular. It concludes with an overview of a systematic product development process – essential to develop, test and roll out new products in a low risk, highly effective manner ... and to ensure their success.

This paper was first presented at the Nepal Microfinance Summit February 15th 2010

¹ Collins, Daryl, Jonathan Morduch, Stuart Rutherford and Orlanda Ruthven, “Portfolios of the Poor – How the World’s Poor Live on \$2 a Day”, *Princeton Press*, 2009

Designing Savings and Loan Products

Graham A.N. Wright

Background

Microfinance is probably the only remaining (largely) “product-driven” business in the world. All other industries have long since moved from producing something and then trying to sell it to a “market-driven” approach under which they identify and meet customers’ needs on a profitable basis. In the commercial world, companies that have simply marketed a product without reference to the customers’ requirements have soon closed. The “market-driven” approach recognises that there is more value in retaining customers than attracting new customers who cost more.

In microfinance, the value of retaining clients is particularly clear. Typically, retained customers are the ones with extensive credit history and who are accessing larger, higher value loans; whereas new customers require induction training and can often weaken the solidarity of groups. MFIs typically break even on a customer only after the fourth or fifth loan. And yet, many MFIs suffer chronic problems with clients leaving their programmes. Careful analysis of the reasons for these “drop outs” almost invariably points to inappropriately designed products that fail to meet the needs of the MFIs’ clients. Much of this problem is driven by the attempts to “replicate” models and products from foreign cultures and lands (usually Bangladesh) without reference to the economic or socio-cultural environment into which they are being imported.

Product development is an essential activity for market-responsive MFIs. As clients and their needs change, so the market-driven, demand-led MFI must refine its existing products or develop new ones. But product development is a complex, resource-consuming activity that should not be entered into lightly. Nonetheless, those MFIs committed to being market leaders and to responding to their clients must indeed conduct product development. More client-responsive products will reduce drop-outs, attract increasing numbers of new clients and contribute substantially to the long-term sustainability of the MFI and significantly increase the developmental impact of the financial services provided.

The Challenges Poor People Face

“Portfolios of the Poor – How the World’s Poor Live on \$2 a Day”² outlines the challenges faced by poor people in graphic and meticulous detail. Indeed, it is a book that each and everyone involved in development (and particularly microfinance) should read. The research is based on “Financial Diaries” collected from interviews with poor people every two weeks over a year in Bangladesh, India and South Africa. Its conclusions provide clear insights into the day-to-day struggle of poor people and how they try to manage their small incomes in the face of repeated expenditure needs and economic shocks.

The authors note that in the face of a need to make expenditure – for planting, to repair the house, to pay the doctor or for medicine or for new clothes for a festival or marriage – the poor have three options:

1. The worst case – go without: this happens all too often, with consequences that threaten lives and wreck opportunities.
2. Raise money by selling assets – if you have them and a buyer who will pay an acceptable price.
3. The best case – use past income or future income to fund today’s expenses.

The third involves intermediating: saving (storing past income that can be spent later) or borrowing (taking an advance now and repaying it from future income). This highlights the exceptionally important role that microfinance can play in the lives of the poor – and helping them escape from the debilitating clutches of poverty.

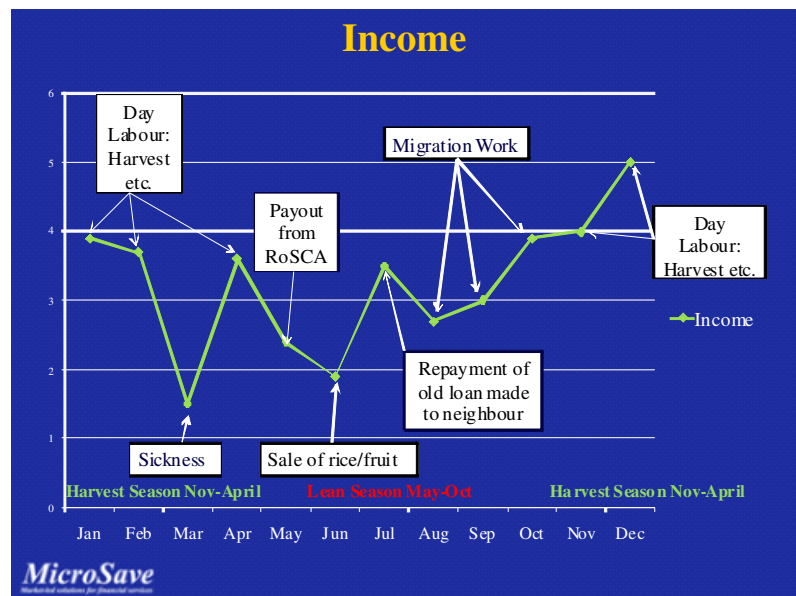
Collins et al. note that poor people face what they call the “triple whammy”: not only are their incomes low, but they are also unpredictable, and furthermore, because they are financially excluded, poor people lack the financial instruments to help them manage what little, irregular income they have.

² Collins, Daryl, Jonathan Morduch, Stuart Rutherford and Orlanda Ruthven, “Portfolios of the Poor – How the World’s Poor Live on \$2 a Day”, Princeton Press, 2009

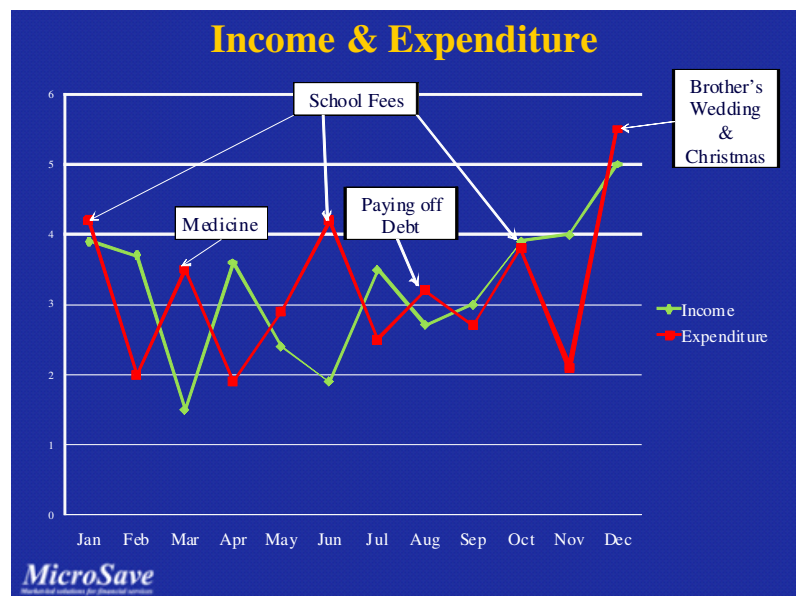
Let's examine this in detail by looking at a typical year in the life of Pon, Melodia and their two children, using *MicroSave's* seasonality analysis, which traces households' income, expenditure, loans and savings over time.



Starting with income, we can see that for this household, the opportunities to generate precious income are dominated by the agricultural cycle – in this case the diversified crops mean that the harvest season and relatively plentiful day labour is available in the months November-April. But in March Pon fell sick, which not only stopped him earning, but also meant that his wife, Melodia, was busy nursing him, and unable to go to the fields. Pon and Melodia managed the first month of the lean season through a payout from one of the savings clubs to which they belong - Rotating Savings and Credit Association (RoSCA). After that they were able to sell some of the rice and fruit they had carefully stored; and to recover a loan they had made to help a friend and neighbour marry off her daughter the year before. By August Pon had to go down to the nearby port city to look for casual work as a construction worker and was able to send enough money home each month to keep rice on the family table. He returned to the village in November as the harvest season resumed.

