

MicroSave

Market-led solutions for financial services

PRODUCT DEVELOPMENT



OPTIMISING PERFORMANCE AND EFFICIENCY SERIES

MicroSave

Market-led solutions for financial services

Presents

OPTIMISING PERFORMANCE AND EFFICIENCY SERIES

PRODUCT DEVELOPMENT

The Optimising Performance and Efficiency Series brings together key insights and ideas on specific topics, with the clear objective of providing microfinance practitioners with practical and actionable advice. Based on *MicroSave's* acclaimed Briefing Notes and India Focus Notes series, the Optimising Performance and Efficiency Series provides succinct guidance on a variety of topics from product innovation to delivery system optimisation. Each of the booklets addresses a key topic that can transform a microfinance institution for the better. The Series will help improve microfinance institutions' double bottom line – both the business and its social performance.

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PRODUCT DEVELOPMENT: THE NEED, APPROACH AND CHALLENGES



The low income population needs a wide variety of financial services. To respond to these needs effectively and seize the opportunities they represent, financial institutions must operate on a market-led basis. Market-led microfinance puts the customer at the centre of the business. In the context of product development, this implies understanding the customer's needs and the circumstances, which lead to very specific demands. This is essential for developing client-responsive, flexible financial services.

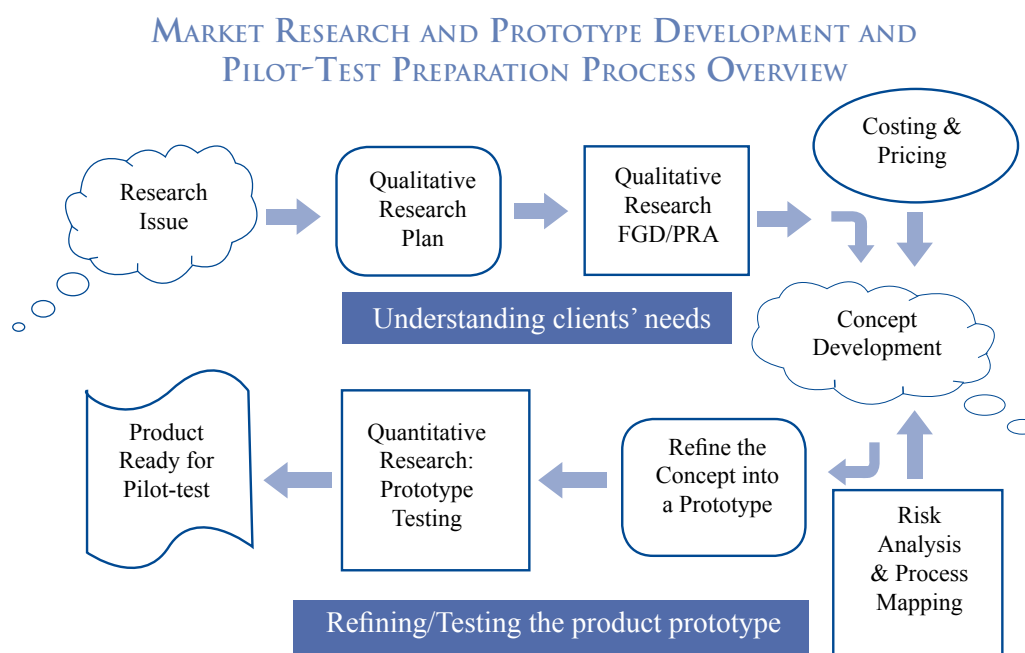
A top-down, supply-driven approach, which still characterises many financial institutions' approach to product development, can have expensive consequences. Experience has proved that it is prudent and cost effective to invest in understanding client needs using qualitative techniques that reveal the details of clients' financial behaviour and preferences. Following a systematic process of product development can save significant costs and/or help generate client loyalty and thus business in the future. With the growth in competition, the need to be aware of the evolving needs of the clients assumes even greater importance.

The demand for financial services is influenced by a number of factors and thus assessing the needs can be a complex task. It needs skills, preparation and commitment. *MicroSave* promotes a systematic approach to product development designed to minimise the risks associated with what can be a complex task. Process mapping as a part of the process helps mitigate possible risks.

Market research results in the development of a product prototype. The prototype needs to be pilot tested, again in a systematic manner. Initial promotion of the product can make a significant difference in the acceptance of the product, especially the way it is priced and delivered.

This booklet brings together publications of *MicroSave* that emphasises the need for a systematic approach to market research and issues related to product development. These papers are based on the rich experience of *MicroSave* in the area of product development. Specific cases of Biashara Imara, the individual loan product of Equity Bank and challenges with new products such as mobile banking have also been included.

The papers are presented in order of the systematic product development process used by *MicroSave* (refer diagram) and are as follows:



1. *The Emerging Market-Led Microfinance Agenda* –
Monique Cohen

This note discusses the market-led approach in microfinance, its core components: the client-product nexus; linkages between clients and institutions and the client's financial landscape; and the emerging trends in the sector concerning product development.

2. *Market Orientation As The Key To Deep Outreach* –
Gary Woller

This note makes the case for market orientation among MFIs to scale up their operations and address the real needs of the poor on a sustainable basis. It explores the stages in research on market orientation conducted by various academicians.

3. *Dinosaurs and Rabbits – Indian Microfinance Market Evolution* –
Christopher Murdoch, Manoj K. Sharma and Graham A.N. Wright

The note the evolution and rapidly changing microfinance world. It highlights that because different clients have different needs and no one product or microfinance player is going to meet all needs. If microfinance is to deliver on its promise it must evolve and adapt in a way which meets clients' needs more effectively, as clients change, and as the world changes around them. This note assesses what is needed for MFIs to keep up with the pace of change.

4. *What Does Competition Mean For Indian MFIs?* –
Graham A.N. Wright

The note reviews the likely effects of competition and the implications for Indian MFIs. It draws lessons from various countries where competition is already prevalent to review the issues related to over-indebtedness, demanding/discerning clients, niche market and price-based differentiation and the implications of each of the factors for the future of Indian MFIs.

5. *Key Questions That Should Precede New Product Development* –
Graham A.N. Wright, Monica Brand, Zan Northrip, Monique Cohen, Michael McCord and Brigit Helms

This note highlights the six essential questions that should be asked prior to setting about new product development in order to assess: motivation, commitment, capacity, cost effectiveness and profitability, simplicity, and complexity. It elaborates the issues and challenges underlying these questions and the benefits for MFIs developing client-responsive products.

6. *The Systematic Product Development Process* –
Graham A.N. Wright

This note outlines the stages of product development for an MFI, which are: evaluation and preparation, market research, concept/prototype design, pilot testing and its launch and roll out. It also gives a brief overview of the various toolkits that have been developed by *MicroSave* to enable MFIs to better understand their clients' needs and serve them efficiently.

7. *Assessment of the Use and Impact of MicroSave's Market Research for Microfinance Toolkit* – Ezra Anyango, Jennefer Sebstad and Monique Cohen

This note discusses the acclaimed “Market Research for MicroFinance” (MR4MF) toolkit developed by *MicroSave* for MFIs to learn about customers’ needs for and perspectives on financial services and thus identify financial products and services that they need. This toolkit highlights innovative participatory approaches to market research and is designed for both practitioners and trainers, combining classroom training with field based action research.

8. *Cost and Benefits of Market Research for Product Development* – Cheryl Frankiewicz (Summarised by Corrinne Ngurukie)

This note illustrates importance of market research in the entire product development process, which is neglected by many financial institutions. It draws on experiences from seven countries - Kenya, Tanzania, Uganda, Bosnia, Herzegovina, India and the Dominican Republic - and analyses the cost-benefit of conducting market research as part of the product development process, concluding that the benefits substantially outweigh the costs.

9. *Process Mapping for Risk Management and Process Improvement* – Pamela Champagne

The note discusses the ten steps of constructing process maps to conduct risk analysis and initiate process improvement. It highlights the importance of optimising the risk-efficiency trade-off in processes. The note also considers various considerations in institutionalising process mapping like management involvement, level of participation, time required, regularity of review and type of people engaged.

10. *Process Mapping in Practice* – Henry Sempangi, David Cracknell, Madhurantika Moulick and Hermann Messan

This note discusses the lessons learned as *MicroSave* worked with a wide variety of its Action Research Partner (ARP) MFIs to implement process mapping and optimise the risk-efficiency trade-off. It highlights the benefits of process mapping in terms of risk management, standardisation of processes, enhancing customer service, optimising the use and productivity of human resources, creation of training materials, controlling costs and improving MIS etc. It also analyses the challenges of implementing process mapping in terms of choosing the right process to map; selecting team members; gathering data and analysing the maps.

11. *Proactive Risk Management: Lessons for Microfinance Institutions* – Lynn Pikholtz and Pamela Champagne

This note discusses the role and benefits of proactive risk management as an essential element for the long-term sustainability of MFIs as well as the product development process. It also provides lessons relating to required organisational change, the risk management feedback loop and the importance of periodic risk management reviews.

12. *The Art and Science of Pricing Financial Services* –
David Cracknell and Hermann Messan

This note discusses the pricing from customers' perspective and the difficulty in understanding the costs associated with the financial services. It underlines the importance of transparency in pricing, elaborates on the factors in pricing loans, savings and e-banking products by the MFIs, and recommends developing capacities to perform pricing.

13. *Lessons from Pilot Testing Financial Services – The Experience of MicroSave* –
David Cracknell, Henry Sempangi, Graham A.N. Wright, Peter Mukwana and
Michael J. McCord

This note presents key lessons learned from *MicroSave's* work with its Action Research Partners (ARPs) on pilot testing new financial services using the ten steps of pilot testing as an analytical framework. It identifies main factors that lead to successful pilot testing, assess three major (and frequently asked) questions: What impact has pilot testing had on the ARPs? Should we always pilot test new products? Should we always pilot test new products?

14. *Costs and Benefits of Pilot Testing for Product Development* –
Cheryl Frankiewicz (Summarised by Corrinne Ngurukie)

This note emphasises on pilot testing as an important component of a new product development process which in turn helps institutions to become more viable and profitable. It explores lessons learnt, the benefits received while drawing experiences from various MFIs across the globe that implemented the pilot testing process. The note analyses the cost-benefit of conducting pilot testing as part of the product development process, concluding that the benefits substantially outweigh the costs.

15. *Developing Cash Flow Based Individual Business Loans – The Experience of Equity Bank with Biashara Imara* –
Trevor Mugwang'a

This note highlights key lessons from the experience of Equity Bank in designing, testing and rolling out a cash flow based individual business loan product. It highlights the challenges that the bank faced and the key lessons learned in pilot testing.

16. *Pilot and Rollout Issues for Mobile Phone Banking Services* –
John Owens

This note explains the strategies and provides guidance on handling the challenges and issues concerning institutional issues; regulatory and compliance issues; generating and monitoring feedback from customers and merchants during pilot test and rollout; partnership support and the importance of coordination in the pilot testing and roll out mobile phone banking services.

THE EMERGING MARKET – LED MICROFINANCE AGENDA

Monique Cohen¹



¹ Monique Cohen is President of Microfinance Opportunities, a client focused microfinance resource centre. www.microfinanceopportunities.org. This note is based on the article “Making Microfinance More Client- Led”, Journal of International Development. 14. 335-350 (2002)

INTRODUCTION

“We don’t understand our clients.”

“We want to deliver more appropriate products and services to our clients.”

“How should we go about assessing our clients’ preferences for financial services?”

These statements and questions have become so common that they do not seem unusual, yet two years ago, they were considered marginal by the mainstream microfinance industry. Clients were primarily of interest only as statistics to determine numbers reached or for impact measurement.

WHY THE CHANGE?

While many clients have remained loyal to their creditors, their mobility and assumption of multiple loans from several microfinance institutions (MFIs) indicates a mismatch between available products and client needs. With few formal alternatives and a constant demand for money, the customer makes do with what is on offer. Sometimes the product fits, other times it does not. Then clients vote with their feet². They might leave for a competitor or just add the services of a competitor to their loan portfolio. A few exit the microfinance market altogether. To understand the disconnect we need to answer three key questions.

Who do microfinance institutions reach?

The majority of microfinance clients operate just above and below the poverty line. Targeted programmes have been more effective at reaching a greater proportion of poorer clients.

How do the poor use financial services?

Microenterprise development is only one use of microfinance. Other uses of credit include home improvement, school fees and health expenses. While the financing of these activities contributes to achieving the millennium development goals, these needs can also be met with more appropriate and finely tuned products.

How can microfinance institutions increase the poor’s access to financial services and serve their needs better?

Many products and services offered by microfinance institutions have limited flexibility, especially when clients urgently need a lump sum of money to respond to a crisis, life cycle event, emergency, or when an opportunity presents itself.

The answers to these three questions inform the demand side of the microfinance equation and contribute to increased efficiency in service delivery. They also suggest ways to increase the scale and depth of outreach.

² For more on client exits from microfinance institutions see the dropouts studies on the *MicroSave* website under the Research Papers section.

THE MARKET-LED APPROACH TO MICROFINANCE³

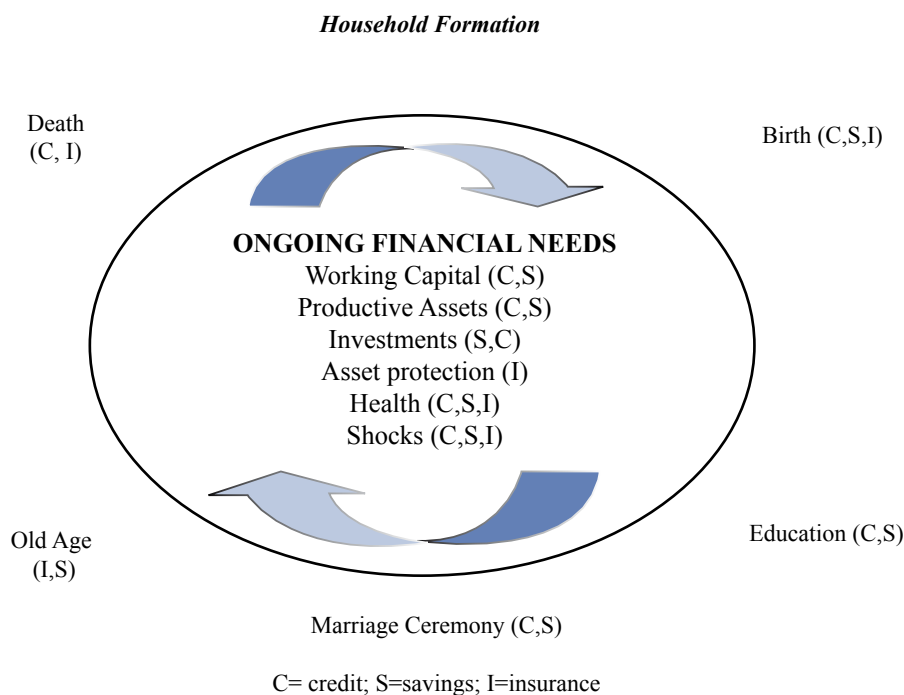
The demand and supply sides of the microfinance equation seem to be coming together. This creates an opportunity to integrate a market-led approach into what has been a largely supply-led or product-driven industry. It moves MFIs closer to operating like businesses and away from the prescriptions of a mainly donor-funded sector. This emerging new market-led agenda for microfinance integrates customers' voices into the design and delivery of products and services by MFIs⁴. Attention focuses on three components:

- the client-product nexus
- linkages between clients and institutions
- the client's financial landscape.

The client-product nexus moves away from an institutional approach characterised by a 'catch as catch can' attitude towards clients to a market focus with specific products attracting particular market niches. It acknowledges that MFIs need to match products to clients' needs, repayment amounts and cycles to clients' cash flow, and loan size to clients' income.

Market segmentation discussions highlight the potential to attract specific populations into the market with a product package that meets their long-term requirements. Health service providers may seek a mix of fixed asset and working capital loans; existing home owners need home improvement financing, etc. Another factor driving market segmentation is the changing financial preferences of the poor over time. While new households may give priority to working capital loans, households with children may need savings and loans to pay school fees (see figure).

