Small Finance Banks: What Can We Learn From International Experience?

MicroSave
Market-led solutions for financial services

Introduction

The creation of Small Finance Banks by the Reserve Bank of India promises to offer a range of exciting opportunities, as well as some challenges, for the provisional licensees. Many of these are discussed in this collection of *MicroSave*'s Briefing Notes and blogs, which provide deep insights into options from across the globe around strategy, operations, product development and agent network development/management. These short articles are based on years of on-the-ground research and technical assistance dedicated to developing sound business models and operations to underpin profitable approaches to serving the mass market, thus advancing financial inclusion.

What Does *MicroSave* Do?

MicroSave partners with participants in financial services ecosystems to achieve sustainable performance improvements and unlock enduring value.

We are an international financial inclusion consulting firm with nearly 20 years of experience, operating in nine offices across Asia and Africa.

Our mission is to strengthen the capacity of institutions to deliver market-led, scalable financial services to all people through guiding policy & facilitating partnerships to develop enabling eco-systems; comprehensive, customised strategic advice; and actionable, on-site operational assistance. We have worked to design and implement a variety of financial inclusion models.

The *MicroSave* Team

We are a team of over 175 professionals who have strategic and technical skills honed through years of working with companies across various sectors to identify, understand and respond to the needs of the mass market. In the words of our clients, *"We are the world's local expert in financial inclusion"*.

More insights from India and across the globe can be found on our **websites:** www.*MicroSave*.net and www.helix-institute.com.

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Strategy

Financial Services That Poor People Want

Graham A.N. Wright

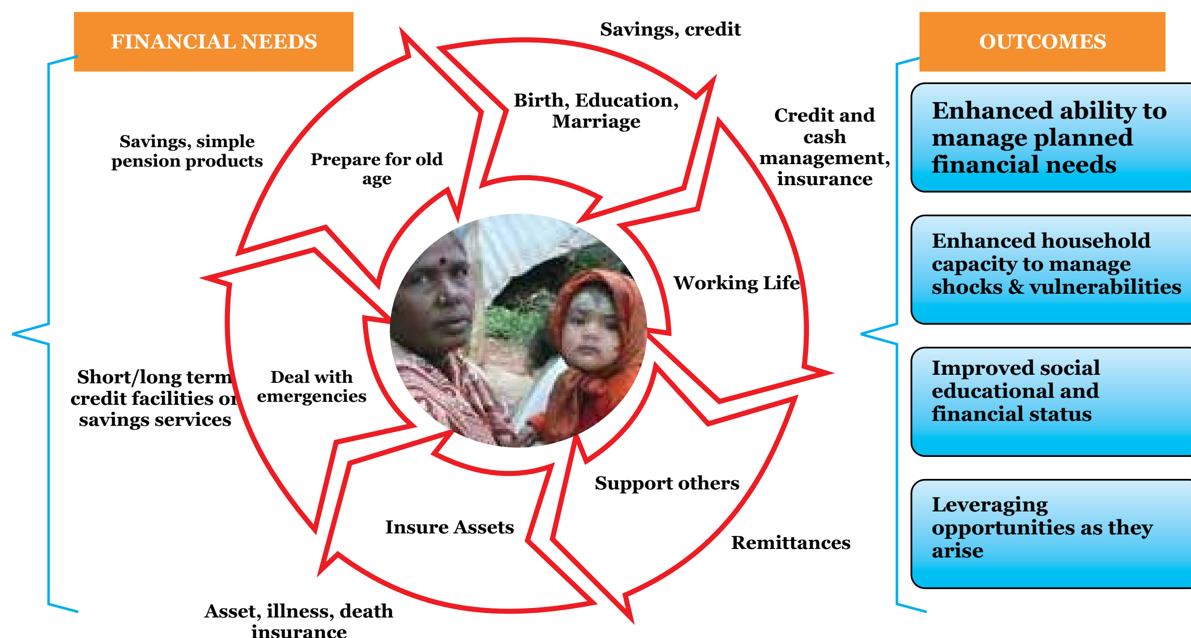
Financial institutions trying to serve the mass market rarely seem to have the time to the conduct market research necessary to identify prospective clients' real needs and aspirations. Many rely on "bath-tub product development" – product ideas developed on the basis of the senior management team's experience and "gut instinct", and often rolled out without any pilot-testing … let alone consultation with the target market.

Others prefer the "me too" strategy and thus simply wait, watch and copy products offered by their competitors. India's "No Frills Accounts" rolled out by a wide variety of banks are a case in point – with dormancy estimated to be 80-90% despite the government's attempts to push conditional cash transfers through them. *MicroSave*'s research into this phenomenon revealed that there were a series of features to which poor people aspired and needs that they could clearly articulate … and that poor customers were, in the main, willing to pay for these services.

MicroSave research over the years across Africa and Asia has highlighted that people need (not just want) financial services that are convenient, accessible, affordable and appropriate … and of course reliable in that they are consistently available, on demand. A single transaction account like the No Frills Account is unlikely to meet these criteria … particularly when delivered through traditional banking branch infrastructure.

- **Convenience** requires proximity and longer opening hours – most obviously through a distributed agent network.
- **Accessibility** often necessitates ATM cards or mobile money solutions to obviate the need to negotiate overcrowded branches, complex forms and intolerant bank staff, and is likely to require us to rethink how we communicate products.
- **Affordable** needs to encompass direct costs (transport to the branch and food when the trip take a full day), indirect costs (lost wages and other opportunity costs); and hidden costs (brides and commissions for filling up and processing forms) - and not just the "on the board" fees/interest rates that are formally charged by bank.
- **Appropriate** must reflect how poor people live and how they think about and manage their money.

Poor people's need for appropriate products mean that they need a range of products (just as you and I do) to reflect their life cycle. They also need disciplined systems that break down their accumulation of lump sums into small manageable amounts (saving up, through or down).