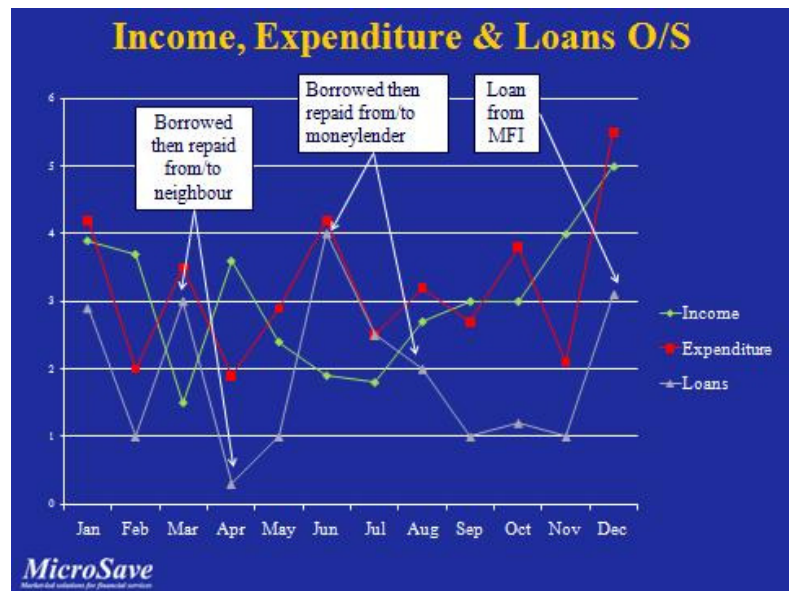


The irregularity and unpredictability of the family's income are further exacerbated by the demands on that income. Three times a year, the family has to find enough money for the school fees and books for the two children. When Pon was sick, doctors' fees and medicine meant that the associated loss of income was amplified by a spike in their expenditure. In August, Pon paid off some of the moneylender's expensive debt with the money that his neighbour had given him in settlement of the (interest free) loan he had given him for his daughter's wedding (Pon had always seen this loan to his friend as a way of saving money out of reach, and thus the temptation to spend it). Finally, the Christmas celebrations and the contribution Pon had to make for his brother's wedding ceremony, meant that expenditure was even higher than usual in December.



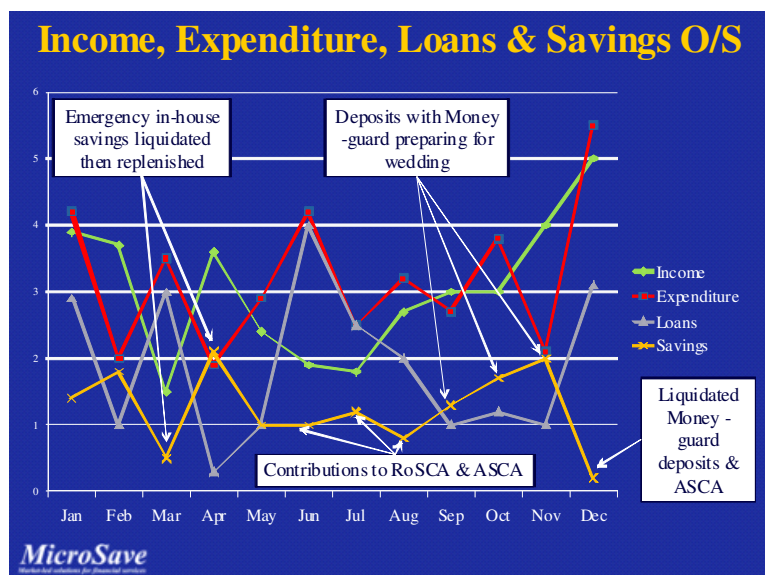
How did the family manage these challenges? How did they juggle the little and irregular income they earned to manage the mix of predictable and unpredictable expenditure requirements?

The answer lies in intermediation: borrowing and saving. In response to the crisis created by Pon's sickness in March, the family borrowed from a kindly and better-off neighbour. This loan was quickly repaid the following month – maintaining this relationship is an essential part of Pon and Melodia's survival strategy. This neighbour is relatively well-off, powerful and has often helped Pon's family in times of need. To finance the June school fees and books, Pon took a loan from the village moneylender, which he repaid off over the following three months from his small savings, deferring payments on his account at the village shop and from the surplus income in September. In December Melodia joined an MFI and got a loan for goat rearing, which allowed her to help contribute to his brother's wedding ... she only bought one goat, but showed two more borrowed from a friend to the Loan Officer who came to conduct the MFI's "loan utilisation check". She was pretty sure that the Loan Officer knew the loan utilisation check was a sham – he certainly did not spend very much time or ask any questions.



The multiple systems the family (particularly Melodia) use to save also played a key role in managing the ups and downs of the income and expenditure mis-match that the family faced during the year.

Melodia always tries to keep some cash savings hidden away inside one of the bamboo poles of the house (she's not telling which) for emergencies. She used these savings to finance the doctor's fees and medicines during Pon's illness – but quickly replenished her secret store of savings the following month. Throughout the lean season she kept her contributions to the savings clubs (both the RoSCA and an Accumulating Savings and Credit Association or ASCA which also lends out to its members). Once the wedding of Pon's brother was announced, the family increased its savings from September by regularly depositing small amounts with the local priest. In December, the ASCA liquidated (as it does every year) and the family took their accumulated savings from the priest to help pay for the wedding.



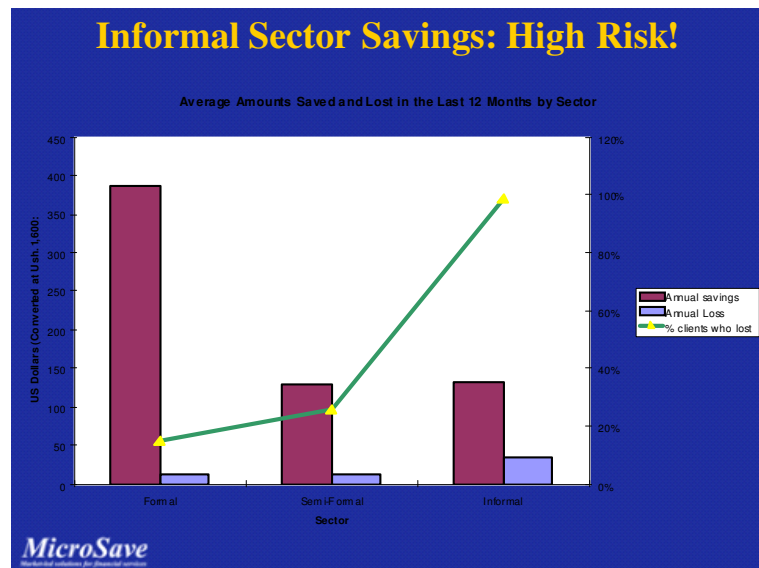
What Poor People Need

As Collins et al. note, from the above, it is clear that three needs that drive much of the financial activity of the poor households:

1. *Managing basics*: cash-flow management to transform irregular income flows into a dependable resource to meet daily needs – in the case of Pon’s family to manage school fees and the lean season.
2. *Coping with risk*: dealing with the emergencies that can derail families with little in reserve – in the case of Pon’s family to manage Pon’s sickness.
3. *Raising lump sums*: seizing opportunities and paying for big-ticket expenses by accumulating usefully large sums of money – in the case of Pon’s family to manage his brother’s wedding.