HOUSEHOLD LIFE CYCLE FINANCIAL NEEDS



³ See *MicroSave's* Briefing Notes numbers 18 and 19 available on the *MicroSave* website under the Briefing Notes section.

⁴ For more on the market-led approach and client responsive product development see Wright, Graham A.N., "Market Research and Client Responsive Product Development", *MicroSave*, 2001 – available on the *MicroSave* website under the Research Papers section.

Institution-client linkages involve creating operational mechanisms to enable the creation and use of client data to inform product development, marketing or service delivery. For many MFIs, this means a shift away from their traditional mode of ‘top down’ information flows, the gathering of client data, if at all, by external resources and little integration of client data into information systems. The new paradigm encourages and supports systemised client data collection by front-line staff. Simple and clear reporting systems allow the flow of client information up to management⁵. These changes also provide a basis for differentiating levels of decision making: minor actions that can be taken at the branch level; operational directives that require authorisation by senior management and policy decisions necessitating board approval. This broadens the base of stakeholders vested in change. Those who tend to be the most disenfranchised, the loan officer and clients, gain a voice. The result can be improved financial performance resulting from higher staff productivity, reduced staff turnover and lower transaction costs for the financial service provider and consumer alike.

An analysis of a *client’s financial landscapes* challenges the belief among many MFIs that they are the ‘only game in town.’ Microfinance credit rarely exceeds more than 50% of the client’s debt portfolio. Many clients simultaneously belong to informal financial institutions such as ROSCAs or savings clubs that deliver lump sums of money at regular intervals. In addition, some of the poor remain linked to that long history of projects intended to increase their access to financial services using banks and co-operatives.

Whatever the financial institution, the diversity of sources of financial services inevitably influences how clients use any new financial services that are introduced into their mosaic. For the microfinance industry, an understanding of the formal and informal competition, clients’ use of these services and their role within the financial market is integral to the emerging market-led microfinance agenda.

CONCLUSION

Two years ago, market-led microfinance seemed totally out of sync with the mainstream microfinance industry. Today, product development is a hot topic and the integration of client data into management information systems is being reviewed by many MFIs. There is growing recognition of the importance of institutional-client linkages and the client’s financial landscape. Institutions that have internalised this client focus find that the adoption of these new systems takes time. However, experience has shown that the operational benefits enable MFIs to lower service delivery costs, attract new clients and retain existing ones, all factors that contribute to long-term sustainability.

In ODEF, Honduras, for example, loan-processing time was reduced by requiring less documentation for repeat loans and by changing disbursement and repayment schedules to better match the clients’ weekly cash flow.

Microfinance institutions need to operate as businesses. With donor funds giving way to commercial capital as the future source of financing, all service providers must become more business like. This means identifying the market segment to be served and tailoring products and services that will attract and retain clients.

⁵ See McCord, Michael “The Feedback Loop – A Process for Enhancing Responsiveness to Clients”, *MicroSave*, 2002. This paper is available on the *MicroSave* website under the Research Papers section.

MARKET ORIENTATION AS THE KEY TO DEEP OUTREACH¹

Gary Woller



¹This Briefing Note summarises several of the main arguments in the article by Gary Woller “From Market Failure to Marketing Failure: Market-Oriented As the Key to Deep Outreach in Microfinance,” *Journal of International Development*, vol. 14, no. 3, (2002), pp. 305-324.

MICROFINANCE AND MARKET ORIENTATION

Accumulating evidence indicates that the exclusion of the very poor from microfinance institutions (MFIs) is a widespread phenomenon. Moreover, of the very poor who do join microfinance programs, many drop out after only a few loan cycles and many others in later loan cycles. These together belie microfinance's image as a tool for poverty alleviation.

In explaining this outcome, research points to a lack of a “market orientation” among MFIs. Market orientation holds that *“success will come to those organisations that best determine the perceptions, needs, and wants of target markets and satisfies them through the design, communication, pricing, and delivery of appropriate and competitively viable offerings².”* Underlying a market orientation is the principal that value creation is the key to long-term business success, and that value is determined by the benefits (adjusted for costs) that consumption of an offering makes possible to customers. In contrast to a market orientation, most MFIs possess a “product orientation,” which holds that *“success will come to those organisations that bring to market goods and services they are convinced will be good for the public³.”* Underlying a product orientation is the principal that a market offering possesses value for its own sake, unrelated to the benefits that customers derive there from. In other words, product-orientation asserts that an offering has value because the producer put it there.

The product-oriented approach to microfinance has its origins in the industry's response to its greatest initial challenges: how to deliver small loans in a cost-effective and sustainable manner to a poor and often hard-to-reach clientele, absent physical collateral, given information asymmetries, and with relatively high per-units costs. The solutions—blueprint program design, product standardisation, exclusive focus on enterprise loans, forced savings, de-emphasis on voluntary savings, joint liability, heavy emphasis on repayment discipline, and an overarching emphasis on financial self-sufficiency—satisfied institutional needs at the time, but they have proven over time not to satisfy the needs of very poor customers. MFI programme design also reflects a set of assumptions about the very poor (e.g., uniform market demand, no or little business cyclicality, enterprise loans as the principal financial need) that have proven increasingly out of step with emerging knowledge about the very poor as consumers of financial services. To date, MFIs have focused on the products they could produce rather than the products and services customers want them to produce; on institutional needs rather than on customer needs.

Whereas the initial challenge facing microfinance pioneers was to prove that the very poor were bankable, the challenge today is to push further down the poverty ladder with a set of sustainable financial services that meet the livelihood needs of the very poor. To fulfill this challenge will require an industry-wide shift from a product orientation to a market orientation. The relationship is simply stated: *“Success (in terms of both deep outreach and institutional sustainability) will come to those organisations that best determine the perceptions, needs, and wants of the very poor and satisfies them through the design, communication, pricing, and delivery of appropriate and competitively viable offerings.”*

The transition from product orientation to market orientation is a process that has occurred in virtually all mature industries. The microfinance industry is unique only in that it is relatively young and immature, and it has yet to pass through this phase. But pass through this phase it must, if it is to survive and prosper. The question for MFIs is how to take an abstract concept like market orientation and give it real managerial operational relevance.

²Kotler, P. and Andreasen, A.R. (1996). *Strategic Marketing for Nonprofit Organisations*. Upper Saddle River, NJ: Prentice Hall, Inc, p. 41.

³Kotler and Andreasen, p. 39

RESEARCH ON MARKET ORIENTATION

Toward this end, academic researchers have conducted research on market orientation, making it one of the most thoroughly researched and written-about topics in marketing. This research has covered three stages. The first stage sought to define market orientation. The consensus that emerged from this stage is that market orientation consists of an organisational culture and a set of functional activities aimed principally at creating customer values.

Key elements in a market orientation are:

- Customers and customer value as the core component;
- Customer value as a function of both “expressed” and “latent” (undiscovered) needs and wants;
- Inter-departmental coordination and cooperation in the acquisition and dissemination of market intelligence (e.g., a market-oriented organisation is a learning organisation);
- Organisation-wide responsiveness to market intelligence;
- A causal link between market orientation and long-term institutional performance.

The second stage of research focused on identifying determinants of market orientation. Finally, the third stage sought to consolidate and generalise extant learning and to test empirically the actual antecedents of market orientation and the relationship between market orientation and institutional performance. Overall researchers have conducted dozens of empirical studies on market orientation. Study subjects have included large businesses, small and medium-sized enterprises, non-profit organisations, and federal government agencies in over 14 countries in North America, Europe, Asia, and Africa.

From this research, senior management, and particularly the level of senior management’s emphasis on and commitment to market orientation and its willingness to undertake risk, emerged as *the* single most important determinant of market orientation. Second in importance were customer-focused reward systems. Other important determinants of market orientation were inter-department collaboration, organisational formality, and centralisation.

Of 48 studies testing the relationship between market orientation and institutional performance, 44 found a positive relationship between market orientation and at least one measure of institutional performance as measured by profitability, sales, market share, or innovation success. The same studies also found positive relationships between market orientation and other organisational variables, such as customer retention, customer service, esprit de corps, trust in senior management, job satisfaction, and the intent to remain at an institution. The weight of these empirical findings offers conclusive evidence that higher levels of market orientation lead generally to higher levels of institutional performance.

IMPLICATIONS FOR MICROFINANCE

The implications of the market orientation research for MFIs are many:

- Market orientation is by extension an important determinant of MFI performance (e.g., financial self-sufficiency, revenue growth, customer desertion, repayment rates, etc.);
- The best way to achieve long-term financial self-sufficiency and achieve deep outreach is to identify the needs and wants of the very poor and to provide products of value to them;
- To the extent MFIs explicitly target the very poor and create learning institutions in tune with their needs and wants, competition and the drive for sustainable competitive advantage will drive MFIs to find ways to serve the very poor in an increasingly cost-effective manner;

- The creation of a market-oriented institutional culture and market-oriented institutional practices is the distinct responsibility of senior management. Without the explicit and active participation of management (in both word and deed), the transition to market orientation will fail;
- The creation of an appropriate customer-centred reward system is an integral component of the transition to market orientation. It is an unambiguous statement of managerial values that connect rhetoric to practice. Other market-oriented practices include monitoring customer satisfaction and otherwise routinely soliciting customer feedback, hiring staff with customer-centred attitudes and firing those without, increasing interaction and decreasing conflict between functional departments, or pushing the decision-making locus closer to the customer.

Five rules of thumb can help guide the transition to market orientation for MFIs:

1. Senior management should not assume that change can be delegated to subordinates;
2. Transition to a market orientation should be viewed as a long-term evolutionary process;
3. Transition must involve all organisational levels and functions;
4. Transition requires extensive and continual training and development of staff;
5. Transition must be continually evaluated, monitored, and reinforced.

DINOSAURS AND RABBITS – INDIAN MICROFINANCE MARKET EVOLUTION

Christopher Murdoch¹, Manoj K. Sharma and Graham A.N. Wright



¹ Christopher Murdoch is Strategic Services Director at Opportunity International Australia

BACKGROUND

No one really knows what happened to the dinosaurs. In their day they were the largest and most powerful creatures alive on the earth. Some scientists argue that the earth was struck by a meteorite and the dinosaurs wiped out in a cataclysmic mass extinction. Others say there is no evidence of a meteorite of the size required, and that the dinosaurs died out gradually. Everybody agrees that today they are dead. And mostly scientists agree that the most likely explanation for the disappearance of the dinosaurs is that somehow the environment changed and the dinosaurs failed to adapt. Over time they were replaced by warm blooded furry creatures - rabbits if you will - that were better suited to the new world.

In India today the world is changing - fast. The microfinance world is changing - very fast. In some places the meteor of competition has already struck the ground; in other places MFIs are breaking new ground in savings product innovation; and in still others there are interesting experiments in distribution technologies that will change the economics of microfinance for good.

SIGNS OF CHANGE IN KOLAR DISTRICT KARNATAKA

There is growing consensus that the large-scale defaults in Kolar are, in the main, driven the over-indebtedness of a small, but influential, subset of MFIs' clientele. With the rapid emergence of competition, these clients have taken loans from 3-5 MFIs, and are now struggling to repay. In desperation they turned to their community leaders, who have sought to organise mass default.

In Bangladesh, most villages are served by ten or more MFIs of varying sizes and product offerings². And yet over indebtedness is limited, and repayments are largely made on time. The difference may lie in the speed at which the growth in competition emerged. In Kolar, villagers moved from having no source of reasonably-priced credit, to being able to access five or more MFI loans, in the space of a couple of years. For many of the self confident ones (many of whom became the group leaders), this was an opportunity, and temptation, they were not able to refuse. And so they amassed as many loans as they could ... and are then discovered the implications and pain of being over indebted.

By contrast, in Bangladesh, it took over a decade for a fully competitive environment to emerge. As a result, Bangladeshi villagers were able to learn about, and gauge, their household debt-carrying capacity. They learnt this without falling into the type of large-scale, widespread over-indebtedness in Kolar, and possibly elsewhere in India.

WHAT ARE THE LESSONS FROM KOLAR?

1. The idea that several MFIs lending Rs.10,000 each to a single client somehow diversifies or reduces risk is optimistic. This approach simply increases the transaction costs for the clients who have to sit in many meetings.
2. Many clients do indeed need loans greater than Rs.10,000 ... or indeed Rs.20,000; but some need less than Rs.10,000. It all depends on what is being financed.
3. It is hugely important for MFIs to understand their clients and their debt carrying capacity better. Group guarantee will not necessarily adequately reduce over-borrowing – particularly when it is often the influential group leaders that take multiple loans. Indeed group solidarity may even be used to instigate coordinated, mass default.
4. Understanding clients better will require MFIs to move quickly to cashflow-based individual lending; and many will leverage the potential of m-banking technology to make this cost effective.

² See India Focus Note # 12, "Are There Lessons For India From Bangladesh?"

CAN THE TRADITIONAL MICROFINANCE PLAYERS ADAPT?

Successful adaptation involves managing both the pace and degree of change. A small change undertaken quickly is not too challenging. A large change conducted over a long time might be more difficult, but would still be expected to be conducted successfully. After all that is the story of microfinance in Bangladesh. But what about very large changes conducted very quickly? The challenge is daunting.

HOW WELL PREPARED ARE TRADITIONAL MFIs TO NAVIGATE CHANGE?

Existing large players in India today by and large share the same broad characteristics:

- Growth is by geographical expansion
 - Product suite is dominated by a single product
 - Distribution is carried out via one channel
 - Their operating focus is efficiency
 - Operations are strongly standardised
 - They are very flat organisations
 - Over 95% of the labour is devoted to operations
 - Product feature trade-offs are in favour of the MFI
- ...all copied from an existing successful model.

And if you were to choose a set of capabilities to grow a single model very fast then this would be the right model. It is rather like having a fast powerful rocket, with only limited navigation equipment and engineering.

WHAT IF THE FOLLOWING WERE REQUIRED?

- Growth by wallet expansion of existing customers
 - Multiple products
 - Multiple channels
 - Effectiveness but much less labour
 - More complex profit centre-based structures
 - Some staff focussed on market sensing, and product and channel innovation
- ...invented from first principles

It is fair to suggest that not only would the existing organisations lack the capabilities, but the essentially conservative culture of such an organisation around standardisation and simplicity (the very thing that powers the organisation for success today) would be like a ball and chain slowing change.

MFIs need four new capabilities on the same footing in terms of respect and influence within the organisation as operations currently enjoys today. These are:

1. Sensing
 2. Learning
 3. Design
 4. Change implementation
- ... as well as operations.

1. *Sensing* is the capability to gather structured and reliable data from the external environment to assess changes in: client circumstances; client satisfaction; product responsiveness to client needs; competition; and in technology available for reaching and transacting with clients.
2. *Learning* is the capability to understand the implications of the data captured through sensing.

This implies that the organisation is able to discuss and debate the implications of the data, and arrive at a consensus view of what actions, if any, to take in the light of the data from the external environment.

3. *Design* is the capability to design and test changes to products and distribution structures, based on the consensus agreed on during the learning. It includes designing coherent business processes, systems, and organisation structures and people skills.
4. *Change implementation* is the capability to manage the changes required to implement new products: project planning and management; resource allocation; and management of the human factors surrounding the change.

MAKING THE CHANGE

Each of these capabilities is required for change in MFIs, products and channels. Of course undertaking major change takes time, and capital support. Capital participants in MFIs in India generally operate around two time frames. Either they are long term patient capital providers, with a strong interest in effective products to maintain strong engagement with clients; or they are short term participants looking to grow the size of single product players and exit within 2 to 3 years.

The second kind of capital providers are generally much less tolerant of time and effort spend on long term change, because it diverts resources and distracts management. But, of course, such changes may well be important to the medium term success of the organisation in the market. Alignment of capital provider time frames with market strategy appears to be very important and a strong consideration.

CONCLUSION

In summary, it is desirable that dinosaurs become warm blooded and furry ... and that agile, and successful bunnies emerge too. Because different clients have different needs and no one product or microfinance player is going to meet all needs. If microfinance is to deliver on its promise it must evolve and adapt in a way which meets clients' needs more effectively, as clients change, and as the world changes around them.