The products used to accumulate lump sums should ideally be differentiated and ear-marked for specific needs, in the same way that poor people often ear mark specific income streams for specific uses to help with their mental accounting. For example: savings for a bicycle, to buy some land and for old age are very different in terms of the time horizons and instalment amounts.

Similarly, loans for a medical emergency and for investing in a fixed asset are very different in terms of loan size and structure, as well as the pace at which they need to be appraised and disbursed. This has very important implications for financial institutions seeking to offer a range of products to the lower income market segment: a single transaction account will not help manage a series of complex savings goals; and a standard working capital loan repayable in weekly instalments over a year is only appropriate for a limited set of business people.

As a bare minimum, therefore poor people need a suite of products that includes:

- **A transaction or very basic savings account** (linked to a reliable and efficient **payments/remittance system** that is not too costly);
- **Recurring deposit accounts for different goals** (with an attached overdraft to which they have automatic and immediate access – up to 90% of the value of the amount deposited);
- A general **short-term (up to one year) loan** (that can be used for working capital as well as consumption smoothing, education etc.);
- A **longer term loan** (secured against assets acquired with the loan).

Clearly this suite of basic products need to be tailored for, and communicated to, specific markets and market segments – but a market-led approach to product development is essential if we are to have real positive impact on the lives of poor people. Just try imagining how you would manage your finances if you only had access to a typical microcredit product – a loan repayable weekly for 50 weeks!

Follow the Money Approach: Introducing a powerful strategy tool for your mobile money / banking initiatives (Part I)

Krishna Thacker

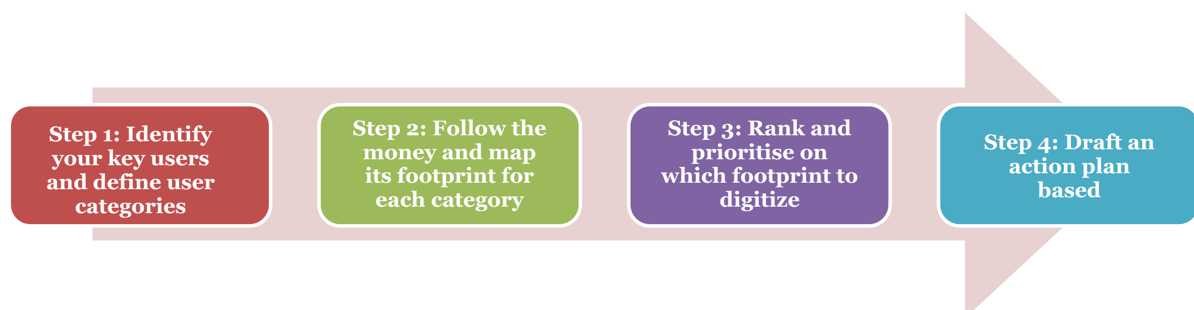
Let us start with a quick reality check. Most financial service institutions aspire to gain a bigger share of client's wallet not only in terms of profit but also the value and number of transactions with them. This is true irrespective of whether you are a single, double or triple bottom line institution. Those in the digital financial services space are of course no different. That brings us to some core and high level strategic questions for those involved in developing a strategy for their financial services institutions: 1) What do you (as an institution) need to do to gain a bigger share of client's wallet? 2) How do you dominate the market on a sustainable basis? All institutions try to answer these fundamental questions in one or other form (albeit a bit more specific and contextual) as they think about their strategy.

This two-part blog introduces the framework / approach which *MicroSave* has used with some institutions to help them answer these questions through a quick exercise. Let us call it, 'Follow the *Money Approach*' (FMA). It has proved to be very effective irrespective of what stage of life cycle these institutions are at; whether they are developing their go to market strategy, whether they are just revisiting their strategy or they are trying to expand. Following are some of its key benefits:

- It helps you understand and clearly see your target customer's financial world from a transactional as well as from a financial ecosystem perspective.
- It lays out a pictorial map of the potential user's financial ecosystem in terms of money coming in, staying and money going out.
- Once that is done, it also helps institutions, based on an understanding of their market and their unique situation, strategise and prioritise on what type of transactions to digitise.
- And, ultimately it provides an informed and clear strategic foresight on what to focus on in the short, medium and long run.

In simple terms, this helps you put your mouth where there is money.

There are four key steps towards a successful implementation of the FMA approach:



The following is a detailed 'how to' explanation for each step. We will cover the first two steps in first part of the blog and the remaining two steps in the second part.

Step one: Identify your users and user categories

The objective is to understand different use cases of your offering more than doing a rigid categorisation of a fluid client base into narrow segments. And, the ultimate objective is to find high potential intervention points for you to covert a cash footprint into digital footprint or to convert an existing inefficient digital footprint (such as interbank cheque transfers or expensive money transfer system) into a more efficient (for yourself, your agents as well as for the end users) digital foot print.

First activity within this step is to brain storm and identify your key user types or client segments. Following is a sample categorisation of use cases:

User type	Broad definition
Rural, medium farmer plus mix of other activities	This rural family with farming as a key source of income. However, they do have regular inflows from live stock (selling of milk, selling of chickens etc.) as well as some other sources of income such as seasonal wage labour.
Rural bussiness (daily cash flows), daily wages and marginal farming	Their main activity is a business in rural or semi urban area with daily cash flows. Supported by some other sources of income such as wage labour and marginal farming.
Rural, migrant family with inward remittances, plus some mix of activities locally	Their main source of livelihood is inward remittances supported by income from farming as well as livestock.

There are a few useful guiding points to help you come up with a dynamic categorisation:

1. **Identify top livelihood activities:** The categorisation should be based on a solid understanding of the market in terms of the top livelihood activities for your market segment.