1. Reliability

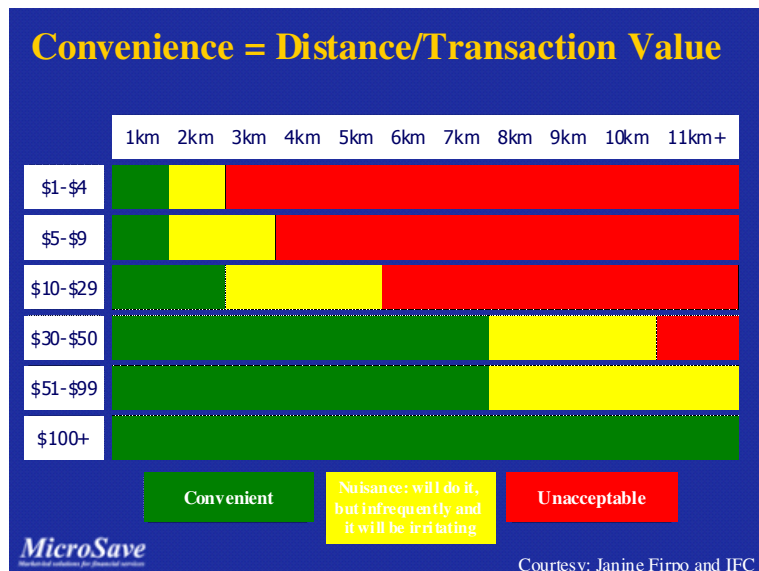
Again drawing on the observations of Collins et al., the most useful financial services for the poor are those that are reliable (the promised amount is delivered at the promised time, at the promised place and at the promised price). The services in the informal sector are rarely reliable – the kindly relative or neighbour does not always have the cash to extend a loan, the moneylender may charge more than expected and the ASCA’s funds are not always available. On the savings side, it is worse ... indeed *MicroSave’s* work in Uganda (corroborated by the evidence in the “Portfolios of the Poor”) is that the very informal savings instruments that Pon and so many others across the globe depend upon are extremely risky. The research revealed that 99% of clients saving in the informal sector reported that they lost some of their savings and on average they had lost 22% of the amount they had saved in the last year. 15% of those saving in the formal sector report that they had lost some savings and 26% reported that they had lost savings in the semi-formal sector. Thus the formal sector, for those lucky enough to have access to it, is safer both in terms of likelihood of losing any savings and in terms of the relative loss (amount lost to amount saved). Those with no option but to save in the informal sector are almost bound to lose some money – probably around one quarter of what they save there.



2. Convenience

Poor people also need convenient financial services. This includes the opportunity to access and repay loans close to home, without having to pay bribes ... and ideally without the requirement to sit in time-consuming groups that enforce obligations to pay defaulters’ instalments. There is growing evidence from Bangladesh and many countries elsewhere that voluntary group solidarity, which leverages and replicates reciprocal lending arrangements in the villages, is more effective than enforced joint liability in more mature groups. Enforcing repayment on behalf of defaulting members, particularly when larger amounts are involved, risks the entire group defaulting and (in the words of Stuart Rutherford) “unzipping”. Similarly, poor people seek convenience when they save. Indeed savings services that are close to home, quick, unobtrusive and private are likely to yield much higher levels of deposits: the deposit collectors that roam so many markets across the globe collect extraordinarily large amounts of savings, and are able to charge remarkably high interest rates for providing such a convenient service.

Janine Firpo has recently completed work to look at the distances people are willing to travel to make a transaction, and unsurprisingly, it depends on the amount involved. Thus, when it comes to small amounts, for example deposits, convenience is the key determinant of where (and often whether) a poor person will save.



3. Flexibility

The irregularity and unpredictability of poor household’s cashflows means that flexibility of financial services is extremely important to them. While a disciplined, inflexible deposit product is desirable for saving up in readiness for predictable events (school fees, weddings etc.); flexible, rapid response opportunities to withdraw and borrow are essential to respond to the unpredictable crises and needs that beset the poor. For this reason, emergency or general purpose loans that are disbursed rapidly are immensely popular amongst MFI clients across the globe.

4. Structure

Finally the poor need structure within their financial services to make them more convenient and disciplined. For this reason, recurring deposit schemes (and even rigorously disciplined loan repayment schedules – particularly those that break down the lump sum repayable into small, manageable bite-size bits) are particularly popular with the poor. When they are reliable, savings clubs with regular meetings are immensely useful for poor people – they create the structure and discipline to build up lump sums. As Collins et al. note, “Structure becomes important as values rise and term lengths grow, above all in commitment savings plans and longer-term and higher-value loans”.

So What Does All this Mean for Designing Savings and Loan Products?

We have seen that poor people need three basic types of services:

1. To manage money on a day-to-day basis
2. To build savings over the longer term
3. To borrow money for a wide variety of purposes

Managing money on a short term basis reflects poor households’ need to juggle the small amount of income they have to meet basic needs – and can be met through two key basic products: a current savings account into which they can deposit, and from which they can withdraw, conveniently. This, supplemented with an emergency or general loan that can be taken and repaid quickly, would do much to meet poor people’s day-to-day money management needs.

Building savings on a longer term basis for predictable needs (marriages, land acquisition etc.) is best done through disciplined, structured savings mechanisms that mirror the savings clubs that (despite being very risky and associated with high levels of loss of precious savings) are so commonly used by the poor. Thus recurring, commitment or contractual savings products are highly valued by poor, and indeed all households – as Grameen Bank has discovered (see section on Grameen II below).

Finally, the need for borrowing money for a wide variety of purposes is the one that the microfinance industry has done so much to meet. This is, despite annoying (and largely ineffective) loan utilisation checks, recent studies (for example those in the AIMS project) show that borrowers typically divert around 40% of their loans to “non-productive” purposes like school expenses, doctors’ fees/medicines and social obligations, is the true success of most microcredit institutions. Thus microfinance institutions across the world have provided a remarkably valuable, if not entirely convenient, service for the poor. With the growing movement towards providing individual loans, the convenience of this service will improve.

Where Has This Been Done?

Stuart Rutherford's SafeSave in Bangladesh is a well known implementation of the principles outlined above. Furthermore, *MicroSave* has worked with several organisations to implement products and delivery systems to respond to these challenges and to offer market-led approaches to serving the poor. Most notable of these are BURO-Bangladesh and Equity Bank in Kenya, which have developed an array of client responsive products and client-focused delivery systems that have taken them into massive uptake of their services, millions of loyal clients and leadership positions within the industry. But perhaps the best known of the organisations that have implemented a market-led approach is Grameen Bank with its Grameen II.