WHAT DOES COMPETITION MEAN FOR INDIAN MFIs?

Graham A. N. Wright



In the last two years competition amongst microfinance institutions (MFIs) as well as with the Self Help Group (SHG) movement has emerged India. In Puri, Orissa, 7-8 MFIs co-exist and some of them have common set of clients and groups. In one of the groups visited, members were part of one MFI from 10am and were borrowing/repaying to another MFI from 10:30am without the group having to leave the meeting place! This represents an important change, since until 2005, most MFIs did not have to worry about competition. This period of low competition allowed MFIs the freedom to focus on the methodology and management systems necessary to reach scale and sustainability. But growing competition is not unique to India, indeed competition has been an important factor in several countries around the globe for many years. Bangladesh, Bolivia and Uganda are acknowledged to have particularly competitive environments. These market places offer an opportunity to learn about the effects of competition on microfinance institutions and their clients ... and draw lessons for the future of Indian microfinance.

In a competitive environment, microfinance institutions must shift their thinking to respond to different challenges³:

Pre-Competitive Stage	Competitive Stage
<i>Objective:</i> To reach more people and to become financially viable.	<i>Objective:</i> To retain or increase market share, while remaining profitable.
<i>Internal focus:</i> Developing the institution's internal capabilities and optimising efficiency.	<i>Internal issues remain important, but external focus is added:</i> Understanding the external environment and incorporating that understanding into business strategy. Issues like corporate branding, strategic marketing and governance gain importance.
<i>Driving motivation:</i> Access to funding.	<i>Driving motivation:</i> Attracting and retaining customers.
<i>Growth:</i> High growth possible. Some MFIs have doubled their portfolio annually for several successive years with no competition and abundant donor/bank funds.	<i>Growth:</i> Low growth, stagnation, or even portfolio shrinkage possible, even for large well-managed MFIs, as the experience in Bolivia and Bangladesh shows.
<i>Market assessment:</i> Little need to take the behaviour of other players into account.	<i>Market assessment:</i> Must study the behaviour of the clients, prospective clients, and competitors, or suffer grave consequences.
<i>Client demand:</i> Taken as given. Institutions can grow and be profitable with unchanging, unpopular products.	<i>Client demand:</i> Can evaporate quickly if competitors provide better service. Institutions that think strategically, satisfy customers' needs and desires, and innovate intelligently are likely to do well; others are likely to have hard times.

Indian microfinance has entered its "competitive stage" - the implications for MFIs and their clients are significant. The following reviews lessons learned in Bangladesh, Bolivia and Uganda to extract the implications for India.

³ Based on a presentation by Elizabeth Rhyne to the MicroFinance Network in July 2001.

OVER INDEBTEDNESS?

In Bolivia, “The momentum of lending growth that propelled both the microfinance institutions and consumer lenders created a bidding war, with competitors vying for clients by offering larger loans, faster service, and lower interest rates. ... Over indebtedness was rampant, particularly common among the high proportion of clients who had borrowed from multiple microlenders at the same time” (Rhyne, 2002⁴). However, experience in Bangladesh shows, there are different drivers of over indebtedness. “It appears that for deficit households, distress management is the reason for multiple borrowing, while for better off households multiple borrowing is mostly opportunity driven. The main supply-side challenge is that the lending technology fails to distinguish between the two types of clients and offers uniform products” (Chaudhury and Matin, 2002⁵). This has significant implications for the Indian MFIs’ response to over indebtedness. “Multiple-membership calls not only for creating arrangements such as credit bureaux, but also for more concrete advances in providing protective financial services while diversifying the range of promotional ones. In this sense, it is an opportunity as much as a challenge” (Chaudhury and Matin, 2002).

DEMANDING/DISCERNING CLIENTS

As clients gain access to greater choice, so they become more demanding and discerning, and many chose to leave the group-based lending institutions in preference for individual lending-focused institutions. In India, we may see the fast tracking of the individual lending approach with the entry of Non-Banking Finance Companies into the microfinance market segment. Furthermore, under highly stressful or competitive conditions, the operational principles of group guarantee may even increase portfolio at risk. Groups may “unzip”⁶ and the entire group, burdened by excessive or multiple default, sees no further hope for continuing loans and elects to default en masse. “It is this risk that drives MFI field workers to continue to give loans to the good payers in the longer established groups - after all they have developed a long credit history - and thus to negate the group guarantee principle. And it is for this reason that, despite all the rhetoric, the effectiveness of the group guarantee principle is limited to the first few loan cycles” (Wright, 2000⁷).

MicroSave’s work on competitive environment in Uganda (Wright and Rippey 2004⁸) unambiguously demonstrated the strong negative feelings that many Ugandan group members have towards group-based loans. In Uganda, MFIs were compelled to move towards individual lending-based methodologies, to respond to the challenge and opportunity presented by these client preferences ... in India Spandana, SKS and others are already moving in a similar direction.

OPPORTUNITIES IN NICHE MARKETS

But even for MFIs focused on using the group-based lending methods, the performance of Pro Mujer and Crecer in Bolivia suggests that there is still a potential to serve niche markets. This approach may prove to be a necessary and important survival strategy for poverty-focused microcredit organisations in India as the competition heats up. Many rural areas, and lower-income clients, remain under-served ... as do many SME borrowers. Identifying and focusing on less contested market niches has proved

⁴ Rhyne, Elizabeth, “Surviving the Crisis: Microfinance in Bolivia, 1999-2002”, ACCION mimeo for Symposium on Financial Sector Development in South-east Europe, Kreditanstalt für Wiederaufbau, 2002.

⁵ Chaudhury, Iftekar A. and Imran Matin, “Dimensions and Dynamics of Microfinance Membership Overlap – A Micro Study from Bangladesh”, Journal of Small Enterprise Development, Vol. 13 No.2, ITDG, London, 2002.

⁶ A term first coined by Rutherford during 1992.

⁷ Wright, Graham A.N., “MicroFinance Systems: Designing Quality Financial Services for the Poor”, University Press Ltd., Dhaka and Zed Books, London and New York, 2000.

⁸ Wright, Graham A.N. and Paul Rippey, “The Competitive Environment in Uganda: Implications for Microfinance Institutions and their Clients”, *MicroSave*, Nairobi, 2003.

a viable strategy as MFIs seek new approaches to serving both poorer clients and the small businesses previously excluded by targeting strategies. This move may also be reflected in India as MFIs move increasingly towards urban and individual lending, or in some instances, to serve remote rural areas.

PRICE-BASED DIFFERENTIATION

When confined to the highly competitive market niche (typically working capital loans for market traders) perhaps the most obvious strategy for MFIs to adopt might be to differentiate themselves on the basis of price. This has indeed happened in Bangladesh where the interest rates on the standard one year MFI loans has been falling since the mid 1990s (Wright, 2000). Similarly, in Bolivia, “For the first time there was some evidence that at least some customers would switch institutions on the basis of price. ... Not only did yields fall over time, they narrowed, as institutions priced their services on a competitive basis rather than on the basis of their own internal cost factors” (Rhyne, 2002). The implications for the Indian market, where price is already such a politically charged issue, remains unclear... but it is reasonable to suggest that prices are likely to fall.

CONCLUSION

Thus, it is clear that highly competitive environments present risks both for the MFIs and their clients. MFIs may adopt less stringent loan assessment or approval criteria; or be forced out of their traditional markets into new ones with higher risk profiles and cost structures; or may be forced to reduce the prices they charge in the more competitive market niches. Clients may be tempted into a situation of over indebtedness either by using the competition to negotiate faster access to larger loans from their financial service providers, or by accessing multiple loans from several providers. Clearly, this type of behaviour would be a source of great concern if it were happening in the Indian context.

KEY QUESTIONS THAT SHOULD PRECEDE NEW PRODUCT DEVELOPMENT¹

Graham A.N. Wright, Monica Brand, Zan Northrip, Monique Cohen, Michael McCord and Brigit Helms



¹Looking Before You Leap: Key Questions That Should Precede Starting New Product Development, available on *MicroSave's* website www.MicroSave.org under the Research Papers section. For more on the product development process see Wright, Graham A.N., "Market Research and Client Responsive Product Development", *MicroSave*, 2001 – available on *MicroSave's* website: www.MicroSave.org under the Research Papers section.

INTRODUCTION

Many MFIs are looking at new product development as a way of responding to their clients' needs. However, they often do not understand the complexity and cost of product development. This note suggests six essential questions to ask prior to setting about new product development.

1. **Motivation: Are we starting product development to make our MFI more market-driven?**

MFIs profess many motivations to undertake product development, and it is essential that the Board, management and staff involved in the process of product development clarify their motivations. The less convincing reasons for initiating product development include getting access to the growing plethora of “innovation funds” available from donors and the current interest in product development.

Effective product development is driven by an MFI's desire to become client responsive. Those MFIs developing products for reasons other than a commitment to responding to the market and becoming demand-driven may well discover that they have entered into a more complex and time/resource-consuming process than expected. On the other hand, MFIs have to live with the products they deliver and the investment in developing client-responsive services may well be the most important and cost-effective one they will ever make.

2. **Commitment: Are we setting about product development as a process?**

Under the prevalent top-down model that characterises most MFI'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 MFIs 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 product.

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 MFI from subsequent problems. A proper process also provides the MFI an opportunity to correct problems or respond to issues while they are limited by the confines of each step.

3. **Capacity: Can our MFI handle the strains and stresses of introducing a new product?**

The process of product development consumes time and money. It often highlights opportunities or needs to change central elements of an MFI's systems. MFIs should therefore carefully consider before jumping into product development the questions: “Are we really ready?”, “Do we have the resources?” and “Are we really committed to this?”. As a first step to answering these questions, the MFI should conduct a thorough institutional analysis, reviewing strategy, financial viability, organisational structure and philosophy, human resources, marketing and systems.

In summary, an MFI should already:

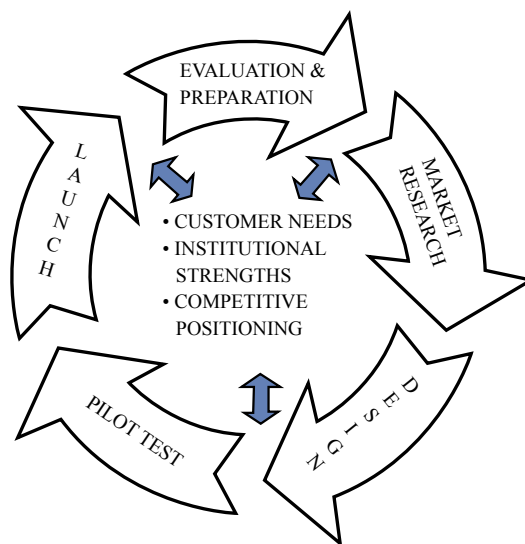
- Practice the level of tracking and management required of a new product;
- Understand the capacity issues in all relevant departments;
- Have the will and full commitment of management and the Board behind the process;
- Have the capacity to train all relevant staff; and
- Possess or have available staff and systems that can manage, implement, and develop the new product before significant funds are expended on the new product development process.

4. *Cost Effectiveness and Profitability:* Do we fully understand the cost structure of our products?

In view of increasing professionalism of MFIs and the competition in the MFI market place, it is essential that MFIs understand exactly how much each part of their operations costs to facilitate informed management decisions. Key decisions include how to increase profitability by cutting costs and/or increasing income, how to assess product-level performance, and if necessary modify the price of existing products, whether to accept and implement new products, and how to price new products.

Product costing on a simple allocation basis is a relatively straight-forward exercise which provides the MFI with a wealth of information, while more complex activity based costing provides additional information on how and why costs are incurred.

SYSTEMATIC PRODUCT DEVELOPMENT PROCESS



5. *Simplicity:* Can we refine, repackage and re-launch existing product(s) before we develop a new one?

Product refinement fine-tunes or adjusts existing products, often with limited effect on the existing systems – for example by changing the interest rate or marketing strategies of an existing product.

New product development is the process of developing a brand new product – for example a housing loan or a contractual savings product. Prior to starting the process of new product development, MFIs should give careful consideration to options for refining, repackage or re-launching their existing products.

Product refinement is considerably less expensive, time-consuming and disruptive than new product development. Opportunities for product refinement can arise from both the front and back office aspects of the existing product. In the front office, the way staff talk about, and market, a product can yield valuable benefits. In the back office, increasing the efficiency of the staff or systems can have a significant effect on the demand for the product and the retention of clients. Re-engineering back office systems is as much of an innovation as developing a new product, a fact that should be clear to those administering donors' innovation funds.

6. *Complexity and Cannibalisation*²: Are we falling into the product proliferation trap?

Product proliferation is increasingly common amongst some MFIs that try to tailor products to respond to individual market segments with specific needs.

These MFIs can find themselves offering many slightly different products. A multitude of products often results in:

- Confusion amongst front-line staff and clients;
- Complex delivery systems;
- Complicated management information systems; and
- Cannibalisation among products.

MFIs Cannot Do Everything! When evaluating the diverse needs of clients, the MFI should recognise that it cannot design a product to respond to each and every individual specific need. The MFI should group the most common and prevalent needs and develop products in response to them. One product can be marketed in many different ways to meet a variety of clients' needs.

CONCLUSION

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.

²Cannibalisation is when the introduction of a new product diverts sales from a company's existing products and when revenue is displaced, rather than created

THE SYSTEMATIC PRODUCT DEVELOPMENT PROCESS

Graham A.N. Wright



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 microfinance institution (MFI) 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 PRODUCT DEVELOPMENT PROCESS

I. Evaluation and Preparation

- 1.1. Analyse the institutional capacity and “readiness” to undertake product development
- 1.2. Assemble the multi-disciplinary product development team, including a “product champion”

II. Market Research

- 2.1 Define the research objective or issue
- 2.2 Extract and analyse secondary market data
- 2.3 Analyse institution-based information, financial information/client results from consultative groups, feed back from frontline staff, competition analysis, etc.
- 2.4 Plan and undertake primary market research

III. Concept/Prototype Design

- 3.1 Define initial product concept
- 3.2 Map out operational logistics and processes (including MIS and personnel functions)
- 3.3 Undertake cost analysis and revenue projections to complete initial financial analysis of product
- 3.4 Verify legal and regulatory compliance
- 3.5 On the basis of the above plus client feedback sessions, refine the product concept into a product prototype in clear, concise, client language
- 3.6 Finalise prototype for final quantitative prototype testing or pilot testing, according to the risk/cost nature of the product

IV. Pilot Testing

- 4.1 Define objectives to be measured and monitored during pilot test, primarily based on financial projections
- 4.2 Establish parameters of pilot test through the pilot test protocol, including sample size, location, duration, periodic evaluation dates, etc.
- 4.3 Prepare for pilot test, install and test systems, draft procedures manuals, develop marketing materials, train staff, etc.
- 4.4 Monitor and evaluate pilot test results
- 4.5 Complete recommendation letter documenting the results of the pilot test, comparison with projections, lessons learned, finalised systems/procedures manuals, etc. and the initial plans for the roll out

V. Product Launch and Rollout

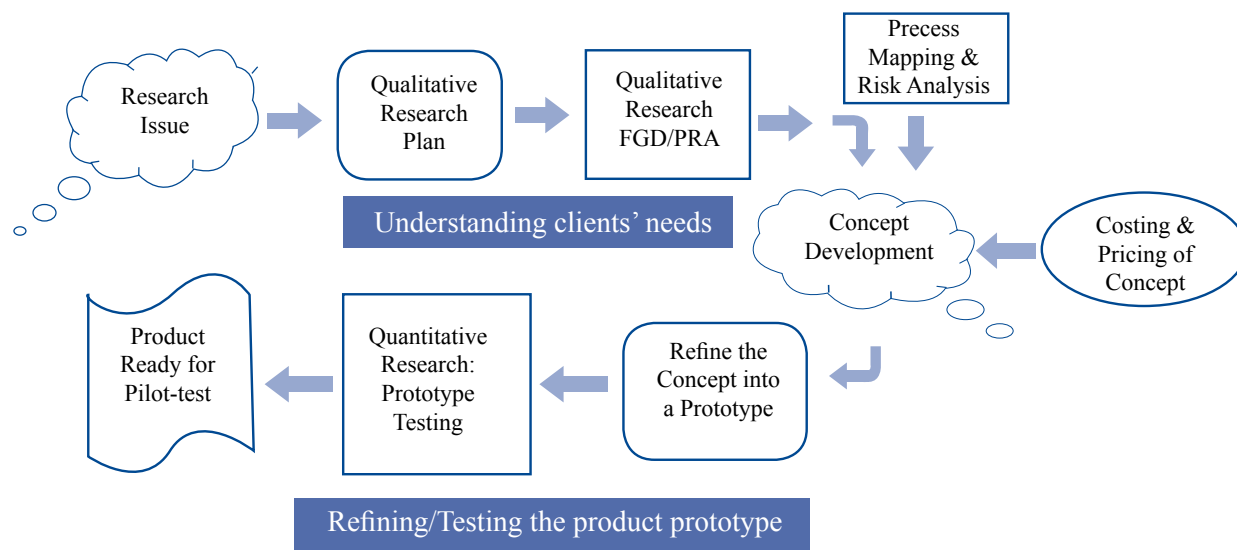
- 5.1 Manage transfer of product prototype into mainstream operations
- 5.2 Define objectives to be measured and monitored during roll out based on financial projections
- 5.3 Establish parameters of rollout through the rollout protocol including schedule, location, tracking, budget, process
- 5.4 Prepare for rollout, install and test systems, finalise procedures manuals, develop marketing materials, train staff etc.
- 5.5 Monitor and evaluate rollout process and results

Using *MicroSave's* “*Market Research MicroFinance Toolkit*” MFI staff are provided with the skills needed to 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 and to refine the product concepts into prototypes for testing.