2. **Household as a unit of analysis:** It is best to consider household / family as a user type and not an individual. It is because, in most cases, a household is the central processing unit for majority of monetary transactions as well as decisions. And, of course, money is fungible between different sources / types of inflows. It makes the equation or analysis a bit more dynamic, vibrant and broad based and, most importantly, realistic.

3. **Multiple livelihood sources:** And, in almost all cases, households have multiple sources of income and inflows. Therefore your categories should not be focussed on a single livelihood source. Considering that, it is best to define your categories by putting the primary source of income first followed by a secondary source of income and/or other key attributes of this category.

4. **Number of categories:** Optimally, one should have a minimum of 2-3 user segments to a maximum of five user segments.

Step two: Follow the money and map its footprint

The main objective here is to draw a unique Financial Footprint Map for each user segment.

Once the user types are identified, the next activity is to hit the ground, identify a few random households for each category (ideally 5-7 households per category) and engage in detailed qualitative conversations with the user segments.

Under this step, all you have to do is follow the money, map its footprints and organise these footprints in a logical structure. In any active financial ecosystem, you will inadvertently observe that money (whether cash or digital) has the following logical (as well as practical) trial as it leaves it footprints:

1. **Money comes in (Inflows):** Money has to come in from somewhere. All inflows such as income from farm, loan from bank or remittance from a family member fall under this category. As discussed there are often multiple sources and it is actually best if an institution starts with capturing / digitising at least one or two key inflows and bringing them into their fold. Include questions around how much and how often.

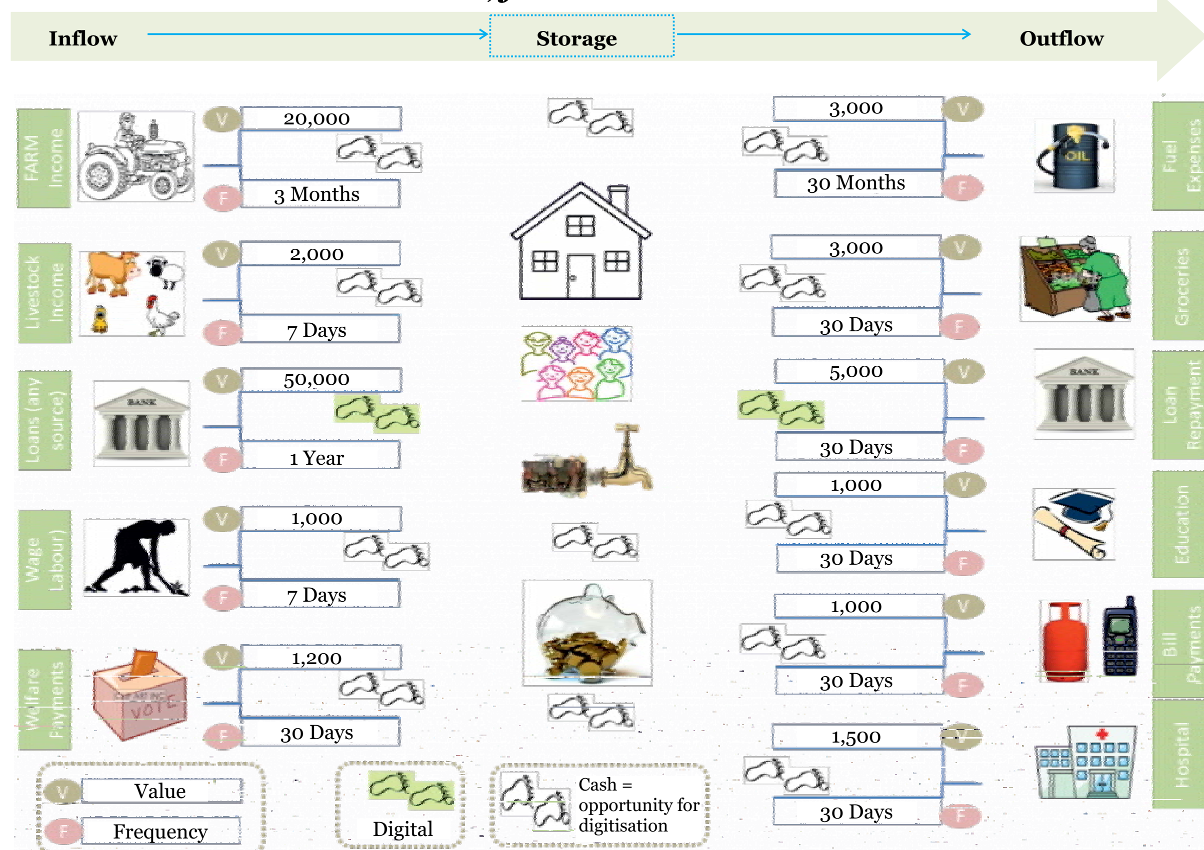
2. **Money stays (Storage):** Money has to stay somewhere. A household often uses several mechanisms, formal as well as semi-formal / informal, to store their money. The basic savings / deposit account is falls under this category. Most banks in India have only focussed on this product for their financial inclusion initiatives. In the following sections, we will see why is it important to move (and quickly so) beyond this minimalistic approach. Include questions around where and how long does it stay (in the bank or household).

3. **Money goes out (Outflows):** Money has to go somewhere. All payments, purchases, fees and expenses fall into this category. Include questions around how much and how often.