The Revised "Grameen II" Products

Under its Grameen II programme, Grameen Bank has completely re-invented its product offering. As Stuart Rutherford notes, "Grameen II consolidates many of the lessons from [the bank's] experience, but goes beyond that by making some fundamental changes. Among the more important are:

- **Public deposit services:** the bank has become a true intermediary by mobilising deposits from the general public (and not just from its members).
- **Extended member deposit services:** there is a wider range of savings opportunities for members, including a commitment-saving account known as 'Grameen Pension Savings' (GPS). Personal savings accounts have been made far more flexible, and group savings accounts have largely gone.
- **Improved loan contracts:** there is a wider range of loan contracts with variable terms and repayment schedules. Larger loans for business use are available. Loans may be 'topped up' mid-term, or paid off early. There is no obligation to borrow. Borrowers in repayment difficulties have their loans rescheduled (into 'flexi' loans). Joint financial liability is formally banned (though members still undertake to help each other in other ways)" (Rutherford, 2004)



In an innovation similar to BURO, Bangladesh's "Supplementary Loan" that was developed to maintain working capital within customers' businesses, Grameen II offers loan "top-ups". In the words of Stuart Rutherford, "For loans of 12 months duration or more, you may 'top up' the loan after six months (twenty-six weeks). That is, you may re-borrow the amount you have repaid during the first six months of your loan term, adding that amount to your loan outstanding balance. In that case, the term of the loan is extended by a further period (usually six months) so that in most cases weekly repayment amounts

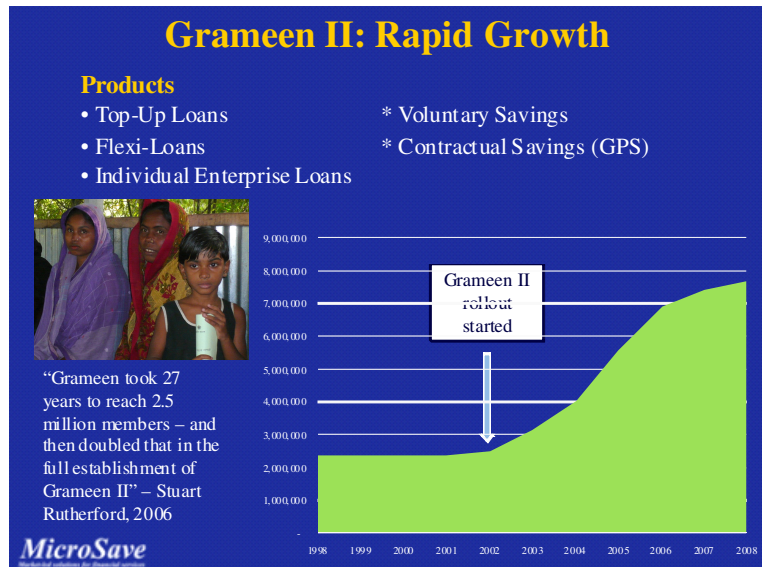
do not rise – and may even fall – as a result of a top-up. In some cases you may extend the loan term *without* topping up the loan amount. ...

Kendra [groups of 40-50 members] Managers quickly identify members with repayment problems, and under Grameen II they can take advantage of the six month (twenty-six week) 'top-up' rule: they coax such members through to the twenty-sixth week, when they can borrow again an amount equal to half the original loan, enough to pay down any debts still outstanding to fellow-members and to provide some helpful liquidity to manage the remainder of the loan. We have also witnessed – though such cases are still uncommon as far as we know – another inventive use of the top-up rule. I call it the 'empty top-up'. At twenty-six weeks a member in repayment problems may be given an extension of term without any cash top-up. The effect of this is to halve the weekly repayment amount due. This achieves much (though not all) of what the flexi-loan was meant to achieve" (Rutherford, 2004).

These loan top-ups are proving very popular indeed. Rutherford notes in *MicroSave* Grameen Bank II Briefing Note # 3, "Members quickly understood the loan 'top-up' system. At first there were mixed feelings, some members believing it slowed the growth of credit limits, but by 2004 we found very few who dislike the system, none who didn't know it, and many who value and use it." But even more popular is the

‘Grameen Pension Savings’ (GPS). Rutherford notes in *MicroSave* Briefing Note # 2, “The GPS offers another entirely new, but quite different, form of saving service to Grameen members. It allows members to save up steadily over the long haul for large expenditures: marriage for daughters, careers for sons, and future business investments were the three uses most often quoted by our respondents. It features growing balances, and it already dominates the savings portfolios of our three sample branches, with shares of 35%, 38% and 43%, rising rapidly, and typically twice the share held by personal savings and by special savings.

The results have been extraordinary. After a difficult period of stagnation and compromised portfolio quality, the bank has grown significantly both in the number of customers served and in profitability. Grameen took 27 years to reach 2.5 million members – and then tripled that in the full establishment of Grameen II. Even in Bangladesh’s fiercely competitive environment Grameen in 2004-2006 continued to grow at a remarkable rate attracting around 140,000 new members each month – a staggering 1.7 million new members every year. In the three years to December 2005, Grameen’s deposit base tripled and its loans outstanding doubled. In the same period the bank has introduced a more conservative provisioning policy and built up a formidable loan provision for its troubled housing loan portfolio. At the same time the quality of the loan portfolio significantly improved. As did profitability: despite much heavier loan loss provisioning, profits soared from around 60 million taka in 2001 to 442 million taka (about \$7 million) in 2004. Drop-outs returned, and even some old defaulters repaid and re-joined. Market-led Grameen II is yielding very encouraging results.



“Profits came from growing interest income on loans outstripping even faster growing interest expense on the new range of savings accounts, from containing costs, and from a fall in loan loss provision. Yet only three years ago the Bank admitted to falling repayment rates, and Muhammad Yunus, its Managing Director, noted that ‘Grameen II’ was needed to improve performance through more flexible product design, including the use of quick loan rescheduling using the new ‘flexi’ loans. He also promised stringent provisioning policies for more transparent accounting of the quality of the loan portfolio.

Membership growth involves not only new members but also past members who had left but returned after Grameen II started. This is evidenced by the remarkable rise since 2002 in recovery of bad debts: that is, loans that had been written off but subsequently recovered:

Recovered loan debt, Grameen Bank, millions of Taka [Taka 60: \$1]:

2000	2001	2002	2003
10	47	105	132

Not all who repaid old debt returned to membership, but our field-level investigation show that the majority of such payments are made by members seeking to return to Grameen and to borrow again. It seems, therefore, that Grameen II loan products have managed to both satisfy new members and attract back old ones, and satisfied clients tend to repay loans well. ...

We conclude that the improvement in the bank’s financial performance is real, and is related to the greater attractiveness of Grameen II’s wider range of more user-friendly loan products, and to its decision to attract deposits in much greater volume, which has allowed it to expand its loan portfolio and serve many new borrowers” (Hossain, 2005).