Product Costing – To enable MFIs develop profitable products and credible financial projections, it is essential to implement a product costing system. On the basis of *MicroSave's* experience with Allocation Based Costing, it has developed a “*Costing and Pricing Financial Services Toolkit*” to assist MFIs with this process.

“Making costs more transparent is key in controlling them.”

MARKET RESEARCH AND PROTOTYPE DEVELOPMENT AND PILOT-TEST PREPARATION PROCESS OVERVIEW



Pilot Testing – *MicroSave* assists MFIs to plan and establish a pilot test to test the product that they have developed. The pilot testing process has ten stages detailed in *MicroSave's* “*Planning, Implementing and Monitoring Pilot Tests Toolkit*”, outlined below. Typically assistance is given in planning the pilot test, setting goals and indicators, and in developing financial projections.

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

“As always *MicroSave* is providing very useful and easily accessible resources and documents”

“We are now reaping the benefits of working with *MicroSave*”

“*MicroSave* is the best technical assistance provider we have”

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

Rollout – On the basis of its experience with its Action Research Partners, *MicroSave* has completed a “*Product Rollout: A Toolkit for Expanding a Tested Product Throughout the Market*” for use in the microfinance industry. The toolkit provides practical tips and checklists to assist MFIs with all aspects of the rollout process: recommendation letters, handover, finances, human resources, systems and marketing, as well as assessment of the rollout process.

ASSESSMENT OF THE USE AND IMPACT OF *MicroSave*'s MARKET RESEARCH FOR MICROFINANCE TOOLKIT¹

Ezra Anyango, Jennefer Sebstad and Monique Cohen



¹ For more on *MicroSave*'s "Market Research for MicroFinance" toolkit visit the *MicroSave* website.

Market research is at the forefront of *MicroSave*'s vigorous campaign to promote a client-oriented microfinance industry. Over the past several years, *MicroSave* has developed an innovative participatory market research methodology that builds capacity within microfinance institutions (MFIs) to improve understanding of the demand side of microfinance. The methodology is supported by a 'toolkit' that consists of more than 20 participatory rapid appraisal (PRA) tools. These tools are designed to learn about customer perspectives on financial services and identify financial products and services that they want and need. Microfinance practitioners and trainers learn how to use the tools in *MicroSave*'s Market Research for MicroFinance training courses. Classroom and in-field training prepares participants to use the tools to identify customer needs and preferences, and options for responding to them.

“...The tools are a powerful instrument for MFIs that want to be market driven”

(Email respondent, 1/02)

DESCRIPTION OF THE MARKET RESEARCH FOR MICROFINANCE TOOLKIT

The Market Research for MicroFinance toolkit consists of standard PRA tools adapted to microfinance as well as original PRA tools developed by *MicroSave*. The toolkit includes:

- Simple and detailed wealth ranking tools;
- Seasonality, life cycle, and time series tools adapted to learn about the characteristics and financial dynamics, patterns, needs, and preferences of MFI customers; and
- Several original PRA tools developed to understand the financial service use, options, and opportunities within communities, including tools for assessing the gender issues and household control of sources.

“...Recognising customers perceptions and considering them in product refinement has decreased the rate of dropout in all branches”

(Email respondent, 1/02)

The toolkit includes guidance on using the tools in the context of focus group discussions (FGDs). It also offers examples of analysis matrices to help organise and process information generated by each tool. A key feature of the toolkit is its dynamic and flexible nature. The tools can be changed, combined, and adapted to examine areas of specific of interest to the market researcher. Depending on the purpose, new tools can be added, while others can be adapted for different kinds of purposes. In this way, the toolkit continues to evolve as it is used to address new issues.

MicroSave's Market Research for MicroFinance training involves two basic courses. One course is targeted at microfinance practitioners who will use the tools directly in their work. Another ToT course is targeted at trainers who will teach others how to use the tools. The content of the training is similar in both courses with classroom training focused on the product development process, market research methodologies, qualitative market research methods and techniques, product concept and prototype development, prototype testing, pilot testing and launch. Participants then prepare an action research plan for in-field research. The 'practitioner' trainees have one day of in-field training and then return to their own MFIs to implement their market research plans with one to two weeks of on-site "mentoring" by *MicroSave* staff or Certified Service Providers. The ToT course has over a week of in-field training with guidance and support from *MicroSave* mentors, after which participants return to practice the tools in their own environments backed by email support from *MicroSave*. This intense "classroom plus practice" approach characterises all *MicroSave* training courses. It is particularly important for the Market Research for MicroFinance course.

MAIN FINDINGS

MicroSave has an excellent staff of professionals who conduct the training and mentor MFIs on how to use the tools as part of the product development process. Their experience, hard work, enthusiasm, and ability to work effectively with MFI practitioners on the ground have been key to *MicroSave*'s accomplishments to date.

“... The tools offer MFIs a structured way to listen to and learn from clients.”

“...The market research process creates a bond between the clients and staff of an organisation. Clients realise you are concerned about them and listening.”

“...The biggest change resulting from the use of the tools is in attitudes towards microfinance clients. They are seen as having rights as consumers.”

(Email respondents, 1/02)

The outreach of the *MicroSave* Market Research for MicroFinance toolkit has been impressive. The training has involved international, regional, and national MFIs, networks and support organisations working both within and outside of Africa. Aggressive marketing, promotion and the relevance of the training to current interests in the MF industry, have been key to its successful outreach.

The assessment found the tools training to be solid in both content and process. The practical field experience is invaluable and has had a direct influence on the way many institutions now carry out their activities. The training is highly rated by participants and the fact that they pay up to \$2,500 to attend the course indicates the value it is afforded by participants and their institutions.

The tools are well designed and easy to adapt to different settings and purposes. With training, users can generate information that is credible and useful for improving products and services. Given the growing interest in the microfinance industry for meeting a broader range of client financial needs, the *MicroSave* Market Research for MicroFinance toolkit is timely and in high demand.

The tools have contributed to the development of new and improved market oriented products and services. For example, one financial institution refined and repackaged their existing savings and loan products.

Another introduced money transfer services. Another is working on a strategy for providing funeral insurance. One organisation used the tools to design loans and insurance packages for franchise health-service providers.

New and improved products and services can help MFIs to reduce drop out rates, attract a broader range of clients, and become more competitive. *MicroSave* market research training and tools have been important in promoting the “demand side” agenda of microfinance. Overall, the tools have been very effective in changing the thinking of MFIs and raising awareness of client needs, preferences, and opportunities.

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

“...To grow, you need to listen to clients...Only MFIs that see client needs will be here in 15 years.”

(Interview with user, 2/02)

“...The tools help build momentum for client centered and responsive approaches within organisations.”

(Email respondent, 1/02)

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.***

“...The tools made research so easy, so interactive. They offer many ways of interacting with clients.”

“...Customers are proud of the new changes. They feel they own them since they were involved in their development. Customers are now advocating for the organisation as they feel they own the products.”

(Interviews with users, 2/02)

COST AND BENEFITS OF MARKET RESEARCH FOR PRODUCT DEVELOPMENT

Cheryl Frankiewicz (Summarised by Corrinne Ngurukie)



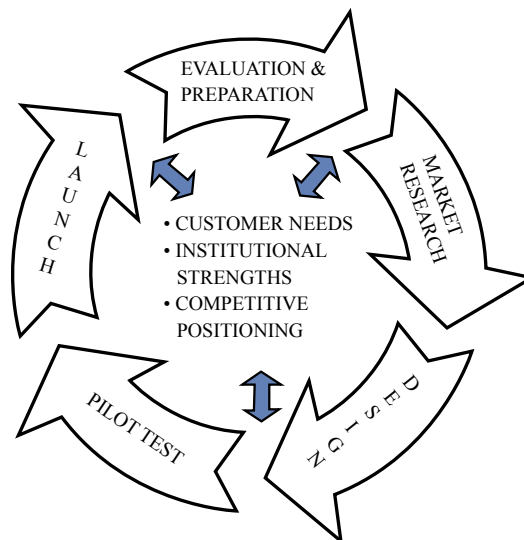
INTRODUCTION

The microfinance agenda in the last decade and a half has shifted from supply- to demand-driven solutions with stakeholders having taken cognisance that poor clients demand a wider, more flexible range of financial services beyond microcredit. Microfinance institutions have realised that in order to grow, keep clients, they must introduce products that meet the demands of their existing and potential clients. The big question for many MFIs has been, and still is, “How is this done?”

Today, a successful MFI is typically defined as one that has successfully adapted the market-led approach. Essentially, such an institution has made deliberate efforts to align its business strategy and model in a way that it responds to clients’ needs and preferences. The institution has normally invested significant resources on programmes and activities to help them develop appropriate products and services that meet the needs of their target market.

MicroSave’s experience and reviews of successful new products reveal that market research is the starting point in most successful product development. The process of product development is illustrated below. Unfortunately, the market research step is too often left by MFIs. Such institutions instead opt to design the product from an internal idea and then launch the product, without direct reference to customer needs.

SYSTEMATIC PRODUCT DEVELOPMENT PROCESS



THE HYPOTHESIS

A simple hypothesis to explain the lack of research, which provoked an extensive study¹, is that institutions fail to believe that the benefits of market research sufficiently outweigh the costs to make investing in this process worthwhile. Institutions are undoubtedly battling with the question, “Is market research really worth it?” Do the costs of market research outweigh the benefits for MFIs? Are there certain conditions that must be fulfilled in order for market research to be worthwhile?

Interestingly, the cost-benefit questions quickly moved to revolve not around whether to conduct market research, but rather to what extent research should be undertaken. And of course, the scale and scope of the research more or less dictates the costs.

Many lessons, discussed in this note, were drawn from a study that involved MFIs in seven countries namely: Kenya, Tanzania, Uganda, Bosnia, Herzegovina, India and the Dominican Republic.

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 is accessible through www.MicroSave.org

THE COSTS

Financial Costs

Although the case study MFIs had difficulty reporting market research related costs, they nonetheless reported spending between US\$10,000 and \$63,780 (between 0.04% and 1.7% of their total assets) on market research activities designed to produce new product prototypes for testing. Much care was taken to recognise the benefits that this exercise brought when extended to other parts of the product development cycle from conducting the research phase to pilot testing before roll out. Most of these expenses relate to human resources (approximately 15-50 person days) and the institutional resources required to support these activities.

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 is accessible through www.MicroSave.org. Further observations with the study MFIs showed that variations on costs were largely attributable to the different methods used in estimating costs as well as the cost of labour employed for this process. For instance, the larger the scope of the market research and the more external consultants are employed, the more expensive the process was. The study continued to show that it indeed is difficult to gauge the relative significance of a market research investment simply by looking at the absolute costs. A small institution for example is likely to find a \$50,000 investment in market research more significant than a large institution.

The real headache, however, reported by most MFIs is the opportunity cost.

Non-financial Costs

It is that delicate and difficult decision that MFIs sometimes have to make on whether to engage new opportunities or expand existing business to maximise return on investments. There is also the cost incurred due to delay of introducing a product in the market because of the time it takes to complete the market research and the product development process. This poses the threat of losing 'the first mover' position in the market.

Reputation risk is another cost borne if a product, highly anticipated by the target market, is delayed or is never offered. Clients will both be disappointed and discouraged to give feedback to the institution in the future.

THE BENEFITS

Granted, research that leads to the development of new products demands a more involving, intense and complex exercise compared to research associated with product refinement or monitoring, which essentially seek out "quick wins" – solutions that can be generated through relatively inexpensive research.

Further study revealed with the case study MFIs revealed that there are more gains to be achieved when one engages market research for product development. In essence, market research was, and still is, regarded as an integral part of new product development largely because it is at the heart of a market-led approach. Interestingly also, despite the costs, they all responded with an overwhelming "YES!" to the need for research. The good news also is that, almost invariably, the resultant product(s) does, within reasonable time, generate sufficient revenue to cover the costs incurred during the baseline activities.

Additional benefits that the case study MFIs continued to enjoy as a result of successful market research are:

- (i) **Better understanding of the market** – Moving beyond assumptions to hearing clients’ articulate what is important to them and why.
- (ii) **Identification of client perceptions** – A misperception of the product pricing at Equity Building Society (now Equity Bank) caused a change in pricing that resulted in even better reward for the institution. As a result, the number of new accounts opened every day jumped from 20/30 to about 200 within two months.
- (iii) **Better understanding of internal capacity** – Market research reveals attitudes and aptitudes of staff as well as institutional efficiency levels.
- (iv) **Tool for managing change/buy-in** – Getting staff involved in research provides them two things:
 - a. An enlightened view of their clients; and
 - b. Greater institutional support as a wide range of stakeholders is involved in the process.
- (v) **Enhanced image or reputation** – A response to client feedback immediately creates a positive perception of an institution that listens and values the opinions of their clients.
- (vi) **Building of internal skills while increasing staff motivation and satisfaction** – Staff gain market research skills useful in obtaining client/market feedback quickly on a regular basis in a systematic and professional manner. This role helps their institution become more market-led.
- (vii) **An institutional culture more open to learning and experimentation** – Is developed as staff members become more eager to listen to their clients and share knowledge across the institution.
- (viii) **Mission fulfilment** – Clients are empowered through the feedback loop process, opportunity for deeper outreach by the institution.

LESSONS LEARNED

Institutions cautioned that poorly structured research will not yield the potential benefits, no matter the cost. Other lessons learned on how to minimise the costs and maximise the benefits of market research for product development are:

1. The first time you engage in market research get help from those who have done it before;
2. Institutionalise the capacity gained during the research process;
3. Have designated and committed multiple research teams operating simultaneously;
4. Keep the sample size manageable and use segmentation to help;
5. Start with training staff of the product development team and then involve others;
6. Drive the process with clear, focused objectives;
7. Conduct secondary data research before primary research;
8. Choose carefully, borrow, adapt and test the research tools;
9. Process research results daily.

CONCLUSION

“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.

PROCESS MAPPING FOR RISK MANAGEMENT AND PROCESS IMPROVEMENT¹

Pamela Champagne²



¹This Briefing Note was prepared on the basis of the *MicroSave*'s: "Process Mapping" Toolkit available on *MicroSave*'s website: www.MicroSave.org under Toolkits section.

²Pamela Champagne is a Senior Team Consultant for the Shorebank Advisory Services, USA, who together with *MicroSave* and Women's World Banking developed the Process Mapping toolkit.

INTRODUCTION

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.