The Financial Footprint Map, as an outcome of this exercise should ultimately look like this:

A couple of useful points to remember during this step:

USE Case 1: Rural, farm and other sources household



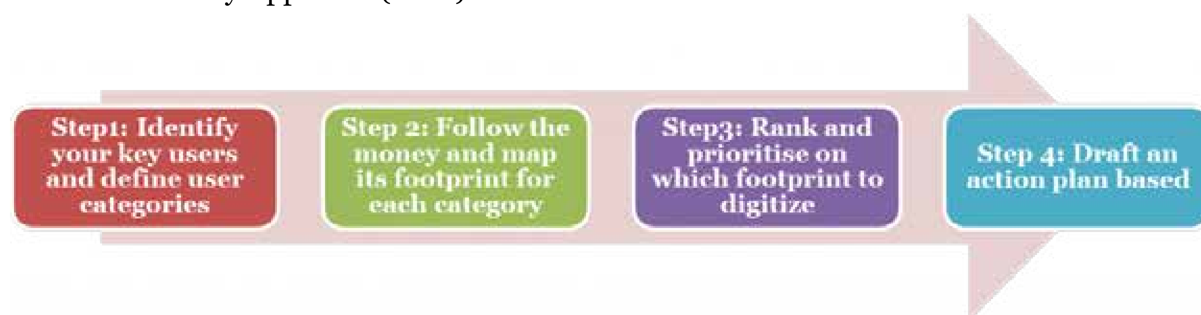
1. Though each household would be different even within the same categories, but, that should not be a concern, as the broad idea / objective is to understand the most popular types of (high value and/or high frequency) irrespective of use cases. The use cases allow you to see things from a bit more holistic and realistic standpoint instead of just focussing on different types of transactions.
2. Try and include as many transactions as possible. It is not advisable to filter at this stage as we will do so in the next step.

Once you have a financial footprint map ready, it is time to move to step three...

Follow the Money Approach: Introducing a powerful strategy tool for your mobile money / banking initiatives (Part II)

Krishna Thacker

In the previous blog in this series, we discussed the first two steps of the four steps under the Follow the Money Approach (FMA).



Now we consider the next two steps.

Step Three: Rank and Prioritise

By now, you have 1) identified your key user segments 2) a clear picture of their financial ecosystem along with the value and frequency for each of the footprint or transaction.

The objective of this activity is to collate the key transactions identified into a single analysis framework to help us select the best transactions / footprints to focus on and plan accordingly for the short, medium and long term.

Following is a sample analysis framework with some suggestive attributes, each of which needs be assigned a score on a scale of 1 to 5 based on its impact and relevance. The score then will be totalled in the second last column to help prioritise.

Priority Matrix: Use Case 1, Rural, farm and other mix sources of income household

Transaction types / footprints	Value	Frequency	Ease of conversion	Strategic Fit	Client Preferences	Final Score	Remarks / Comments
Inflow 1, 2, ...	4	5	6	2	3	20	
Storage 1,2, ...							
Outflow 1,2, ...							

A couple of useful points to remember during this step:

1. It is essential to extrapolate these anecdotal numbers for the larger market to assess the size of the market you are dealing with. Once you do so, triangulate it with other industry level data sources to ensure that you are on the right track. What may look like a small value, simple transaction (e.g. top up) may actually be a highly profitable transaction for you in the initial phase, once these numbers are put into context.

2. Please note that the remarks and comments section is extremely crucial. It is important to describe the footprint by providing more details such as following:
   - How do they pay currently and what are their challenges and limitations. Very often you may/will actually have to go and meet them up for more details.
   - What are the reasons we may or we may not be able to digitise it and/or bring it into our fold?

It does sound difficult to pursue several types of transactions at the same time and it is easy to just focus on one and be the best. True, in the short run. But, basing your entire business model on only one or two footprints has several critical disadvantages:

1. It is very easy for clients to switch and move to a competitor. M-PESA could be the next Blackberry or Nokia if it does not diversify.
2. Lost opportunities to cross-sell and up-sell to the same client.
3. Higher risk from external environment in terms of changes in trends, policies and disasters.

And, there is not much point making only payments easy if clients have to make a lot of effort to bring / convert theirs inflow on your platform and likewise, if it is difficult for them to make payments or withdrawals from your platform. This is not to say that making payments (or for that matter a single transaction) easy for end users is not important. But, it is to say that making just one footprint in the ecosystem convenient without looking at the entire ecosystem will not add sustainable value for the client and therefore ultimately the service provider. It makes the service provider very vulnerable to competition and other external factors.

Step four: Draft an action plan based on the above

This last step is simple. A bit too simple that one and may want to skip it entirely. However, converting priorities into actionable activities is an extremely crucial step to convert all the efforts made so far into some useful action and thus results. Therefore, a simple but quick action plan and road map is developed based on the above priorities. The action plan will ideally contain activities such as developing a customised offer / business models for various partnerships, arranging meetings with them, designing process flows, upgrading so and so module of the technology etc.

Make it yours. Use it. Share.

If you have been a part of the strategic planning process for your digital finance deployment, you would have surely thought about many of these points or issues. But, this framework helps you to be a bit more methodical and structured in your approach. It also helps you look at the larger picture and decide where you want to stand. In our experience so far, this approach has been immensely helpful in providing a great deal of clarity in often a very complex and rapidly evolving environment.

The idea is to share and spread what works and test its wider applicability. It is to encourage and challenge you to use it in your own institutions and context. Feel free to customise and modify it. We would be extremely happy to hear from you and listen to your thoughts, opinions and feedback as well as to be of any help we can in providing more clarity on this approach.

The Market Led Revolution of Equity Bank

Graham A.N. Wright
and David Cracknell

Today Equity Bank is a remarkable institution. But in 1993, the Central Bank of Kenya confirmed that, as Equity Building Society, it was technically insolvent, had poor board supervision and inadequate management. Non-performing loans were 54% of the portfolio, and accumulated losses totalled KSh.33 million ($500,000), on a paid up capital of KSh.3 million. Equity's liquidity stood at 5.8%, far below the required 20%.

Contrast this to the situation today. As at March 2008, Equity Bank had become the most highly capitalised bank in Kenya with total shareholders funds more than $250m, serving more than 2 million customers, through 76 branches, and more than 350 ATMs, with continued expansion planned. This Briefing Note outlines the success factors underlying this remarkable change.