Rutherford et al.’s work shows that the Grameen customers are using the Grameen II products in a wide variety of ways, to meet the diversity of needs and challenges that face them. The introduction of individual

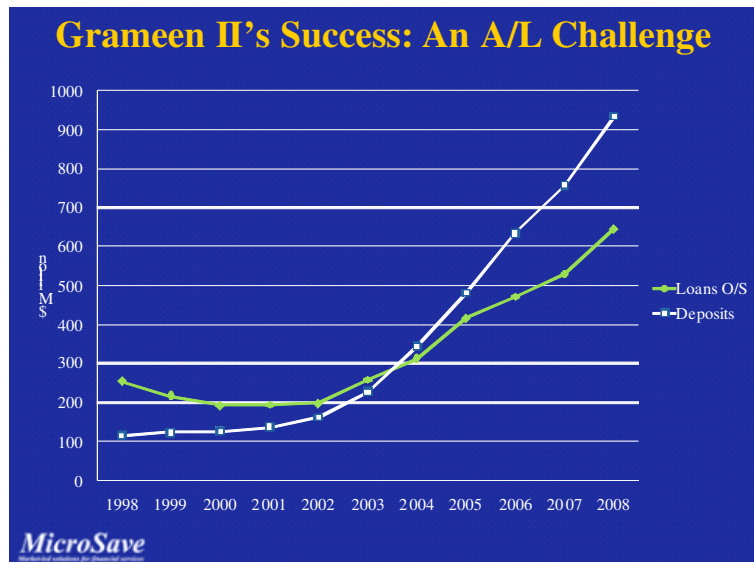
passbook savings accounts and contractual or programmed savings products allows them to save “up” as well as “down”³, and increases the range of financial instruments and options that they have to manage their complex household budgets. The top-up loans allow members to maintain the capital in their businesses or to manage unforeseen challenges/shortfalls and extend repayment periods in a structured (and carefully tracked) manner where necessary. There is evidence that for some members Grameen is meeting most of their needs, leaving them much less dependent on the informal financial services sector. In short, Grameen II shows that as the breadth of products on offer increases, the utility to the users increases dramatically⁴. It is this increased utility that encouraged drop-outs to return and defaulters to repay and rejoin Grameen – access to a range of market-responsive, (reliable, convenient, flexible and structured) products is a valuable asset. It is not unreasonable to surmise that with the increased utility and ability of the poor to manage their meagre financial resources, the developmental impact will be higher too.

In short, the Grameen II’s responsiveness to the market has created a very positive response from it – both the clients and the institution have benefited greatly from the change.

International rollout of Grameen II will almost inevitably mean a more diverse implementation of the Grameen “model” as the real needs and demand of the poor in the different countries and regions where the replicators work are reflected in product and delivery system design. Even without adopting many of the more challenging aspects of the Grameen II approach, the news that group guarantee or joint-liability is not to be enforced will challenge the basic operational principles of many replicators, a substantial proportion of whom enforce joint liability with alarming zeal⁵. For many involved in microfinance, it has long since been apparent that after 3-4 loan cycles group guarantee is increasingly ineffective, and that ongoing access to financial services was the key to ensuring repayment. It is logical therefore that the higher the quality of those financial services, and the more responsive they are to clients’ needs, the more likely clients are to repay on time. This conclusion is demonstrated in the large number of Grameen drop-out and defaulters who have returned and repaid long over-due loans to get access to Grameen II’s new range of market-led products.

The gradual spread of product knowledge and increased transparency of services, may in turn have consequences for the delivery of products, with customers expecting more consistent levels of service across the institution. Greater consistency need not mean a lack of flexibility, if flexibility is designed into products and services. Indeed, consistency should enable easier identification of problems and consequent improvements in service levels. Moreover, greater consistency in delivery may be a prerequisite if benefits from the use of information technology are to be maximised. As Rutherford posits “*The potential of IT is waiting to be explored*”.

Finally, with the rapidly increasing liabilities driven by the programmed savings product, Grameen will face increasing pressure to lend in order to finance the 12% per annum interest rate that these savings attract. Grameen is unlikely to find this level of return on investment in the traditional market place and is therefore likely to have to finance the interest payable through its own lending operations – either to its traditional



³ See **Rutherford** Stuart, *The Poor and Their Money*, Oxford University Press, Delhi, 2000, for an explanation of the terms saving “up” and saving “down”.

⁴ For many years BURO, Bangladesh was able to charge a 60% higher interest rate on its loan products because it offered a range of credit and savings products that were greatly valued by its membership.

⁵ At the extreme one African Grameen replicator locks the groups into the meeting hall until they have settled all outstanding loan repayments for that week.

client base (and those that have graduated out of poverty as they used Grameen Bank's services) or to the other better-off members who have joined the Bank to access the attractive contractual savings product.

How To Do This? The Need for Systematic Product Development

Implementing such market-led products and delivery systems is not straight-forward, and requires care and attention to detail. Under the prevalent top-down model that characterises many financial institution's approach to product development, there is little or no market research, inadequate costing/pricing of the new product, no attempt to describe the product in clear, concise client-language, no pilot-testing and no attempt at a planned roll-out of the new product. A top-down approach to product development can have expensive consequences – as many financial institutions that have introduced products without following a systematic process have discovered. Problems have arisen in such diverse areas as:

- Limited demand for the new product (in some extreme cases, additional client drop-outs);
- Poor profitability of (or more specifically losses generated by) the new product;
- Management information systems unable to monitor/report on the new product; and
- Staff inadequately trained to market and deliver the new product⁶.

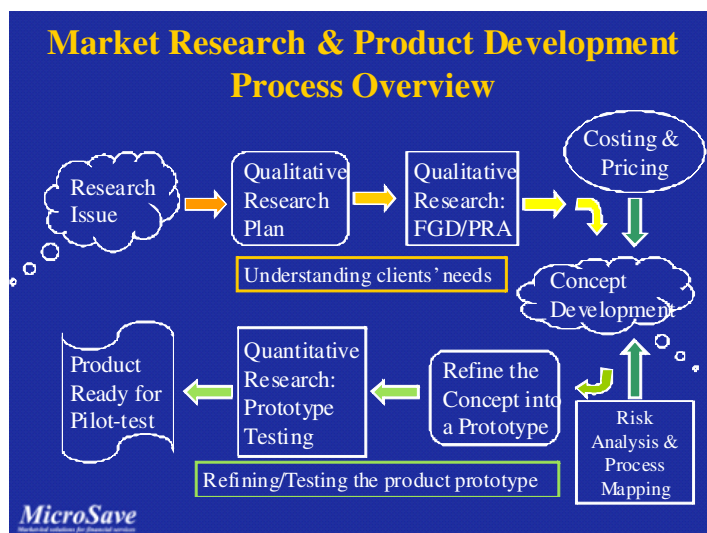
Experience has repeatedly shown that investing small amounts up front in a systematic process of product development can save large amounts and/or generate larger amounts of business in the future. One step of the product development process leads to and informs the next ... and provides a disaster/reality check that insulates the financial institution from subsequent problems. A proper process also provides the financial institution an opportunity to correct problems or respond to issues while they are limited by the confines of each step.

A Systematic Process to Product Development

MicroSave promotes a systematic approach to product development designed to minimise the risks associated with what is a complex task. The approach looks to maximise the information the financial institution can gain at each step before proceeding to the next one – thus optimising the product for the clients in the market, and the institution offering it. The approach is shown in the diagram below:

Research Issue - A clear, focused objective should drive any market research. A precisely defined research objective will allow the financial institution to derive credible, actionable results cost-effectively. Poorly defined, or unfocused, research objectives are likely to require more time and effort to conduct the research - and often leave the financial institution with a mass of confusing data.

The research objective often is best driven by an on-going monitoring system that tracks key performance indicators. These indicators are usually linked to the strategic goals or institutional/product risk drivers of the organisation – for example Portfolio at Risk. These indicators should be built into the Management Information System (MIS) and routinely tracked to enable the organisation to assess when *ad hoc* research is required.