PROCESS MAP SYMBOLS TELL THE READER

- What is happening
- When it is happening
- Who is doing it
- Where it is happening
- How long does it take
- How it is being done

USES FOR PROCESS MAPS

Process mapping has broad applicability to many business functions, such as risk analysis, process improvement, training, developing activity-based costing system, documenting procedures, visualising future-state processes before changing current-state processes, new product development. Process maps can be used to document three states: “**As Is**” maps the current process as it is practiced; “**Should Be**” maps how procedures and processes should be performed as set out in the MFI's formal procedural manuals; “**Could Be**” maps how the process would look after making process improvements.

RISK ANALYSIS

MicroSave has developed a four-tiered approach to process mapping for risk analysis: the symbols, the process description, the risks at each step, and the risk mitigation tactics (controls) each form a tier. This allows organisations to examine their processes for risks (both covered and not covered by current processing activities), how risks are affected by changing the steps, and understanding (from a risk perspective) why certain steps are performed. Introducing process improvements is closely linked to identifying risks, balancing optimum efficiency with effectiveness in meeting corporate objectives. A process, such as a savings withdrawal, may be very efficient if a teller is allowed to pay upon presentation of a passbook and withdrawal slip, yet the institution may not have the tolerance for the losses it may incur as a result of not introducing certain controls, such as teller limits, customer identification, and posting controls to insure the correct account and amount are entered to accounting systems.

SIX STEPS TO CONSTRUCTING PROCESS MAPS FOR RISK ANALYSIS

1. Draw flow chart of process
2. Describe process outlined in flow chart
3. Isolate risks associated with process
4. Evaluate risks for potential impact and likely frequency
5. Identify high impact and frequency risks
6. Identify control mechanisms to cover risks

TEN STEPS TO CONSTRUCTING PROCESS MAPS FOR RISK ANALYSIS AND PROCESS IMPROVEMENTS

To gain significant benefits of a mapping exercise, MFIs must devote sufficient time and resources. It is better to map one process well with demonstrable outputs than many with no clear outputs.

- 1. *Identify and prioritise operational gaps:*** How do you determine what are your key processes and where to begin? Identifying the problems within a function is a good starting point. These problems probably represent risk to the MFI in the form of customer dissatisfaction, inefficiencies, and errors. Process mapping allows you to look for the cause of problems, using a process perspective, eliminating internal politics and personalities from the problem-solving exercise. Once you know what is causing the problem, you can fix it. Without knowing the cause, you are only addressing symptoms.
- 2. *Choose process to be mapped based on prioritised operational gaps:*** People selected to do the maps tend to select the processes they are involved in, thus mapping resources may not be devoted to processes that are in the best interests of the organisation to improve. Obtain management approval of the priorities.
- 3. *Assemble an appropriate team:*** People are busy with their daily duties and cannot always allocate the time required to create a map. They must have the approval of their senior managers to allocate required time. The “right” people on the team include all levels, from very junior, to senior staff involved in the process, with as much cross-functionality as dictated by the process itself.
- 4. *Define process to be mapped and mapping objectives:*** What are the start and end points to the process? What state (“As Is”, “Should Be”, or “Could Be”) are you mapping? Why are you mapping this process? Your intended audience and use dictates the level of detail required to be put in the map.
- 5. *Gather required data:*** Process maps will only be as good as the techniques used to produce the maps. Sources of data include:
 - **Interview** everyone who touches the process. Leave assumptions and preconceptions behind, ask open-ended questions, and conduct interviews in a non-threatening environment;
 - **Observation** Maps reflect a process as if a single transaction were occurring. Observation shows up where delays occur in the process, such as the batching of work before sending it to the next step. Use of a Mystery Shopper is an additional technique.
 - **Documents** Identify, review, and follow the documents from where they enter the process, how they are used during the process, and how they exit the process. Forms drive processes. An examination of credit files will show you what forms are used, who signs them, and how they are used in the process; this is especially important when mapping a loan process, since the process occurs over a much longer span of time than can be observed from start to finish.
- 6. *Construct and Validate Maps:*** Using a software program such as Visio reduces the actual time spent placing symbols in a map. Validation techniques include:
 - Triangulate results using techniques listed in Step 5 so that the accuracy of the map is confirmed by three sources;
 - Perform a walk-through of the map, explaining it to someone who was not involved in creating the map to point out flaws in the construction of the map itself;
 - External review by someone experienced in process mapping.

7. Analyse Process Map for Risks and Process Improvements:

- Time What may seem very efficient on paper may not be in fact. This dimension becomes clear when time is added to the map. Show the minimum (optimal) time for each task, then show total time from start to finish; the difference is caused by delays and represents the process improvement opportunity;
- Internal auditors a good source for identifying risks, as is Tool 3a in *MicroSave's* Institutional and Product Risk Toolkit for product related processes;
- Broader risks that exist throughout the process become redundant to list at every step. Focus on the risks pertinent to that activity. Ask how often it occurs or what is its impact;
- Internal control questionnaires are a good source for control tactics (see Appendix in Risk Toolkit);
- Make sure process improvements address problems;
- Conduct interviews from the customer point of view (What does the customer do next?), not the staff point of view;
- Why is work batched? Batching is a source of delay. If you know why it is batched, then you have a better opportunity for eliminating that delay.

8. Analysis of Should Be and Could Be Maps:

- There is usually not much point in mapping “Should Be” if such a map is not already in existence at the time an “As Is” map is commissioned, unless management really needs to see where deviations to policy are occurring. (Such a comparison is also an important internal audit technique). One of the most compelling reasons to construct an “As Is” map is when certain institutional stresses have caused problems or lead you to suspect that processes are not functioning as they should be. It is then just as efficient and effective to derive the “Could Be” map from the “As Is” map.
- “Could Be” maps may not look a very different from the as-is maps, as what improves the process is not a step, but an improved physical environment, form, or equipment. For example, non-standard layouts for branches may mean that a process that works well in one branch may not work as well in another branch.

9. Summarise and Distribute Findings:

- Expressing results quantitatively, such as reduced cycle time, number of times customer must return to the bank to complete a loan, reduced number of handoffs (touch points that provide an opportunity to redeploy staff or increase staff utilisation) will get management’s attention. You need to be able to measure what you want to improve.
- Quality measurements accompanied by quantity measures (error rate vs. transactions posted rate) balances efficiency and effectiveness.

10. Implement Process Improvements: Begin with a pilot test, monitor and evaluate results of pilot to ensure that processes are improved and no new risks emerge, then (and only then) roll out new process.

TIPS

- Add a tier to your map for analysis points, as problems are pointed out along the way;
- Experience in mapping and in processes is a big help;
- Different processes have different degrees of complexity. Loan processes tend to be lengthy, while savings processes tend to be shorter and less complex. The same techniques that work for one process may not be as well suited for another process;
- Doing “quick win” process improvements could preclude longer-term redesign that may ultimately yield greater benefits to the organisation.

CONSIDERATIONS IN INSTITUTIONALISING MAPPING

- People are too busy in their daily work; this is not a part-time task initially;
- People trained won't necessarily be the ones doing the maps;
- Requires management thought;
- Levels of people involved may impact degree and quality of participation – junior staff may not speak out freely in front of their supervisors.

PROCESS MAPPING IN PRACTICE

Henry Sempangi, David Cracknell,
Madhurantika Moulick and Hermann Messan



WHAT IS PROCESS MAPPING

Process mapping¹ is a technique that makes workflows visible. A process map is a flowchart that shows who is doing what, with whom, when, for how long and with what documents². It shows how operational decisions are made and the sequence of events.

MicroSave goes beyond drawing flowcharts, adopting a four-tier approach. The four tiers are, the flowchart, a description of the process, potential risks in the process and possible controls. This approach enables efficiency and internal controls to be carefully balanced, to the benefit of the institution and its customers.

STEPS IN PROCESS MAPPING³

1. Identifying and prioritising operational gaps
2. Choose processes to be mapped
3. Select people for the process mapping exercise
4. Define process along with process mapping objectives
5. Gather data
6. Construct “As Is” map
7. Analyse “As Is” map
8. Analyse “Could Be” and “Should Be” maps
9. Summarise and distribute findings
10. Getting into action – testing new processes

BENEFITS OF PROCESS MAPPING

Action Research Partners report extremely positive results from mapping processes. 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. The speed at which visible efficiency gains can be realised suggests that significant benefits can be derived from a first round of process mapping. Benefits reported operate at strategic, managerial and operational levels.

Risk Management: Risks are quickly identified and appropriate responses designed. Risk mitigation tactics can be monitored and assessed. Tanzania Postal Bank for example is using process mapping to strengthen their management of credit risk.

Human Resource Management: There is usually improved assignment of tasks between individuals. Assessment of process related blockages can lead to reallocation of staff, and process improvements result in more efficient use of staff.

Standardisation of Practices: Process maps act as reference points for day-to-day work, they are easy to refer to, read and understand. To encourage standardisation, Equity Bank placed process maps on its intranet system.

¹This Briefing Note is based on a paper of the same name available on *MicroSave*'s website www.MicroSave.org under the Studies section.

² For guidance on how to produce process maps *MicroSave* has produced a toolkit “Process Mapping for Financial Institutions”, which is available on the website under the Toolkits section.

³ See Briefing Note # 29 “Process Mapping for Risk Management and Process Improvement”, available on the website under the Briefing Notes section.

Feedback Loop: Properly drawn maps identify information flows to and from management and thereby can guide and improve decision-making.

Customer Service: Almost all Action Research Partners have reported improvements in service levels. Process mapping improves service levels through examining processes for bottlenecks, delays, preventable errors, role ambiguity, duplications, unnecessary handovers and cycle time. Kenya Post Office Savings Bank has implemented changes that significantly reduce congestion in their banking halls.

Change Management: Process and many non-process areas that require change are identified. Process related changes can be tested prior to institution wide implantation increasing the chance of successful change being introduced.

Activity Based Costing: A detailed understanding of processes facilitates the creation of an appropriate activity dictionary for Activity Based Costing (ABC). Standardisation of the application of processes, makes the results of ABC more representative.

Cost Control: Process mapping enables procedure related bottlenecks to be identified and removed. For Commercial Microfinance Limited (CMF) in Uganda the decision to simplify loan application procedures saved staff and clients, time and money. FINCA Uganda reports improved efficiency with a slowing in the rate of staff recruitment.

Banking and MIS: Process mapping is a frequent starting point for system audits. FINCA Uganda used process mapping to identify weaknesses in their banking system and to guide system related improvements. CMF were able to document and improve their disaster recovery procedures.

Staff Performance and Training: Process mapping enables the creation of performance standards by determining how long a particular process should take and through encouraging consistency in application it makes it easier to identify staff performing above or below expectations. Through streamlining processes and removing excessive handovers, it can improve the attribution of performance. As a visual tool, process maps can replace pages of text and significantly shorten procedure manuals. Equity Bank already uses the first two tiers of the process map – the flowchart and its description to teach procedures to new and existing staff.

Reduced Documentation: Most Action Research Partners report significant reductions in documentation. CMF consolidated information requirements into a single loan agreement, thereby reducing duplication of information in the process.

New Product Development: Process mapping enables new product procedures to be adapted from existing procedures or developed from scratch and changed easily before they are written into policies and procedure manuals. FINCA Tanzania has used process mapping to develop and document new procedures around individual lending products.

STEP-BY-STEP CHALLENGES AND TIPS

Choosing processes: Linked processes represent a significant challenge in determining which processes to map. For example, U-Trust wanted to improve liquidity management, but first had to determine which of its many interrelated processes to concentrate upon.

Team Composition: Selecting the right team to produce and analyse the initial “As Is” maps is critical. Team members need to include implementers of processes. Having a member of senior management as a core member of the team increases the likelihood of the recommendation being implemented by management but carries the risk that the senior manager may not commit adequate time to the

assignment itself. When Equity decided to process map the entire institution it quickly realised this was a much more involving exercise than mapping an individual process. Establishing appropriate teams was key to success. Functional teams comprised of end users created the initial “As Is” Maps. Working teams, comprised of supervisors and managers reviewed the maps. A senior management team then developed “Could Be” maps. External consultants and experts advised on compliance and risk management.

Gathering data – what, where, how: To map a process completely it often needs to be studied from various perspectives. A range of approaches was used which included interviews with staff and customers, direct observation of processes, review of internal audit reports, reference to existing procedures and reference to job descriptions. Respondents sometimes detail processes as they believe they should operate, rather than as they actually operate. Direct observation is an essential control. The process of developing the maps is time consuming; each map can take several days to generate. So teams had to have relative freedom from existing responsibilities.

Gathering Data – Capturing Non-Process Benefits: When the process mapping team is gathering data and making observations, non-process benefits will be identified. Although capturing non-process benefits is not the core objective of process mapping, the team should document observations and make appropriate recommendations. CMF’s team improved signage, notice boards and queue management systems.

Construction of Maps: Consistency in drawing maps between team members is difficult to maintain, with variance in symbols for uncommon activities, deciding on the level of detail to analyse sub-processes, the extent and placement of text on the map, and the degree of detail in the description accompanying the map.

Analyse Maps: Once “As Is” maps have been drawn they should be carefully analysed to ensure processes operate as described; to ensure that if necessary two or more “As Is” maps are drawn to describe major variations and that risks within processes are correctly identified. At this stage, senior management involvement is essential, in the words of one respondent “it was difficult to get enough time from some senior managers, so we consistently had to fall back on the core team and did not produce the best results.” Analysis of maps should be a participatory process, while performing risk analysis inputs should be taken from those operating and supervising the process. Senior management must be involved as they have a responsibility to maintain a balance between control and functionality. Internal audit and risk managers should also be involved.

Constructing “Should Be” Maps: In some cases “Should Be” maps indicated that multiple and fundamental changes to existing processes was necessary. In this case, a graduated approach that implemented “quick wins” first was often necessary to maintain momentum behind the change process.

Testing new processes: Pilot tests enable major changes to be tested for unanticipated consequences. They provide information on the best way to implement changes and the extent to which reversion to previous procedures is likely.

In Summary: Carefully analysed process maps bring efficiency and risk management gains that to date outweigh the significant investment in time and resources required to generate the maps. Consider it now!

PROACTIVE RISK MANAGEMENT: LESSONS FOR MICROFINANCE INSTITUTIONS¹

Lynn Pikhholz and Pamela Champagne²



¹This Briefing Note was prepared on the basis of the *MicroSave* toolkit: “Institutional and Product Development Risk Analysis Toolkit” available on *MicroSave*’s website: www.MicroSave.org under Toolkits section.

²Lynn Pikhholz and Pamela Champagne are the Managing Director and Senior Team Consultant respectively for the Shorebank Advisory Services, USA, who together with *MicroSave* developed the Risk Analysis toolkit.

INTRODUCTION

The increased emphasis on risk management in microfinance institutions (MFIs) reflects a fundamental shift among managers and regulators to better anticipate risks, rather than just react to them. Under Basel II banks must meet a series of qualitative standards including, the existence of an independent risk control and audit function and effective use of risk reporting systems.³

Proactive risk management is essential to the long-term sustainability of a microfinance institution. It lays out the general framework for identifying, assessing, mitigating and monitoring risk in the MFI as a whole. A key management responsibility is to provide reasonable assurance that the MFI's business is adequately controlled, and until it has embraced risk management at an institutional level, there is very little chance that the MFI's product-level risk management strategies can succeed.

Effective risk management has several benefits:

- **Early warning system for potential problems:** Less time fixing problems means more time for production and growth;
- **Efficient use of capital:** Risk management allows management to qualitatively measure risk, fine-tune the capital adequacy ratio, and evaluate the impact of potential shocks to the financial system or institution;
- **Successful new product development and roll-out:** Systematically addressing the risks inherent in new-product development and roll-out can result in enhanced corporate reputation, improved customer loyalty, easier cross-selling of services, and better knowledge for developing future business.

Risk management is either nonexistent or a fledgling process in most organisations. Rapid growth, new market and new product introductions, and major organisational and structural changes should all trigger an institutional risk analysis. Below is a brief discussion of some risk-management lessons, based on a review of four of *MicroSave's* Action Research Partners. These institutions exemplify different institutional cultures, styles and maturity, and are facing different product development challenges.