Managing Continuous Change

Change is the most notable feature of Equity Bank. In year 2000, this saw the introduction of an IT system, "Bank2000", and the strengthening of the Board of Directors. With technical assistance from *MicroSave* and others, products and procedures were refined, and new products developed. Credit expertise was drafted in, which caused Equity to rethink and redevelop its credit strategies. A major development for Equity was the development of strategic alignment approaches. Stepwise Management, a German consulting firm, guided Equity through this process. Months of staff time was spent developing mission, values and vision and preparing a "structure tree" outlining critical success factors, "stretch goals", targets/activities and measures. By the end of 2004, all senior and middle management had played a role in developing and internalising the strategic plan. By the middle of 2005 everyone within Equity knew, and had bought into, the institution's plan and understood the roles they played in achieving it.

A further defining moment for Equity was the introduction of its current FINACLE banking system, and building a highly talented IT team. The seriousness of the strategic alignment process was seen in the level of investment and focus placed on IT development. Within six months Equity bank had migrated hundreds of thousands of accounts to the new system. It now had a platform for the future, capable of handling millions of clients, and electronic banking channels.

Lesson 1: Commitment to Customer Focus
From the beginning of its renaissance, Equity has been customer focused. Initially this was a basic survival strategy, focused on grass-roots, relationship-based banking. Strategies included: market place marketing; social and community based activities; and inside the branches, the introduction of Bank2000. The new IT system significantly decreased service time, from 20 to 5 minutes. Armed with insights from market research conducted by the bank with assistance from *MicroSave*, Equity re-priced its products and conducted a customer communications campaign. From 2002, Equity upgraded its banking halls; despite this with the rapid growth in customers banking halls were becoming congested. In response, Equity introduced floor managers who interacted with customers in the banking hall; it lengthened its operating hours, and began to streamline its operational processes. It developed a customer service strategy that employed service quality questionnaires, focus group discussions and mystery shopping.

Lesson 2: Harnessing the Market-led approach, Word of Mouth and PR to Stimulate Growth The strength of word of mouth marketing has meant that Equity has not had to conduct any significant above or below the line promotion or marketing activities since September 2003. It has simply relied on the "buzz" around Equity and its operations that pulses through the market and periodically supplements this with carefully planned public relations activities. At the community level, managers and staff remain involved in local activities, present at "baraazas" community (meetings) and committed to building relationships with opinion leaders around their branches. At the national level, press releases are used to build the image of the institution. A lower key approach is used when the Managing Director or senior management attend key events in Kenya or abroad. For example, when the Managing Director attended the African Business Leaders' Forum that preceded the G8 Gleneagles conference and the concluding conference for the UN Year of MicroCredit, the local media were encouraged and assisted (through carefully crafted press releases) to report Equity's participation as a matter of pride for Kenyans and more broadly Africans.

Lesson 3: Maintaining Corporate Culture
"That when years turn our vision dim and grey we shall still be seeing beauty in the tired wrinkles of our faces. We will find comfort in the wisdom and knowledge of the fact that, we did all that we could in our power to achieve our goals."

This inspiration statement emerged from, and is engrained with, the dust, sweat and tears of the door-todoor, market-to-market selling that Equity's staff and management undertook in the period 1993-2001. This period defined much of Equity's culture that combines the professional demeanour and dress code of a traditional banker with a commitment to serve each and every customer – however poor – with the same care, respect and enthusiasm. As part of its strategic planning process, Equity collectively defined its core values. These values are the "PICTURE" that Equity wants to present: Professionalism, Integrity, Creativity and innovation, Teamwork, Unity of purpose, Respect and dedication to customer care, and Effective corporate governance.

Lesson 4: Optimising Corporate Governance
Equity has gradually strengthened its Board, in 2000, four new members were introduced. Today, along with the long term vision of the Chairman, Equity has a Board consisting of carefully selected members with specific talents and contacts drawn from the media, from insurance, from the corporate and legal sectors.

The Board of Directors is expected to foster the long-term business of the bank consistent with their fiduciary responsibilities to shareholders and depositors. It is committed to conducting the affairs of the Bank with openness, integrity and accountability and in accordance with the highest standards of corporate governance. To formalise this commitment, Board members have all signed and are expected to deliver on Equity's 86-page Code of Corporate Practices and Conduct, which developed over the year prior to March 2005. This outlines their duties and responsibilities, as well as the systems and forms for the formal annual evaluation of the Board as a whole. In addition there is a bi-annual individual assessment of each Director's performance. The Code also explicitly outlaws Directors conducting business with, or taking any loans from, the bank. Directors are given regular training and often attend retreats and workshop with some of the banks' strategic partners.

Lesson 5: Management of Donor Inputs

Since Equity has been able to attract donor funds, it has used these strategically to increase its credibility and profile within the market and the capacity of its systems and staff. Under the EU-funded MESP programme, Equity, in 1997 acquired a total of Ksh.70 million ($900,000) for on-lending to support start-ups and the expansion of micro-enterprises. An additional part of the grant was used to train staff and conduct study tours. Similarly the UNDP-Micro-Start funds Equity received in 2000 were used to strengthen operations (particularly the IT systems). Relationships with MESP and UNDP were used as evidence that international donor agencies believed in and supported the organisation in order to strengthen its reputation in the marketplace. When discussing the Africap investment Equity often highlighted the key and prestigious donors backing Africap – particularly the IFC and the European Investment Bank. In 2002 DFID, though the FSD Kenya Programme and Africap joined Swiss Contact and *MicroSave* support to Equity. A Steering Committee was formed to coordinate inputs. This has proved an effective mechanism to ensure a commonality of vision, a prioritisation of inputs and that Equity remained in the driving seat to manage the use of the technical assistance grant funding made available by the donors supporting it.