Market Research and Concept/Prototype Development - Using *MicroSave*'s "Market Research MicroFinance Toolkit", the financial institution is able understand their clients' perceptions, needs and opportunities using Focus Group Discussions (FGDs) and Participatory Rapid Appraisal (PRA) tools. The techniques are used to develop initial product ideas into concepts using the 8Ps Matrix (see Appendix 1 for an example of this), and subsequently to refine the product concepts into prototypes for testing. The market

⁶ A recent *MicroSave* virtual conference on pilot testing financial services re-emphasised these issues and the need for systematic pilot-testing. For a report on the virtual conference, see www.MicroSave.org.

research tools are also used to evaluate the progress of pilot-tests from the clients' perspectives as well as to test marketing materials and develop/assess customer service standards.

"There's a perception that it's expensive, but when you look at the end results, the savings and the impact...you find out how cheap the research is".

- James Mwangi (CEO) Equity Bank.

*"This assessment confirms the very positive value and effectiveness of MicroSave Market Research for MicroFinance toolkit. The PRA tools are well conceived, useful and effective; the training is excellent; and both have received extremely positive reviews by almost all users. The tools have had a significant outreach to MFIs in East Africa and beyond. They have had positive impacts on MFI thinking about and approach to clients and market research. They are unique in the microfinance field and have brought many MFIs to a point where they "can't go back" to their old supply led ways. This has led to the development of a wide range of new and improved products and services that have improved the competitive position of many MFIs. **The change in approach is profound**" (Anyango et al., 2002).*

Product Costing and Pricing – To enable financial institutions develop profitable products and credible financial projections, it is essential to implement a product costing system. *MicroSave's "Costing and Pricing Financial Services Toolkit"* outlines how Allocation Based Costing can assist financial institutions with this process. CGAP has also developed an Activity Based Costing manual. Product costing is an essential tool in developing profitable and efficient financial services through identifying inefficiencies and loss making products. For MFIs focused on achieving the bottom line with outreach it is indispensable.

"Allocation based costing allowed Equity Building Society to obtain a range of "quick wins"...[it] enabled us to identify some of the factors that are driving costs within the institution. ... Product Costing has already become an indispensable tool... after only three months costing it is impacting on many of the strategic decisions being made within the institution." – James Mwangi, CEO, Equity Bank.

While marketing texts typical offer a bewildering variety of complex pricing strategies, such as loss leading, penetration pricing etc., these are rarely practical for most financial institutions serving the low-income market. *MicroSave* also assists its Action Research Partners with the pricing of their products using a simple "cost-competition-demand" approach. In the words of David Cracknell, "To price products first assess the cost of providing financial services; second examine the prices charged by the competition for similar products and third examine whether customer perceptions of the product justify premium pricing. When this approach is combined with transparent communication of pricing, the results can be significant. When Equity Bank re-priced its services in 2002, after performing market research it communicated these changes carefully. Deposit account sales increased ten-fold" (Cracknell et al., 2005).

Risk Analysis – As part of the preparation for pilot-testing, *MicroSave* conducts risk analysis and process-mapping. Introducing a new product inevitably increases the strategic and operational risk of the institution. *MicroSave* has worked with ShoreBank to develop an "Institutional and New Product Development Risk Analysis Toolkit" to assist financial institutions assess and manage these risks.

"Risk management is at the core of the Basel II guidelines and essential to optimising the performance of microfinance institutions (MFIs) ... The risk management tools developed are dynamic, and change as the MFI cycles through the steps of the feedback loop. The MicroSave "Toolkit for Institutional and Product Development Risk Analysis" helps guide an MFI through the risk identification process, management, and measurement of their risks. Early indications based on the pilot test reveal that the tools, if rigorously applied, will help in the early detection and management of risks, especially in the development of new products" (Pikholz and Champagne, 2004).

Process Mapping - *MicroSave* uses process mapping as part of the risk analysis and management methodology and to make the workflows visible (since the latter greatly assists with the development of policies and procedures and, subsequently, staff training). A process map is a flowchart that shows who is doing what, with whom, when and for how long. It shows how operational decisions are made and the sequence of events. Process maps are good for streamlining work activities and in explaining processes.

"Process mapping is a powerful management tool that looks beyond an organisation's functional boundaries in order to reveal its core processes and how the different parts work together to serve

customers. *Process Maps are visual representations of a process, that use symbols, arrows, and concise wording to show inputs, outputs, tasks performed, and task sequence*" (Champagne, 2004).

MicroSave goes further than drawing a flowchart – it adopts a four-tier approach:

1. The flowchart,
2. A description of the process,
3. An assessment of the potential risks in the process, and
4. Documentation of the controls to manage the risks identified.

This approach enables efficiency and internal controls to be carefully balanced, to the benefit of the institution and its customers. *MicroSave* has also developed a toolkit on "Process Mapping".

"Action Research Partners have reported extremely positive results from process mapping. In many institutions this may reflect the prior absence of a mechanism to review processes holistically combined with the organic growth of processes over time. This suggests that significant benefits can be derived from a first round of process mapping. Benefits reported operate at strategic, managerial and operational levels" (Sempangi et al., 2005).

Pilot Testing – *MicroSave* assists financial institutions to plan and establish a pilot test to analyse the product that they have developed. The pilot testing process has ten steps detailed in *MicroSave*'s "Planning, Implementing and Monitoring Pilot Tests Toolkit". Pilot-tests are essential for the successful development and rollout of new products.

The Ten Steps of Pilot Testing

1. Composing the Pilot Test Team
2. Developing the Testing Protocol
3. Defining the Objectives
4. Preparing All Systems
5. Modelling the Financial Projections
6. Documenting the Product Definitions & Procedures
7. Training the Relevant Staff
8. Developing Product Marketing Plans and Materials
9. Commencing the Product Test
10. Monitoring and Evaluating the Test

"Launching new products without a pilot test is another mistake that MFIs in Latin America often make", says Luis Echarte, founding partner of Paraguay's Servicios Internacionales de Consultoría para el Desarrollo (SIC). "The need for growth (of MFIs) causes them to imitate local competitors or successful organizations in other countries without conducting an appropriate analysis of the implications of the innovations they introduce," he explains. Microlenders can be blinded by illusions. Rapid growth is one such common illusion that can prove costly to microcredit institutions. In fact, according to experts, it's a situation that may conceal a number of dangerous traps" (Microenterprise Americas Magazine, 2003.).

A well-designed, implemented and evaluated pilot-test can save the financial institution significant strategic and operational problems and financial/non-financial losses ...

"There are many good reasons for pilot testing new products in terms of reducing risks, controlling costs and in carefully developing products in a controlled environment. A few of the most commonly quoted reasons are provided below:

1. *To reduce the risk of developing inappropriate new products;*
2. *To reduce the cost of making mistakes;*
3. *To grow business volumes and profits through better meeting the needs of prospective customers;*
4. *To perfect the product whilst changes can be made quickly and easily and without risk to reputation;*
5. *To develop innovative new products – to be a product leader not a follower;*
6. *To develop a competitive advantage;*
7. *To experiment in a new sector; and*
8. *To understand / optimise marketing of the new product"* (Cracknell et al., 2003a).

Product Marketing – The successful introduction of new products often depends on the ability of the product development team to market the product to customers *and to staff*. Adapting its "Market Research

for MicroFinance” tools, *MicroSave* helps financial institutions to define product benefits to customers and in communicating the product to staff. *MicroSave* has formalised this experience into a “Product Marketing Strategy Toolkit”. Key outputs of this process are field-based research leading to taglines, benefit and positioning statements, competition analysis, publicity material and a marketing plan.