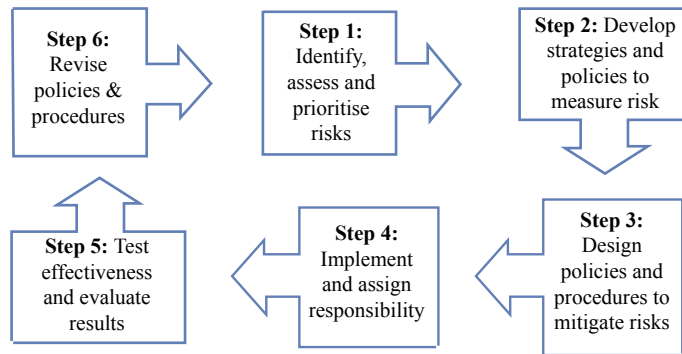
A comprehensive approach to risk management reduces the risk of loss, builds credibility in the marketplace, and creates new opportunities for growth.

Organisational Change – Organisations deal with growth, new markets, new products, and other changes in a variety of ways, including recruiting new staff, hiring consultants, using cross-functional teams and outsourcing. The Project Management Process is a useful tool to help fast growing, resource-short organisations schedule multiple tasks and projects concurrently, prioritise human resources, and manage growth. Risks are better managed when there is a clear line of responsibility to a particular individual. The project management process also helps facilitate proactive management of product or project risks.

Proactive Risk Management – Most project development teams make two timing mistakes. One is waiting until late in the project before assessing and managing risk. Late discovery of potential problems precludes solutions that would have been available earlier and is more disruptive to the schedule, because less time is available to find solutions.

The second mistake is letting risk management lapse. MFIs are often very diligent at identifying risks and building some risk management deliverables at the early stage of the project. However, as

³More information on the Basel II accord is available on the Basel Committee's website: www.bis.org



they proceed to the ‘real work’ of product development they neglect risk management. As a result, when problems occur, they are in the same position as those who never identified risks. Good project management includes explicit risk identification and mitigation tasks at every stage.

Periodic Risk Management Reviews - Periodic risk management reviews and appropriate mitigation strategies can help organisations recognise signs of stress before risks get out of control. Signs of stress, however, can also indicate the failure of risk planning and mitigation. Typical signs of stress include high dropout, default, or turnover rates; an increase in subsidised funding; a decrease in the efficiency ratio; an increase in the average cost per loan; erratic cash management; and reported lapses in security.

Special Event or Significant Change Triggers - Significant changes within the MFI should also trigger an updated institution-wide and cross-functional risk analysis. Examples of special event drivers for risk management reviews include a changed operating environment, new product lines, new or revamped information systems, and rapid growth.

Counterparty Risk - It is important to identify stakeholders and third parties’ that can have a strategic and often detrimental impact on the organisation’s business, profitability and reputation early in the process. Strategies should be developed to mitigate this risk at an institutional level.

Human Resources - Many organisations focus on either the technical aspects of the product development process or the market product drivers, ignoring human resource issues until too late. This puts extraordinary pressure on budgets and the training department. Examples of risks associated with human resource management include insufficient or mismanaged staff resources; insufficient staff skills; a flood of new hires who may bring with them incompatible and/or undesirable cultures and methodologies; and loss of key staff.

Product Development - Because much of the effort that goes into new-product development is technical and systems-driven, there is a tendency to ignore non-technical risks. The opposite is true in customer and market-led organisations, which may pay less attention to operational and systems issues. Cross-functional teams are needed to provide both soft and hard skills during development⁴. Other issues to consider include communications, information systems, training, product costing and pricing, and internal audit and controls.

⁴For more on the systematic product development process see *MicroSave’s* Briefing Note No.14 Wright, Graham A.N. “The Systematic Product Development Process” available on *MicroSave’s* website under Briefing Notes section.

Note: The risk management tools developed by the authors and *MicroSave* are evolving as we learn more from the field and as more MFIs give us feedback. The tools are particularly geared to comprehensive risk management and new product roll-out in MFIs. They can be found on *MicroSave’s* website www.MicroSave.org.

The authors welcome comments and feedback: lpikholz@aol.com; pamelachampagne@hotmail.com

GUIDELINES FOR SETTING UP A SUCCESSFUL RISK MANAGEMENT (RM) PROCESS

1. Lead from the top
2. Incorporate RM into systems design
3. Keep it simple
4. Involve all levels of staff
5. Align RM goals with individual goals
6. Address the most important risks first
7. Assign responsibilities and set monitoring schedule
8. Design informative management reporting to board
9. Develop effective mechanisms to evaluate internal controls
10. Manage risk continuously using a risk management feedback loop

CONCLUSION

The key to fulfilling the responsibility of providing reasonable assurance to stakeholders that the MFI's business is adequately controlled is the development of a comprehensive system of management controls, accounting and internal controls, security procedures, and other risk controls. MFIs committed to proactively managing risks need to establish a risk control structure which defines the roles and responsibilities of managers and board members with respect to managing risk.

THE ART AND SCIENCE OF PRICING FINANCIAL SERVICES¹

David Cracknell and Hermann Messan



¹ This Briefing Note is based on a paper of the same name which can be downloaded from the *MicroSave* website www.MicroSave.org.

PRICING AND THE CONSUMER

Participants in focus group discussions frequently raise concerns related to pricing. However, often accessibility and security of the service is more highly regarded particularly in relation to savings products. This is not a surprise when considering the high cost of participation and risk of loss involved in informal financial mechanisms.

WHY ARE PRICES DIFFICULT TO UNDERSTAND?

Consumers typically find it difficult to compare financial services, as they are intangible. Seemingly similar savings accounts can have different fees for deposits, withdrawals, transfers and other features. Loan interest can be charged flat or declining balance, with variable application and monitoring fees.

HOW TO PRICE: COST, COMPETITION AND VALUE

Marketing textbooks abound with pricing theories and strategies. Pricing theories include penetration pricing to penetrate a market or loss leaders, to secure lifetime business of the customer (for example a children's savings account) or skim pricing to capture a small market at a high price. Theories aside pricing is in essence very simple, and can be reduced in most cases to three core concepts, cost, competition and value.

Cost: Cost plus pricing, one of the simplest pricing methods adds the desired margin onto the base cost. The base cost can be obtained through product costing. There are two principle methods of product costing the simpler, but more subjective allocation based costing and the more complex but authoritative Activity Based Costing.

Competition: Competition in the context of pricing are the range of prices being charged by competing institutions on similar products and services. It is the most common pricing method within *MicroSave's* Action Research Partners. So for example, when Teba Bank priced its Grow With Us Savings, it compared itself with six competitors on the basis of 23 different fees and charges. This type of analysis can be especially useful when establishing on which services to promote heavily. So for example, Equity Bank in Kenya chose to make their Banker's Cheques significantly cheaper than the market and to use this to strengthen their image in their target market.

Value: The third element of the pricing strategy is to establish whether the product or service has any additional value to the customer that can justify premium pricing. How is this done? On one level it is quite simple, it involves comparing competing services across the 8 P's of financial marketing – that is, product design, price, process, place, promotion, physical evidence, people and positioning. The competition matrix is completed using mystery shopping, local knowledge of competitors and through focus group discussions with customers.

TRANSPARENCY

From a customer perspective one of the most important aspects of pricing is the degree of transparency of the products fee structure. As Wright and Rippey note in “The Competitive Environment in Uganda Synthesis”

“The qualitative studies help us understand that clients are more likely to be unable than unwilling to “shop around”. It is the transparency or communication of pricing (or rather the lack of it) that prevents clients from differentiating between suppliers”.

Transparency can improve business. When Equity Bank in Kenya rationalised their fee structure in 2002 and published a tariff list, the number of new accounts increased dramatically. Various techniques can be used to improve transparency. These include, tariff guides and brochures, schedules of payments, frequently asked question guides and simplification of fee structures.

Key to improving transparency is to ensure staff members know their products and services well, so that they can explain them effectively. This becomes particularly important when explaining pricing on complex products such as contractual savings schemes.

REGULATION AND TRANSPARENCY

Regulators often attempt to ensure transparency in pricing through truth in lending laws, or policies that promote the publication of fees and charges, or effective interest rates. Effective interest rate calculations take into account all cash flows around a loan. These include, the initial disbursement of the loan, the repayment instalments and any compulsory deposits, monitoring fees and commissions. Note that even effective interest rate calculations have methodological problems in that they have to compare loans with similar amounts and loan terms. When *MicroSave* compared effective interest rates on micro-leases it found effective interest rates of between 34% and 124%.

MISDIRECTION

Compounding the difficulty of pricing transparently, are the messages given out by staff of financial institutions on the products of competitors. Often these messages are highly selective. Misdirection appears to be a common practice, examples include:

- Quoting flat rate interest without specifying the basis of calculation to appear cheaper than loans charged on a declining balance;
- Using confusing terminology to describe the basis of calculation;
- Having additional fees and charges and then in promotions choosing to disclose only partial information.

PRICING SAVINGS

People have different motivations to save, for transactions, for precautions and to speculate. Products fees and charges often reflect these motivations. For example:

Transaction motive: Transaction based accounts, like current accounts return small amounts of interest and often have transaction based fees.

Precautionary motive: Contractual savings account paying higher rates of interest than ordinary savings accounts, allowing instant access on payment of a penalty.

Qualitative research throughout East Africa has indicated that low-income people prefer to be charged for the financial services they initiate rather than to be charged a ledger fee.

TRANSFORMING MFIs AND PRICING SAVINGS

Microfinance institutions that become licensed to accept deposits face multiple challenges. They need to convince customers to trust them. Part of the solution is to portray the right image and to create an appropriate infrastructure, but another challenge is to price their new savings products appropriately. One solution often adopted by Non Bank Finance Companies is to premium price their savings products and offer a higher than normal return for deposits.

PRICING LOANS

Many factors should be considered when pricing loans, in addition to cost and competition, for example, differential pricing to price for risk or to reward good customers.

Flat or declining: There can be strong institutional or client preferences for calculating interest rates on a flat or declining balance method. A flat rate is considered transparent and easy to understand because it charges the same amount of interest every period. The declining balance method is usually considered fairer because it charges interest on the loan amount outstanding.

“Customers in our market have become quite sophisticated and flat rates regardless of the actual rate being charged are perceived as being expensive and unfair.”

Ugandan MFI leader

Pricing for risk: Loans are priced for risk, this means that salary based loans are less expensive than loans secured on the basis of collateral substitutes or cash flow assessments. Some institutions reward regular customers who have repaid loans successfully, either through reduced interest rates, or through the cancellation or reduction of future appraisal or monitoring fees.

PRICING ELECTRONIC BANKING

Pricing electronic banking products is challenging due to a range of overlapping factors, which include the difficulty in setting realistic assumptions, the absence of benchmark prices and the need to move to a volume rather than a value based pricing model.

BUILDING CAPACITY TO PERFORM PRICING

Based on the cost, competition, value based pricing method. It is possible to define a core set of competencies required to perform pricing within a financial institution.

To understand costs and the impact of different pricing models:

- Detailed knowledge of the management accounts of the institution and an ability to perform allocation and/or activity based costing;
- Technical knowledge on the calculation of interest rates, and an ability to perform financial modelling.

To understand the pricing charged by competition and to research the perceived value of particular services:

- Skills in qualitative market research, to produce a competition matrix, to research customer preferences on pricing and to ascertain how best to explain prices to customers.

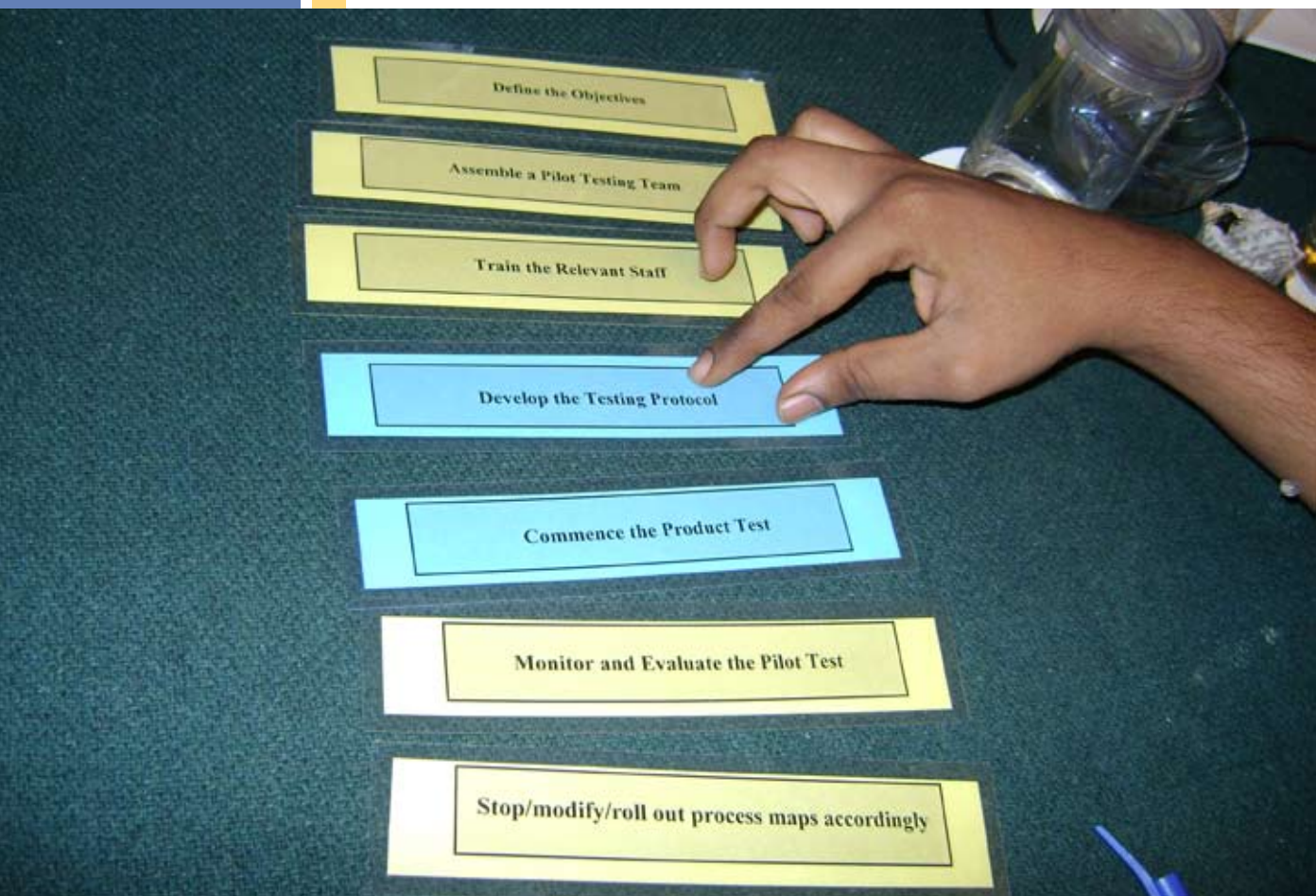
To communicate prices transparently:

- Communication and marketing skills to produce price related communication materials.

These core competencies are unlikely to be found within a single line-function or department. Pricing is therefore, a collaborative effort, largely between finance and marketing, senior management and the Board of Directors.

LESSONS FROM PILOT TESTING FINANCIAL SERVICES – THE EXPERIENCE OF *MicroSave*¹

David Cracknell, Henry Sempangi,
Graham A.N. Wright, Peter Mukwana and Michael J. McCord



¹This Briefing Note was developed from a full paper by the same name available on www.MicroSave.org under *MicroSave* Action Research Programme

INTRODUCTION

This Briefing Note presents key lessons learned from *MicroSave*'s work with its Action Research Partners (ARPs) on pilot testing new financial services. The lessons derived from their successes and failures offer the opportunity for other institutions to benefit from a wealth of product development experience².