Lesson 6: Commitment to Remain Broad Based

Equity continues to pursue a commitment to being a broad based bank. This is evident in the continuous evolution of mass market delivery channels, and in its products and services. After conversion to a commercial bank, while the savings product range has grown to include personal and business current accounts, consistently 80% of savings accounts by volume are Ordinary Savings Accounts – and these account for 5060% of total deposits. Equity has managed its significant growth in client base to more than 2 million clients, through continually expanding the number of its branches and ATMs. Since 2006 Equity has introduced more ATMs into Kenya than any other bank. It had 350 ATMs as at March 2008, with more being installed. Over 70% of withdrawals are handled quickly, through ATMs.

Equity responded to the need for local, rural financial services by creating mobile branches. Mobile branches use secure vehicles to establish a branch for one or two days per week in a local town, typically coinciding with the day that the local market operates.

Equity's approach is characterised by careful market segmentation and product development, a move which has seen it develop a wide range of services for the mass market, including joint liability group lending, cashflowbased lending, finance for business women, agricultural and warehouse receipt products; as well as loans for larger businesses.

Lesson 7: Human Resource Management

Equity has grown successfully, in part because it has been able to manage the consequences of growth. Year on year increases in loans and deposits of more than 50% have forced rapid change in the institution; nowhere more so than in human resources. Growth has required Equity to carefully manage the recruitment and deployment of senior staff from outside the bank – often above the staff that have risen through the ranks. Many longer serving staff members were re-deployed, or additional layers of management were created, in order to allow the bank to place senior staff members recruited from outside in strategic positions. However, while bringing in required experience, not all outside recruits have been a success – many struggled to understand and fit into the Equity institutional culture. In particular Branch Managers recruited from mainstream banks have often simply not been able to readjust. Those unable to work the Equity way are given a limited period to adjust and learn, and if they cannot, are encouraged to leave the bank.

Rebuilding A Bank - Case Study of OK Bank

Agerico Agustin,
Abhishek Anand and
Abhay Pareek

Opportunity Kauswagan Bank is a quiet but interesting turnaround story in-the-making that highlights the case for strategic rethink as the recipe for success. The bank, which was struggling to survive a few years ago, has set its course to turnaround, largely based on its strong, clear, and precise strategy.

OK Bank, created as an outcome of merger between Opportunity Microfinance Bank (OMB) and Kauswagan Bank (K Bank) faced challenges on several fronts, primarily achieving a positive financial bottom-line. High operational costs were proving not only a hindrance to achieve breakeven, but also contributed to unrealised targets for individual and MSME loan client acquisition as a substitute for lost business arising from the strategic decision to move out of group based lending.

The underlying factors for these challenges were:

Financial Management: 58% of assets were funded through public deposits and rest from borrowings and capital. The bank had to rely on high-cost borrowings to fuel its growth. While augmenting public deposits was critical to turn the bank around, lack of public trust due to losses, instability and poor visibility, meant that mobilising low-cost public deposits was a real challenge.

Systems and Processes: Weak systems and processes led to over-manned support departments and poor customer responsiveness.

The combination of poor financial management and inefficient systems had led to a vicious cycle of the bank struggling to generate public deposits with an eroding brand image and thus having to source funds at high cost.

Strategy as an institutional culture

Clearly the bank needed a shift in strategy and greater clarity in the formulation and implementation of that strategy. The new strategic approach focused on expanding business while developing efficient systems and procedures (front and back-end) and assigning strategiclevel importance to branding. Thus began a structured approach of building the brand on a foundation of trust and stability, and on the strategic value discipline of operational excellence. With support from *MicroSave*, the bank commenced restructuring its systems and organisational structure, and building and motivating the team to achieve its new vision. The emphasis was to shift the bank from its unclear market position to one as “the only microfinance bank with operational excellence”. OK Bank’s strategy is based on five strategic pillars built on a cross cutting theme of operational excellence:

Pillar 1: Performance-oriented Culture

- Build skilled and flexible workforce
- Establish strategic discipline
- Institute high-performance evaluation system using Balanced Scorecard (BSS)
- Embed social performance management

Pillar 2: Sophisticated Marketing and Sales

- Develop market and segment focus
- Strengthen marketing and sales function

Pillar 3: Differentiated and Efficient Distribution

- Restructure to serve a wider market
- Expand number of channels to increase reach

Pillar 4: Cost-Efficient Process and IT

- Bring-in cost efficiency and operational excellence
- Introduce new MIS/IT Systems
- Maximise resources use through effective use of outsourcing

Pillar 5: Superior Credit Policy and Skills

- Develop risk management function
- Use technology to manage the portfolio

OK Bank ensured that the strategy formulation was a confluence of top-down and bottom-up approaches. The strategy thus articulates the institution's core values and culture and not just the vision of few people in the bank. *MicroSave* engaged in continuous discussion with the senior management team to detail-out and achieve granularity of the strategic plan and the action plans to implement it.

Institutionalising strategic thinking and discipline as part of organisation culture became top priority, and this under-pinned the development of strategic business plans for each functional group. Bank-wide and departmental strategic workshops led to clear and unified strategic thought process articulated as a robust strategic business plan. *MicroSave* conducted a series of sessions with the Business Development, IT, Audit and Compliance, HR and Administration, Finance and Accounting and Marketing groups to develop their individual strategic plans for 20132015. In line with the changing external and internal environment, another iteration was conducted to finalise the 2014-2016 Strategic Plan.

The core strategy

In order to achieve market leadership, OK Bank identified four strategic determinants to improve the bank's financial and overall social performance:

1. Building a viable brand and being a preferred service provider in two key market segments
2. Developing a culture of continuous improvement in order to achieve lowest cost among peers, while keeping acceptable products and service quality
3. Leveraging technology and efficient processes to understand and address the needs of target clients for simple, lower-cost financial services
4. Achieving superior credit management through technology

The operational challenges that bank needed to answer tactically were:

Competition: *Can OK Bank survive competition and market consolidation?*
The bank decided to develop a competitive strategy built on operational excellence. In the medium-term, the bank aspires to be known for its superior price-to-value financial services. The focus is to counter the emerging trends of banks going down market with better products and MFIs with better customer intimacy.