“... a product marketing strategy must accomplish several objectives to be successful:

- It must define who the MFI wants to serve and which markets it can serve most effectively.
- It must identify the characteristics, needs, desires, preferences, values and priorities of the market(s) it wants to serve.
- It must develop a product that meets market needs better than the competition.
- It must price the product competitively.
- It must craft a message that clearly and concisely conveys the product’s benefits and positions it in line with the corporate brand strategy.
- It must design and implement a sales strategy that effectively communicates the product’s value and encourages purchase.
- It must monitor and manage product performance, learning from the feedback gathered to improve product design, delivery, promotion and sales” (Frankiewicz et al., 2004).

Rollout – Once again, with a view to ensuring a systematic and controlled rollout, *MicroSave* uses a carefully planned, comprehensive approach to the rollout process using its “Product Rollout: A Toolkit for Expanding a Tested Product Throughout the Market”. The toolkit provides practical tips and checklists to assist financial institutions with all aspects of the rollout process: recommendation letters, handover, finances, human resources, systems and marketing, as well as assessment of the rollout process.

“Once a financial service has been piloted, how you introduce the product to each new location has a significant impact upon the success or failure of the product. In each new location as a minimum, staff training, marketing the product to clients and staff and customisation of systems and procedures will be required” (Cracknell et al., 2003).

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!*”

Conclusion

For many years microfinance organisations throughout the world have operated on the basis of replicating a basic working capital loan originally developed Grameen Bank in Bangladesh or FINCA in Central America. In the past few years, it has become very clear that simply replicating products and systems into very different socio-economic conditions will not work. Furthermore, there is a growing recognition that the low-income market has many and diverse needs for financial services, many of which can indeed be met on a profitable basis. In “Portfolios of the Poor”, Collins et al. clearly demonstrate the challenges that face the microfinance industry and options and opportunities that the needs of poor households provide to it.

Worldwide the increasing competition among institutions is resulting in greater efficiency as well as a broader range of products, to the benefit of the clients. Advances in technology is already leading to reduced transaction costs, thus overcoming the long-standing barriers to the expansion of services. E-and m-banking offers a huge opportunity to leapt-frog bankers' traditional concerns about "high volumes of low value transactions" and "investing bricks in bricks and mortar", and will increase volumes while driving down marginal costs. New technologies can also improve information about clients, reducing risk and thus costs. These factors have resulted in a growing number of commercial financial institutions initiating efforts to serve the low-income market.

As the microfinance industry matures and moves towards a market-led basis, financial institutions and other players entering the market are beginning to look for new opportunities and approaches to offering a diverse range of financial services to the low-income market. This has encouraged them to revisit many of the basic questions posed in Stuart Rutherford's "Basis for Designing Quality Financial Services".

The Basis for Designing Quality Financial Services

An organisation wishing to get involved in financial services for the poor might ask the following questions during its surveys of its proposed area of operation.

- **How do poor people manage their savings deposits?** Are there savings banks, or deposit takers, or insurance salesmen, or savings clubs? Do the poor have access to them? If not, how do they save, and how convenient do the poor find the available forms of savings?
- **Can poor temporarily realise the value of assets they hold?** Are there pawnbrokers or are there schemes that allow them to mortgage land or other major assets safely? If such devices exist, are they exploitative or enabling?
- **Can poor people get access to the current value of future savings?** Are there moneylenders willing to advance small loans against future savings? Are there rotating savings and credit associations (ROSCAs) or managed or commercial chits, or co-operative banks or NGOs that offer loans against small regular repayment instalments? Do the very poor have access to them?
- **Can poor people make provision for known life-cycle expenses?** Can they provide for daughters' marriages, their own old age and funeral, and for their heirs? Are there clubs that satisfy these needs, or general savings services or insurance companies that will do as well? Are there government or employer-run schemes?
- **Can poor people secure themselves against emergencies?** What happens when the breadwinner is ill, or when a flood or drought occurs? Does the government have schemes that reach the poor in these circumstances? If not, what local provision can people make?
- **Can poor entrepreneurs get access to business finance?** If so, in what amounts and at what cost?

(Rutherford, 1996b)

Product development is an essential activity for market-responsive financial institutions. As clients and their needs change, so the market-led, demand-driven financial institutions must refine their existing products or develop new ones. But product development is a complex, resource-consuming activity that should not be entered into lightly.

Recognising all of the above, those financial institutions committed to being market leaders, and to responding to their clients, must indeed conduct product development. Effectively conducted, systematic product development will result in products that are popular with clients (even in very competitive environments) and more cost-effective operations for financial institutions. More client-responsive products will reduce drop-outs, attract increasing numbers of new clients and contribute substantially to the long-term sustainability of the financial institution.

MicroSave

MicroSave has worked with a wide variety of institutions across Asia and Africa to develop new market-led savings, loan, insurance and remittance products for the poor. These institutions include: Equity Bank-Kenya, BURO-Bangladesh, OK Bank-Philippines, FINCA-Tanzania, Grameen Koota-India, TSKI-Philippines, Eko-State Bank of India, Kenya Post Office Savings Bank, TSPI-Philippines, Bank Andara-Indonesia, Family Bank-Kenya, Centenary Bank-Uganda, ASKI-Philippines, Equitas-India and many others.

MicroSave's Market Research for MicroFinance and related toolkits on process mapping, costing & pricing, pilot-testing, risk analysis and product rollout have been translated into over 20 languages and are used across the globe.

Visit www.MicroSave.org for more details on the market-led approach and the toolkits to support it.

Bibliography

- Anyango**, Ezra, Jennefer Sebstad and Monique Cohen, "Assessment of the Use and Impact of *MicroSave*'s Market Research for Microfinance Toolkit" *MicroSave*, Nairobi, 2002.
- Basu**, Priya, "India: Improving Access to Rural Finance", *World Bank*, New Delhi, 2004.
- CARE**, "Conference Report of Microfinance India 2008", CARE, New Delhi, India, 2005.
- Champagne**, Pamela and Lynn Pikholtz, "Implementing Risk Management at *MicroSave*'s Partner Microfinance Institutions", *MicroSave* Briefing Note # 34, Nairobi, 2004.
- Champagne**, Pamela "Process Mapping for Risk Management and Process Improvement", *MicroSave*, Briefing Note # 29, Nairobi, 2004.
- Cracknell**, David, Henry Sempangi, Graham A.N. Wright, Leonard Mutesasira, Peter Mukwana and **Michael J. McCord**, "Lessons from *MicroSave*'s Action Research Programme (2002)" *MicroSave*, Briefing Note # 20, Nairobi, 2003.
- Cracknell**, David, Henry Sempangi, Graham A.N. Wright, Peter Mukwana and Michael J. McCord, "Lessons from Pilot Testing Financial Services – The Experience of *MicroSave*", *MicroSave*, Nairobi, 2003a.
- Cracknell**, David, Henry Sempangi, Peter Mukwana, Trevor Mugwanga, Lisa Parrot and Graham A.N. **Wright**, "Lessons from *MicroSave*'s Action Research Programme (2004)" *MicroSave*, Briefing Note # 40, Nairobi, 2005.
- Frankiewicz**, Cheryl, Graham A.N. Wright and David Cracknell, "Product Marketing Toolkit", *MicroSave*, Nairobi, 2004.
- Hossain**, Iftekhar, "Financial Performance", *MicroSave* Briefing Notes on Grameen II # 4, 2005.
- Microenterprise Americas Magazine, "How Not to Manage a Microfinance Institution", *Microenterprise Americas Magazine*, 2003.
- Rutherford**, Stuart, "A Critical Typology of Financial Services for the Poor", *ActionAid and Oxfam*, London 1996.
- Rutherford**, Stuart, "Grameen II At The End Of 2003: A 'Grounded View' Of How Grameen's New Initiative Is Progressing In The Villages", *MicroSave*, Nairobi, 2004.
- Rutherford**, Stuart, "Member Savings", *MicroSave* Briefing Notes on Grameen II # 2, 2005
- Rutherford**, Stuart, "The New Loan Arrangements", *MicroSave* Briefing Notes on Grameen II # 2, 2005
- Sempangi**, Henry, David Cracknell, Madhurantika Moulick and Hermann Messan, "Process Mapping in Practice", *MicroSave* Briefing Note # 41, Nairobi, 2005.
- Sinha**, Sanjay, Tanmy Chetan, Orlanda Ruthven and Nilotpal Pathak, "The Outreach/Viability Conundrum: Can India's Regional Rural Banks Really Serve Low-Income Clients?", *Overseas Development Institute* Working Paper #229, London, 2003.
- World Bank**, "Rural Finance Access Study", *World Bank*, New Delhi, 2003.