SUCCESSFUL PRODUCT DEVELOPMENT

Pilot testing new products has revealed that the following factors underlie successful product development:

- Detailed understanding of customer needs
- Well-defined products that meet those needs
- Focus on the value of the product to the customer
- Total commitment to the product from management and staff
- Developing and retaining a wide range of skill-sets amongst staff
- Time from often over-committed staff
- Financial resources for research and monitoring
- Leadership and coordination
- Internal marketing and clear and consistent communication

RISK ANALYSIS AND MANAGEMENT

Proactive risk analysis and management is essential before, during and when assessing the pilot test. Risks faced during pilot testing are more often operational risks rather than classic banking risks. Risk management appears to be most effective when the risk management function is centralised. A failure to manage risk tends to increase the length of the pilot test as risks that could have been averted materialise.

The pilot testing process as defined by *MicroSave* has ten distinct steps. The following summary presents key lessons learned at each step.

Step 1 - Composing the Pilot Test Team: Success at this stage requires firm leadership. Unless a senior manager who has access to human, physical and financial resources leads the team, decisions take longer to make and resources are difficult to obtain. Managing time demands on the team is extremely challenging. The problem is particularly acute in the case of experienced staff whose skills are in great demand elsewhere in the organisation. Lastly, teams that fail to meet fail to act.

Step 2 - Developing the Testing Protocol: The pilot test protocol at its simplest is a list of tasks to be performed, by whom, in what time frame and at what cost. The length of the pilot test is critically affected by the quality and coordination of preparations during the development phase. Potential causes of delays include failure of internal marketing, problems in system development, inexperienced staff, resource constraints, insufficient leadership, and the departure of key staff.

Step 3 - Defining the Objectives: Most Action Research Partners have found defining pilot test objectives difficult. Whilst it is common to set profitability and growth targets, few institutions set targets in relation to customer efficiency, value for the customer's time, or customer satisfaction.

²*MicroSave* has produced two toolkits to assist Microfinance institutions to pilot test new products. "Planning, Conducting and Monitoring Pilot-tests for Microfinance Institutions - Savings Products", and "Planning, Conducting and Monitoring Pilot-tests for Microfinance Institutions – Loan Products". These toolkits can be downloaded from *MicroSave*'s website www.MicroSave.org

Even fewer institutions set targets for the effectiveness of the marketing effort – even though effective marketing can significantly increase sales.

Step 4 - Preparing All Systems: Challenges related to information systems frequently delay the implementation of a new product. Firstly, to reduce delays, ensure that the chosen IT solution is flexible – this will enable the product features to change as the pilot test moves forward. Secondly, ensure the availability of local or regional IT support. Thirdly, test the set up of the master record for the new product at the beginning of the preparatory phase to ensure that the system can accommodate the product. Fourthly, consider reporting requirements carefully.

Step 5 - Modelling the Financial Projections: Developing financial projections sometimes proves difficult. Reasons for this include insufficient skills in financial modelling and use of spreadsheets, and the lack of critical information on which to build the projection³. Once the projection is constructed it is essential to revise the assumptions underlying the projection in line with actual experience as the pilot test progresses.

Step 6 - Documenting the Product Definitions and Procedures: Most Action Research Partners need to strengthen the documentation of their procedures. This is particularly important for institutions moving from manual to computerised systems. Two factors can improve the quality of the procedures developed: the formal approval of manuals by the Board; and the use of flow charts or process maps to document procedures.

Step 7 - Training the Relevant Staff: Sufficient and quality training is critical to the success of the pilot test. Staff need to be trained on the features of the new product, its processes and procedures, in customer service and in marketing. However, despite the importance of staff training it is usually given a low priority and where it occurs, the effectiveness of the training is rarely monitored.

Step 8 - Marketing: Product marketing should be perfected during the pilot test. Success factors include the effectiveness of internal marketing; the level of pre-existing marketing competencies within the ARP; adequate marketing plans and budgets; and the degree of focus on customer service. During the test, the effectiveness of marketing should be closely monitored⁴.

Beyond product marketing, developing new products represents an opportunity for financial institutions to improve their corporate image, through coordinating related improvements around branch infrastructure, customer communications and customer service.

Step 9 - Commencing the Product Test: Before commencing pilot tests it is important to review the adequacy of the preparations for the test.

Step 10 - Evaluating the Test: Just as pilot testing was a new activity for most Action Research Partners, so was monitoring and evaluating the pilot test. Factors that influence the quality of monitoring include: the monitoring budget, the experience of the monitor, the tools used and the familiarity of the monitor with the product. The monitor should also have the ability to interpret the results of the pilot test and to ensure action is taken against agreed recommendations. To improve monitoring *MicroSave* has developed a series of easy to use monitoring tools. These are included in the “Planning, Conducting and Monitoring Pilot tests for Microfinance Institutions” toolkit.

³ *MicroSave*'s “Planning, Conducting and Monitoring Pilot-tests for Microfinance Institutions” toolkits include simple projection spreadsheets that can be used to assist in this process.

⁴ *MicroSave*'s “Product Marketing Strategy” toolkit provides a useful basis for much of this work and is available on the website under Toolkits.

Evaluation of pilot tests is built on regular monitoring and adjustments throughout the pilot test period. It is the culmination of a process of development rather than an isolated activity. However, given the time and effort invested in a pilot test, it is often difficult for the pilot test team to be fully objective in their evaluation. A possible solution is to have an external reviewer as part of the evaluation team.

FREQUENTLY ASKED QUESTIONS

Three frequently asked questions on pilot testing include:

What impact has pilot testing had on the Action Research Partners?

Pilot testing has encouraged the development of key competencies. To develop new products ARPs have developed skills in market research, marketing, financial analysis, customer service, communication and risk assessment.

The most promising change is that ARPs have become more customer-centric. This is evidenced by increased customer-focused research, new customer service points, improved customer communications and refurbished branches. Such changes have significantly improved the corporate image of ARPs and along with product development and refinement resulted in rapid growth.

Should we always pilot test new products?

Generally new products should always be pilot tested. However, there are occasions when institutions can consider developing products without pilot testing. These are:

- Where the new product is a basic refinement of an existing product;
- Where specific technical expertise is purchased to manage the product; and
- Where the product itself is low-risk.

Does pilot testing reduce costs?

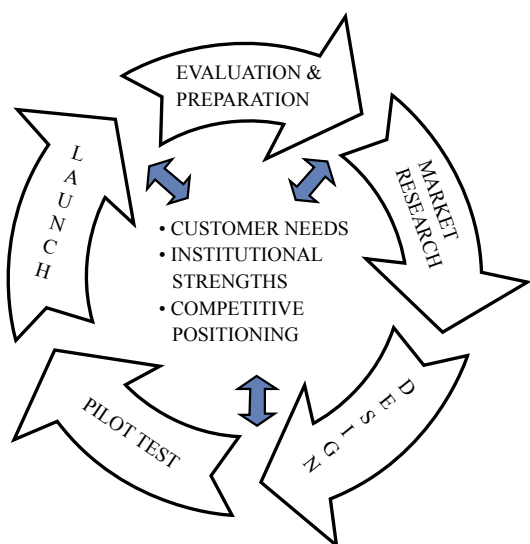
In all of its ARPs, (and many other MFIs) *MicroSave* has seen that pilot testing significantly reduces the cost of making mistakes.

COSTS AND BENEFITS OF PILOT TESTING FOR PRODUCT DEVELOPMENT

Cheryl Frankiewicz (Summarised by Corrinne Ngurukie)



SYSTEMATIC PRODUCT DEVELOPMENT PROCESS



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 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 (See box in page no. 63) 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.

¹The 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.org

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.

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

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.

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.org

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:
 - o Contains costs by minimising the time that it takes to identify and respond to problems
 - o Monitoring is more intense and reaction time even faster than during roll out
 - o 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;

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!”

- 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.”***

DEVELOPING CASH FLOW BASED INDIVIDUAL BUSINESS LOANS

The Experience of Equity Bank with Biashara Imara
Trevor Mugwang'a



Through its Action Research Programme, *MicroSave* learns and disseminates lessons relating to market-led microfinance. This Briefing Note highlights key lessons from the experience of its partner Equity Bank, in designing, testing and rolling out a cash flow based individual business loan product.

WHY CASH FLOW BASED LENDING?

By 2003 Equity, then a Building Society, was undergoing rapid growth in its asset base and client numbers, as a result of adopting an increasingly market-led approach to serving its customers. Its suite of credit products consisted of salary based consumer loans, a business loan product secured by legally perfectible collateral and agricultural loan products developed for the tea and coffee sectors.

The decision to venture into cash flow based micro credit was driven by a realisation that there was a substantial, and largely unmet, demand for this type of product. Equity wanted to grow business by attracting a new type of loan client: one who did not have access to large amounts of traditional collateral. This product would have other benefits too as it would further diversify credit risk. Furthermore, due to higher market rates for cash flow based loan products, it offered the potential for better returns on credit investment ... as long as costs and risks could be controlled.

HISTORY OF INITIAL PILOT TEST

Equity ran an initial pilot test of its *Biashara Imara* (literally translated as “stable business”) product in 2003. However, the pilot test floundered despite repeated extensions. This was due to the following:

Pilot Test Structure: Unfortunately some problems were “designed in” to the structure of the pilot test. The relatively long distance of the pilot branch from Head Office compromised Equity Bank’s ability to actively monitor and address issues around the pilot test. In addition, credit officers assigned to the product were already administering other credit products.

Competing Priorities and the Challenges of Growth: The *Biashara Imara* pilot test reflected challenges within Equity, which was growing very rapidly. These included: insufficient capacity in credit administration at Head Office to support pilot branch staff in addressing problems and refining the product; and an MIS system that was insufficiently customised for the new product. Worse, there was frequent rotation of branch staff and management to other branches to respond to demands fueled by rapid growth in the branch network. In this environment, the product continually competed for resources and the attention of branch management and staff.

Product Operation: During the development phase, Credit Officers failed to screen out unsuitable applicants early in the application process, resulting in high costs of loan processing and field visits. Client experience was inconsistent with different communication of product features - such as eligibility requirements and repayment periods and delays in processing loans.

Missed portfolio growth and quality targets compromised refinement of the product and necessitated extensions to the pilot test, followed ultimately by the decision to cease the pilot and start a new one at a different branch.

REVISED AND SUCCESSFUL PILOT TEST

Learning from its earlier experience Equity established a micro credit unit within its credit department and mandated it to oversee a new pilot at a branch nearer to Head Office.

The pilot team reviewed results of the earlier pilot and decided to refine the product features. Top of the list were the loan amount and term, which were restructured to ensure their appropriateness for different types of businesses. This avoided straining borrowers' business cash flows and stemmed the tendency of customers to seek multiple funding with other MFIs. Continuous client feedback was essential in achieving an appropriate balance for different types of businesses.

The pilot team and pilot branch staff interactively and objectively assessed the extent to which inadequate differentiation between Biashara Imara and other products resulted in client confusion and inadvertent take up of an inappropriate product. Typical problems with differentiation revolved around overlapping loan amounts and collateral requirements as well as inconsistent loan durations, and different processing procedures.

Close monitoring resulted in a number of positive changes:

Policies: An appropriate policy for early payoff of loans was determined to check the tendency for clients to payoff loans in order to qualify for bigger loans often leading to increased default.

Procedure Manuals: These were developed for integral processes and activities including business appraisal where there are few formal accounting records, carrying out chattels assessment, documentation, the conduct of branch credit committees in mitigating the risks of bad loans, default and fraud, and the management of arrears.

Pricing: Refining the product's pricing entailed balancing the need for cost recovery and profitability, with the need for simplicity and clarity within the pricing structure through avoiding multiple charges. In particular, clients resented indirect costs such as those of third parties for perfecting certain securities. There was the additional need to incentivise good client performance, for example through interest rebates for on time payments, and penalties for arrears.

Staff Training: The implementation team developed and continuously refined a detailed class- and field-based training program on loan appraisal, monitoring and delinquency management. This was accompanied by a cessation of rotation of officers from other products to cash flow based loans products without appropriate training, an activity that had been determined to result in portfolio quality deterioration in the initial test.

Remuneration of Biashara Officers: The team and the bank as a whole came to terms with the need for careful structuring of remuneration for Biashara Imara loan officers in relation to credit officers' handling other credit products. Administering individual business loans is considerably more labour intensive than issuing salary loans, especially with regard to client appraisal, loan monitoring and default management, all underpinned by ability to make prudent judgments and substantial field based work.

CURRENT PERFORMANCE

Biashara Imara continues to rollout and extend, taking its place as one of Equity Banks' valued products. *Biashara Imara* reaches a segment of customers that might otherwise go un-served by the bank. Within a year of rollout the portfolio had reached more than 25,000 outstanding loans totaling \$8 million.

During the pilot, most of *Biashara Imara* clients got to know about the product and apply for it through positive word-of-mouth, a trend that has sustained in rollout. Equity recognised this and has continued to strengthen cross selling of *Biashara Imara* and other products to existing and potential clients through

credit officers and current clients who interact with potential clients, guarantors, referees, suppliers, customers' community leaders and others away from the branch.

KEY LESSONS IN PILOT TESTING

So what can we learn from this experience?

Follow a well structured process: When introducing an individual cash flow based business loan a structured process to develop a pilot prototype is needed. Then, it should be subjected to a well planned, controlled and monitored pilot test. It is necessary to have clear targets and a process to evaluate the product along the way culminating in an objective extension, rollout or cessation decision.

Conduct Design Research: To minimise costly product redesign, conduct research to develop and test the concept in order to produce a prototype with distinct and differentiated features that meet client needs.

Ensure Capacity and Support: Address capacity at Head Office by considering oversight, abilities and structure. Through this analysis, build a cross functional and proactive product development team to oversee the whole pilot test. The team helps to ensure that project timelines and standards set in the pilot test are met. At branch level, ensure capacity by having staff trained appropriately and dedicated to the product. Cultivate branch management buy-in and support, which should ensure that necessary operational resources (e.g. logistics for desk and field activities of credit officers and supervisors) are provided.

MIS: The MIS should fully accommodate product features. It should have the capability to produce reports for productivity and trend analysis in addition to accurately reporting arrears to facilitate timely corrective action where necessary.

Procedures: Develop effective and efficient product procedures with accompanying operational manuals to guide staff administering and training on the product.

Careful monitoring: Conduct monitoring with accompanying documentation of test issues to identify how to refine the product as well as strategic decisions (cessation, extension or roll out) on the test as a whole. Obtain regular client feedback in a structured way and ensure this feedback is included in pilot test reporting.