Market: *Can OK Bank customise its services and products on the basis of varying needs of different market segments?*
Niche market segments have different needs that are well serviced by specialised financial institutions. The bank planned two distinct type of customer outlets with highly specialised services and customised products – Red and Blue Bank. The bank calls this as "One Kitchen and Two Restaurants" strategy. While the Red Bank is for economically active working poor, the Blue Bank would serve aspirational middle class. Thus, the bank will serve two underserved segments.

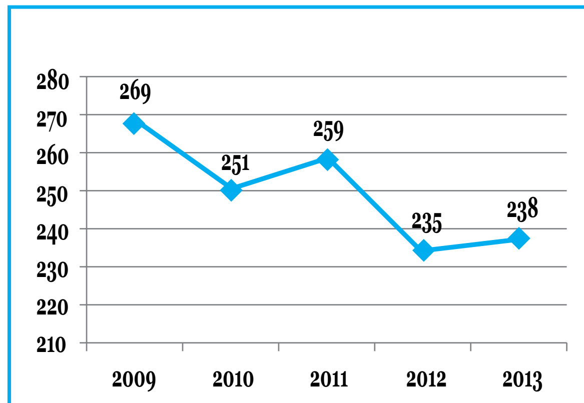
Institutional Capacity: *Does OK Bank have the institutional capacity to carry out its plans? The bank has a well-laid out plan to develop its internal capacity in the following way:*

1. Hire high capacity professionals to develop a strong second line management team
2. Build a brand that epitomises trust and best priceto-value products and services
3. Strengthen systems and processes

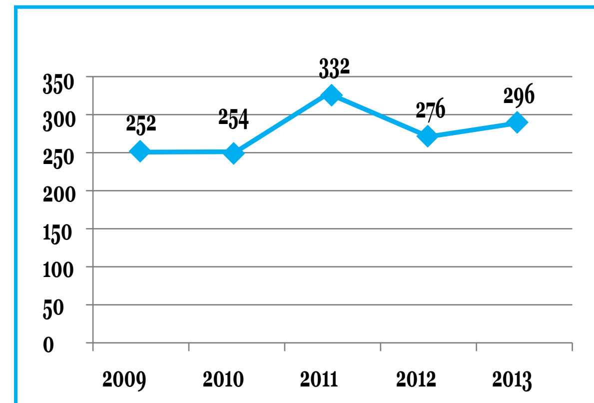
Progress so far

The journey to achieve the strategic intent is nothing but tough. Nonetheless, guided by a clear vision and business strategy, the bank has achieved success on several fronts.

Competition: The bank has developed products, services and processes with the core theme of operational excellence. Thus with continuous strive to achieve improved processes, it is expected that within a year, the bank will achieve its vision of operational excellence as its competitive advantage. The results of strategy are visible in results of 2013. As compared to the past year's performances there is a 7% increase in total loan disbursement. The bank was able to maintain its deposit in the said period.



Total Deposits (in PHPMn)



Total Loans (in PHPMn)

Market: The bank has already identified the two market segments, their needs and requirements. Based on the extensive research, the bank has developed asset and liability product concepts which will be launched in 2014, with introduction of two retail formats of the Red and Blue Banks. The bank is also building a marketing function with technical assistance from *MicroSave*, which would focus on achieving product profitability.

Institutional Capacity: The bank has been able to reduce its operational expenses by 30% through efficient allocation of resources, cutting down on non-priority expenses and, re-engineering and simplifying processes. Also, the bank is moving closer to implementation of a core banking solution, the most critical step to achieving strong and robust systems. Key senior management have been recruited to guide the bank in the second phase of its turnaround.
Challenges The journey has just started and it certainly will take the time and resources to effect the turn around the ship. The strategic business plan for 2014-16 identifies the following challenges: Low cost sources of finance: Though bank has achieved the cost efficiency and thus saved funds that were then used for lending, the bank still requires lowcost fund sources to

finance its projected portfolio increase, as well as additional financing to achieve operational excellence through strong systems and processes.

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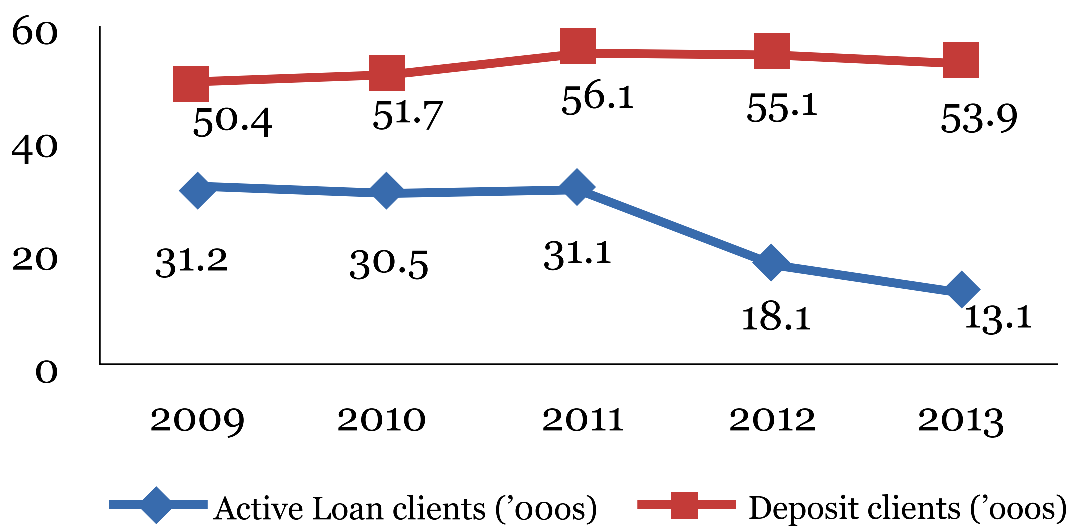
Recruitment and Retention of Human Resources: The bank is going through a change and it is always a struggle to retain human resources especially at the lower levels in the hierarchy. Though bank has initiated several incentive programmes and communication drives, it continues to face the issues of staff turnover at lower levels.