Appendix 1
MicroSave

Concept Design Matrix

Bondhu Bank's "Helping Hand" Emergency Loan Product

Product: Helping Hand	Clients' Demand (as determined by the market research/segmentation exercise)	Competition (refer to the competition matrix and pick only the most effective competitors)	Our MFI (as relates to the other products currently offered by our MFI – consider cannibalisation!)	Proposed Product Concept
Core Product				
Needs Wants	What is the unmet need or want? Easy to access, quickly disbursed loans to finance health, education and other "emergency"/consumer needs.	How are these needs being met by others? Currently people go to friends and relatives (which is often embarrassing) or money lenders (which is expensive – typically 10% per month)	How are we addressing this need/want now, if at all? Around 75% of clients are diverting an average of 40% of their business/working capital loans to meet these emergency loans	Helping Hand Emergency Loan
Actual Product				
<i>Product Design</i>	What terms/ conditions do the clients want? Loan size: Rp.500-5,000 Loan duration: 1-3 months Disbursed in < 30 minutes	What products compete with the proposed product concept? No formal/semi-formal competition. Potential clients will still often go to friends and relatives	How does the new product relate to the others offered by our MFI? Since the price is 1.0% per month higher than the business/working capital loan, the latter is likely to cannibalise	<i>Product Design</i> Loan size: Rp.500-5,000 Loan duration: 1-3 months Disbursed in < 30 minutes Collateral: >A+ credit rating
<i>Price</i>				<i>Price</i> Interest Rate: 4.0% per month

Product: Helping Hand	Clients' Demand (as determined by the market research/segmentation exercise)	Competition (refer to the competition matrix and pick only the most effective competitors)	Our MFI (as relates to the other products currently offered by our MFI – consider cannibalisation!)	Proposed Product Concept
<i>Physical Evidence</i> (passbooks/ cards/ statements etc.)	Interest Rate: up to a maximum 5% per month Collateral: Some savings and on the basis of credit history Passbooks preferred	(since these are typically interest-free) – but research indicates fewer loans are being made available by friends and relatives. If Bondhu Bank can find a way of disbursing these loans very rapidly, it can take the market from the money lenders	the Helping Hand loan on some occasions. However due to timing issues and many clients' needs to use a greater percentage of their business/working loan for the intended purpose. The Helping Hand loans issued will often secure the business/ working capital since they will not be diverted – and inventory/ assets will not be sold off to meet the emergency.	<i>Physical Evidence</i> Laminated Passbooks – used for multiple Bondhu Bank loans
Augmented Product				
<i>Promotion</i>	How do we communicate with the clients? <i>Advertising</i> at branches – the product is only for clients with extensive credit history <i>Delivered at branches</i> – with emphasis on speed	How do the competitors reach the target market? What is the image of the competitors and the product(s) in the market? What can we learn from this? Friends and relatives are part of the (declining) social capital network. The decline is particularly marked in the more urban areas. The money lenders are seen as greedy and often ruthless – either to recover their loans or sometimes to realise the land offered by the borrower to secure the loan. They do	How does our MFI sell its current products (e.g. marketing, incentives etc.) How is our MFI perceived in the market? How is the current product perceived by the clients (and non-clients)? Marketing and credit officers visit clients in their groups and businesses. Bondhu Bank is seen as a business-oriented/focused – and not as “caring” as it aspires to be. The business/working capital loan is seen as a valuable/	<i>Promotion</i> “Helping Hand – <u>because</u> Bondhu Bank cares for you and your family”
<i>Place</i>				<i>Place</i> Delivered at branches only - for clients in good (>A+) credit standing only so they must be used to coming to the branches
<i>Positioning</i>	<i>Positioning:</i> Bondhu Bank as “The Bank that Cares for You and Your Family”			<i>Positioning</i> Bondhu Bank “The Bank that Cares for You and Your Family”
<i>Physical Evidence</i> (branch appearance etc.)	<i>Physical Evidence:</i> Continue with Bondhu Bank’s royal blue. Consider a special counter dedicated or part-dedicated to “Helping Hand”. <i>People:</i> Bondhu Bank			<i>Physical Evidence</i> (branch appearance etc.) Continue with Bondhu Bank’s royal blue – hire “Impact” graphic design company to design posters/image. Establish special counters dedicated to “Helping Hand”, with staff moving to them each time they see a customer there.

Product: Helping Hand	<i>Clients' Demand</i> (as determined by the market research/segmentation exercise)	<i>Competition</i> (refer to the competition matrix and pick only the most effective competitors)	<i>Our MFI</i> (as relates to the other products currently offered by our MFI – consider cannibalisation!)	<i>Proposed Product Concept</i>
<i>People</i>	emphasises caring for the customer – “Helping Hand” could be communicated as part of this commitment. <i>Process:</i> This is key: it must be as simple as possible	however offer rapid response loans. Both friends and relatives/ money lenders deliver money quickly and locally with minimum process.	important source of credit, but as inflexible. Clients actually like going into the branches – they are often proud to be “members” of Bondhu Bank.	<i>People</i> Continue to focus Bondhu Bank’s emphasis on caring for the customer – and promoting the “Helping Hand” product as part of this commitment.
<i>Process</i>				<i>Process:</i> Outline (<i>process maps to be developed in detail by Operations Department/ Internal Audit</i>) Client to present 1. Helping Hand loan application form plus 2. loan passbook Credit Officer to validate credit rating on IT system Credit Officer to authorise loan application form and update loan passbook. Credit Officer to update client’s loan ledger on IT system. Credit Officer to pass loan application form and loan passbook to the Cashier Cashier to check loan application form and loan passbook Cashier to update cashbook Cashier to issue cash/passbook to client Client to sign “cash received” section of loan application form Cashier to return loan application form to Credit Officer Credit Officer to file loan application form in client’s physical file