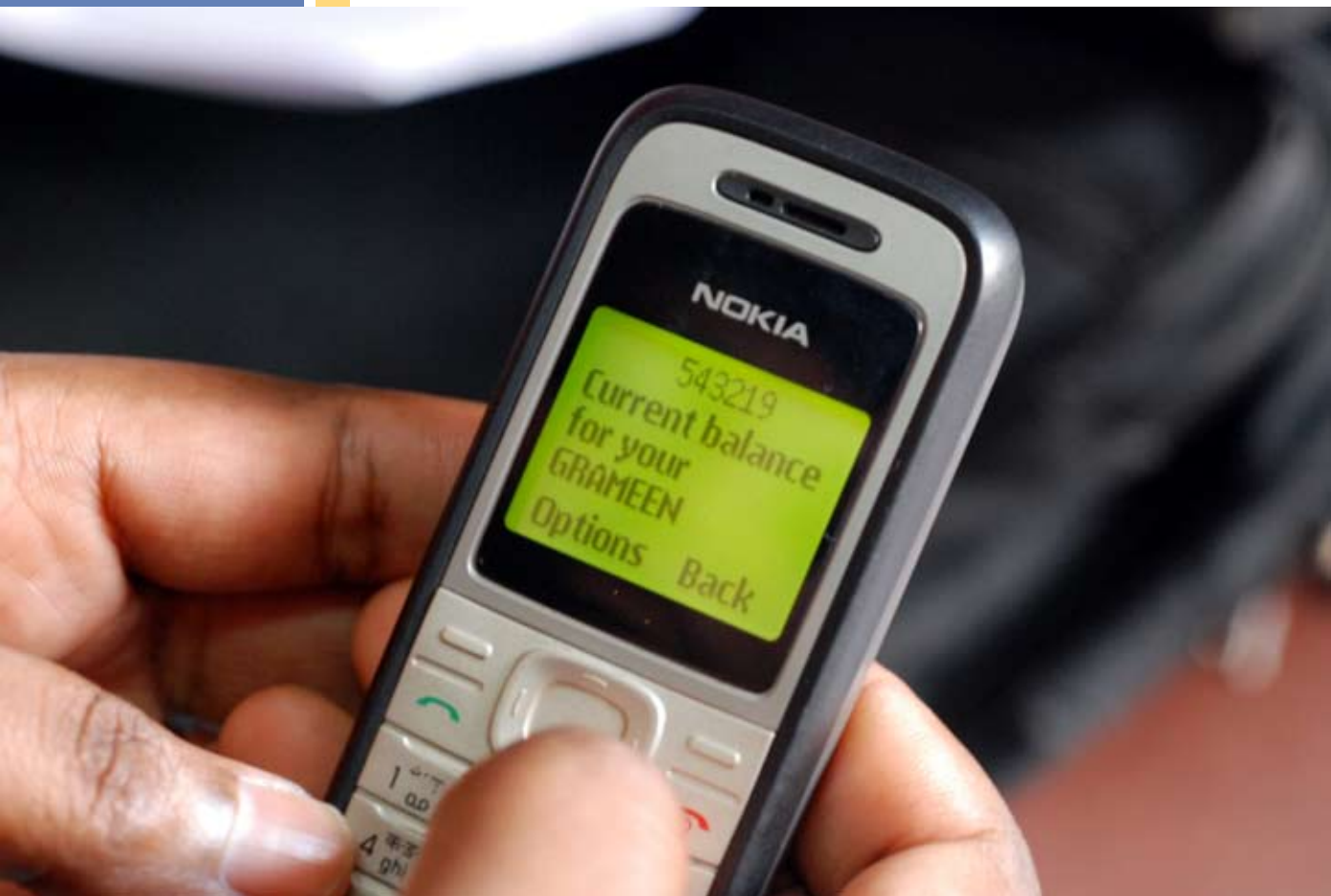
Scale: Ensure that the scale of the test is adequate to reveal any deficiencies in the product's design and processes. Training adequate numbers of new frontline staff and over an adequate period will facilitate eventual roll out.

MANAGING RISKS IN CASH FLOW BASED LENDING

A comprehensive and effective institutional credit risk management framework, complemented by an effective new product development risk management methodology, is essential in minimising loan default and consequently the need to resort to loan recovery through collection of collateral. The scope for realisation of unregistered collateral through legal enforcement and sale for this type of product is usually limited and rarely economical. It is more beneficial to place emphasis on well thought through product features, a solid appraisal system, effective client monitoring and client incentivisation for on time payment, all of which should be developed through careful research with potential clients and perfected through pilot testing.

PILOT AND ROLLOUT ISSUES FOR MOBILE PHONE BANKING SERVICES

John Owens



During a CGAP-*MicroSave* workshop on mobile phone banking services held in Nepal in August 2008, participants shared the challenges in pilot testing and rolling out mobile phone banking services. They noted that during the pilot test, a number of factors have to be taken into account including: institutional issues; regulatory and compliance issues; monitoring and feedback from customers and merchants during pilot test and rollout; partnership support and coordination.

INSTITUTIONAL ISSUES

Frontline Staff: Introducing mobile financial services usually requires quite a bit of training for existing staff especially in small banks or MFIs where multi-tasking is often the norm. Many institutions also initiated their mobile phone banking services by getting their own employees to pilot test the new service and provide feedback. Several rural banks in the Philippines actually decided to require all of their staff to accept their salary and/or allowances via the banks' new mobile payroll service that used the GCASH platform and allowed the bank to test all cash-in and cash-out services. This effectively served to ensure staff members were properly trained in all front line procedures, as well as become accustomed to using mobile money and thus could effectively promote the services to others.

In addition, staff members can be an important resource for pilot testing, especially where there are large numbers of staff that can provide feedback to the institution. Equity Bank's pilot lasted many weeks and staff raised several issues that needed to be addressed over a longer pilot testing period.¹

In addition, specialised marketing staff may be required, especially in the early stages of offering the new service, in order to promote and educate clients about how to register and use of mobile phone banking services. These may be contractual agents, as in the case of WIZZIT, which hired and trained specialised "Wizz Kids", focused on recruiting and promoting the mobile phone banking services offered by the bank.

Marketing and Call Centres: As mobile phone banking services move from a pilot test to rollout stage, the marketing and publicity strategy needs to be properly planned out. Aligning closely with Mobile Network Operators (MNOs) can offer unique mass marketing opportunities that financial institutions would be unable to achieve on their own (i.e. MTN Banking and SMART Money).

Also, institutions will need to either set up a call centre, or coordinate with an existing service, to ensure that customers' and merchants' questions can be properly dealt with and handled. In the case of the Philippines, rural banks using the GCASH platform were able to effectively coordinate and use Globe's own GCASH call centre to answer basic questions about some of the services being offered by the bank. In addition, a website was set up so that bank frontline staff could easily go online to access up-to-date information on frequently asked questions.

Back Office: Institutions must also develop appropriate operations and procedures manuals that document each and every step of the mobile phone banking process. These procedures should be carefully tested during the pilot test and then modified before the rollout. Careful checklists and step-by-step flow charts for each and every product or service are useful to ensure that the new procedures are easily understood by new and existing staff.

¹CGAP-*MicroSave* M-banking Dialogue Deliberations, September 2008.

Systems Development: In almost all cases, institutions will require some amount of strengthening of their back office systems. This is especially the case for larger banks where mobile phone banking services are directly linked into the back-end systems of the institution (as is the case in Equity Bank, XAC Bank, Tameer Bank²). However, it should be noted that as the use of mobile money expands in several countries as a payment option, smaller banks and MFIs may find that they only need to prepare simple procedures and accounting entries to make use of mobile money for loan disbursements, payments or micro remittances.

REGULATORY COMPLIANCE ISSUES

The Basel Risk Management Principles for Electronic Banking also apply to mobile phone banking services and should be understood by small financial institutions planning to offer these services to their clients³.

In the Philippines, the Central Bank (Bangko Sentral ng Pilipinas (BSP)) issued their own guidelines for electronic banking - circulars 240 & 269 (2000), which are a useful resource and guideline for other countries and institutions to follow. In 2006, the BSP went a step further with the issuance of circular 542 that focussed on consumer protection issues. The BSP also set up a specialised department, the Core Information Technology Supervisory Group that focussed on reviewing electronic banking applications. The close working relationship that this group established with MNOs as well as financial institutions is an exemplary model for other regulators dealing with a similar issue in their countries⁴. A case in point, was the approach taken by Rural Bankers Association of the Philippines (RBAP), which was able to assist rural banks with speeding up the application process since the BSP was able to review and approve standardised e-banking procedures for rural banks that had been developed with the support of RBAP and its USAID-supported Microenterprise Access to Banking Services (MABS) program. Once standardised operating procedures were reviewed and approved, the BSP was able to quickly review and approve over 45 separate rural bank applications for mobile phone banking services using the GCASH platform.

PILOT TESTING AND MONITORING

Proper pilot testing includes an initial beta test or user acceptance test phase as well as field-testing the product with staff, clients, and merchants (especially when agent-merchants are utilised) to monitor their response and behaviour; assess how the system performs in different locations; test the validity of third party business cases; and test the entire support and procedures from the frontline staff to the back office operations.

During the pilot testing of mobile phone banking services in the Philippines, it became apparent that the distribution network of cash-in/cash-out agents to facilitate easier access to mobile money needed to be approached differently. The initial strategy of focusing on airtime top-up agents was not a viable due to much higher commissions associated with loading airtime, so the banks shifted to encouraging their own client base to promote cash-in and cash-out services that was made possible by adding the Text-A-Deposit and Text-A-Withdrawal services whereby larger merchants could easily deposit or withdraw mobile money remotely from their bank accounts making access to GCASH much easier. In another pilot test of using M-PESA for microfinance loan payments, a local MFI, Faulu, quickly discovered that the system was not appropriate for group-based lending systems.

²Mas, Ignacio and Kabir Kumar, *Banking on Mobiles, Why, How, For Whom?*, CGCAP Focus Note 48, June 2008

³Bank for International Settlement (2003)

⁴Philippine Regulatory Approach provides exemplary m-banking model, Nokia Expanding Horizons, Q1 2008

One commonly reported challenge for pilot-tests and rollouts of mobile phone-based systems is that after the beta-test, if the system is successful, it is very difficult to keep the number of subscribers low and thus run a neatly controlled test. Several m-banking systems that have met a real market need, report being overwhelmed in a variety of manners (IT systems, call centre management, agent/liquidity management etc) as the product takes off and is accepted. Thus service providers often find themselves struggling to keep up with, and respond to, the changing needs and emerging challenges presented by the burgeoning business. Telenor reached up to two million customers in the weeks after the launch of their new service. Given the difficulty in stress testing systems, it is extremely important to ensure systems can handle considerably more demand than is anticipated⁵.

PARTNERSHIP SUPPORT AND COORDINATION

Except for larger banks, creating greater access to financial services via a mobile phone will require a partnership approach to achieve economies of scale. This means that smaller banks and MFIs will need to coordinate with MNOs, banks, merchants and others. Support from specialised third-party service providers (for example Eko) or networks (MABS, PlaNet Finance, *MicroSave*, ACCION) can assist member banks, credit cooperatives, or MFIs to develop proper standards and procedures that make developing, pilot testing, and rolling out mobile financial services much easier than would be possible if they attempted to develop a similar service on their own. In negotiating with MNOs, small individual banks or MFIs generally need to consider sharing a mobile payment platform and establish a single negotiation with the operator(s)⁶. The pilot test phase also offers an opportunity to test partnerships, this was especially the case between MNOs and MFIs such as Globe-RBAP-MABS-Rural Banks, M-PAISA-First Microfinance Bank, and M-PESA-Faulu and third-party agents such as Eko India. The pilot test phase also allows all parties to analyse the business case for each partner to ensure that each is benefiting from the partnership.

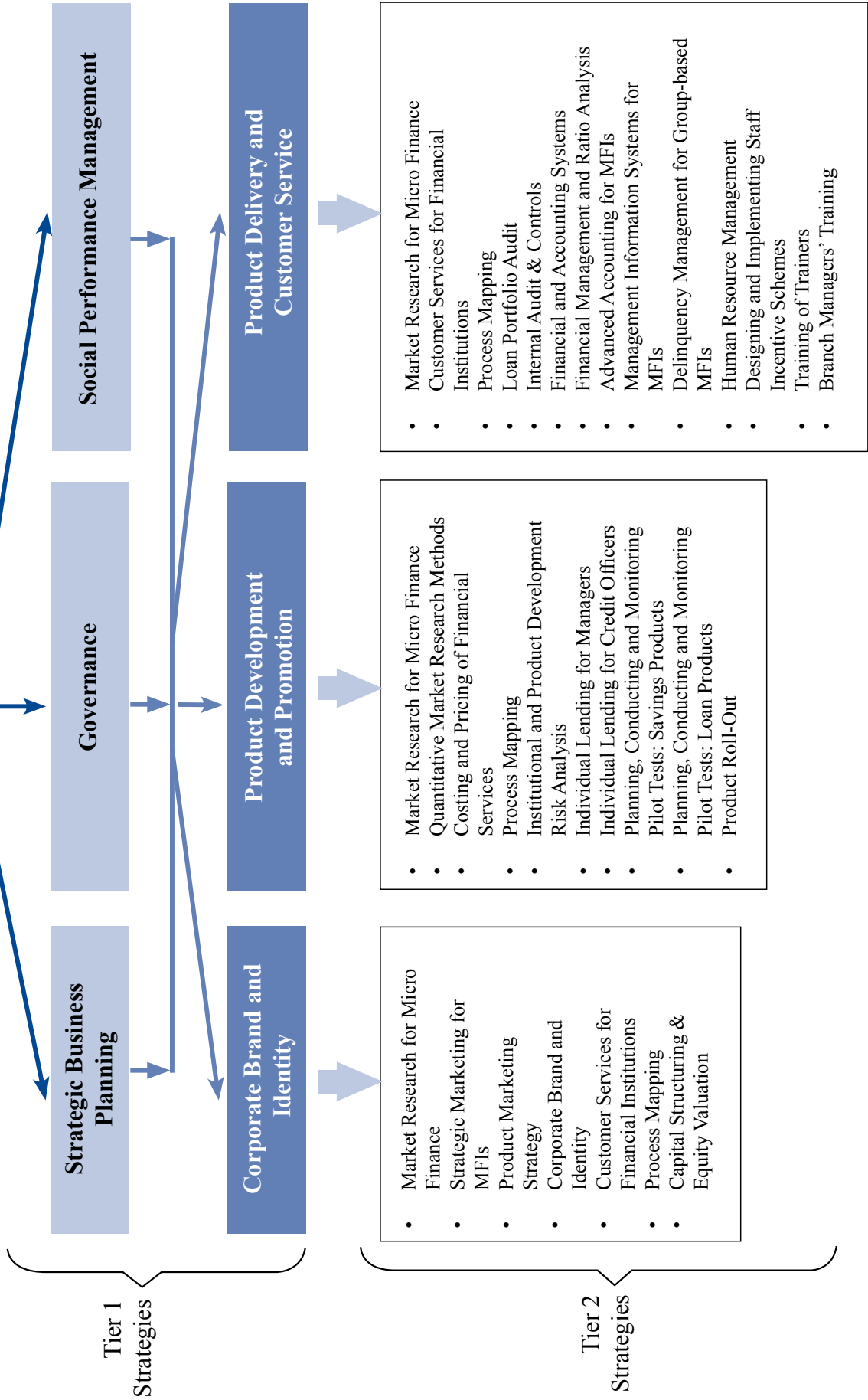
IN CONCLUSION

The experience to date is that traditional pilot testing and incremental entry for mobile phone banking services is difficult and quite unique from testing and rolling out other financial services and products due to the newness of the technology, new partner relationships, and regulatory challenges. Institutional issues include significant training for frontline and back office staff. New technologies also require changes in systems and procedures. Regulatory compliance issues must also be addressed and it is important to get the regulators on board early. Pilot testing mobile phone banking applications can also be challenging due to the potential for exponential uptake which may make controlled pilot tests more difficult so most institutions at least start with their staff and selected clients in the beginning. Testing partner relationships whether they are between banks, MFIs, MNOs, or third party service providers, or combinations of all four, are important. Smaller MFIs will most likely need to group together or work through networks in order to offer mobile phone banking solutions.

⁵ CGAP-*MicroSave* M-banking Dialogue Deliberations, September 2008.

⁶ Mas, Ignacio and Kabir Kumar, Banking on Mobiles, Why, How, For Whom?, CGCAP Focus Note 48, June 2008

INSTITUTIONAL DEVELOPMENT



Tier 1 Strategies

Tier 2 Strategies

- Market Research for Micro Finance
- Strategic Marketing for MFIs
- Product Marketing
- Corporate Brand and Identity
- Customer Services for Financial Institutions
- Process Mapping
- Capital Structuring & Equity Valuation

- Market Research for Micro Finance
- Quantitative Market Research Methods
- Costing and Pricing of Financial Services
- Process Mapping
- Institutional and Product Development
- Risk Analysis
- Individual Lending for Managers
- Individual Lending for Credit Officers
- Planning, Conducting and Monitoring
- Pilot Tests: Savings Products
- Planning, Conducting and Monitoring
- Pilot Tests: Loan Products
- Product Roll-Out

- Market Research for Micro Finance
- Customer Services for Financial Institutions
- Process Mapping
- Loan Portfolio Audit
- Internal Audit & Controls
- Financial and Accounting Systems
- Financial Management and Ratio Analysis
- Advanced Accounting for MFIs
- Management Information Systems for MFIs
- Delinquency Management for Group-based MFIs
- Human Resource Management
- Designing and Implementing Staff Incentive Schemes
- Training of Trainers
- Branch Managers' Training

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