Building Operational Excellence as a Core Differentiator

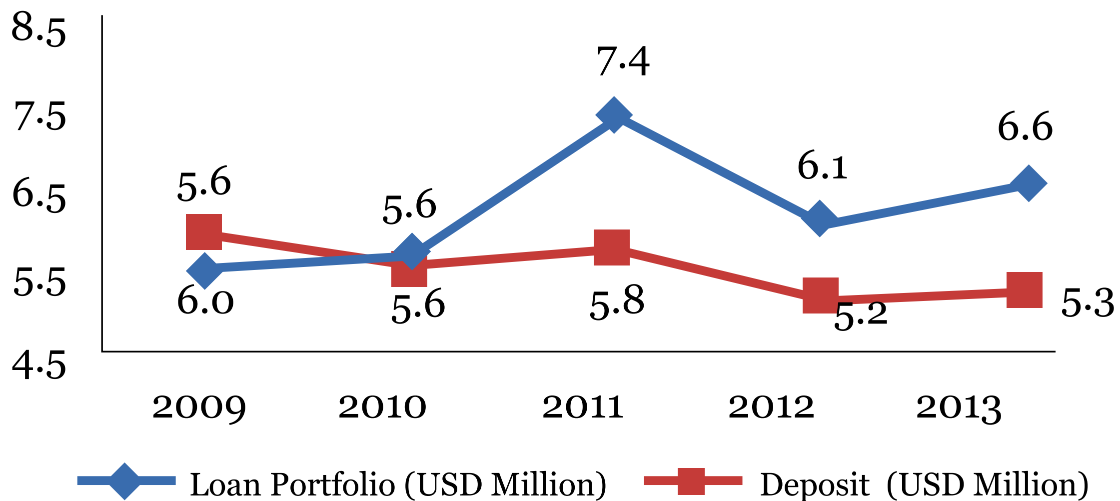
Anup Singh and
Raunak Kapoor

Opportunity Kauswagan (OK) Bank was formed through the merger of two banks - Opportunity Microfinance Bank (OMB) and Kauswagan Bank (KB). KB was established to serve the low and middle income (LMI) population and enjoyed a successful start on account of an experienced management team and the strong underlying microfinance operations of TSKI, KB's parent organisation. OMB was another such pioneer in microfinance banking, however the bank was never able to deliver growth and continued to operate with a high degree of dissatisfaction from the clients it served and mounting losses. KB saw a merger with OMB as a strategic opportunity to enhance its outreach and strengthen its capital base (with the assistance of Opportunity International). In October 2008, OK Bank (a microfinance-oriented thrift bank) emerged as an outcome of merger of OMB and KB.

OK Bank started with 50,400 depositors and 31,200 loan lients. In 2009, over 85% of the loan clients were group-lending customers. In 2009, the bank decided to differentiate itself from TSKI by focusing on individual and SME lending. As a result, from 2009 to 2013, the bank experienced a decline in number of customers from 31,200 to 13,100 as group-lending customers were gradually handed over to TSKI.



While there was a decline in the number of loan clients, in terms of loan portfolio, the bank experienced growth in the period from 2009-13.



In 2012, in a strategic re-think, the new CEO of the bank, Mr. Agerico Agustin, broached the idea of operational excellence as the key differentiator for the bank to outcompete the peers in markets in which they operate. The focus of the CEO was not only to cut costs and boost efficiency to survive, but was hinged on issues far more important than mere survival. The questions to which the CEO was seeking answers were:

- How can the efficiency at operational-level be maximised? and
- Can the funds released as a result of cost cutting be used to fuel new growth?

As a result, the philosophy of operational excellence for the bank was anchored on the design and implementation of efficient operating structures.

Building operational excellence

With support from technical assistance programme offered by *MicroSave* and funded by Opportunity International Australia, OK Bank embarked on a highly ambitious operational excellence programme.

The programme had three primary principles:

- ***Efficiency:*** With an understanding that more efficient operations were needed, the bank built a culture of cost consciousness. This began with a bank-wide department- level assessment of avoidable costs and eradicating these costs through doing away with such processes/ activities. The bank formed a business processes re-engineering function to incorporate best practices, optimise the risk-efficiency trade-off in processes and enable the bank to achieve scale quickly.

To drive cost cutting, the bank looked at the quick wins such as reduction of full time equivalent (FTE) staff at the head office level to 10% of the total organisation-wide FI'E and cutting down administrative costs. Also, in terms of streamlining data management, the bank is on its way to implement a new core banking system and deploying an automated credit scoring tool to enhance efficiency and reduce the human errors.

A team from *MicroSave*, led by the Resident Advisor (on secondment) supported the entire mission with review and refinement of back-end processes focused on administration and human resource management department. In our review, we identified gaps in processes such as redundancies leading to duplication of efforts and wasted time, inefficient data management, and delays in turn around of files. The focus was to identify how technological solutions such Human Resources Information System and Workflow Management Systems can overcome the challenges.

In addition, to assist with the implementation of a credit- scoring engine - one of the major goals of the overall strategy aimed at driving efficiencies in credit delivery systems - *MicroSave* worked closely with OK Bank to develop an expert credit-scoring tool. In order to further enhance the robustness of the credit-scoring engine, OK Bank is currently restructuring the credit-scoring engine to enhance statistical analytics, with support from M icroSave and PSR Consulting.

- ***Productivity:*** The bank developed targets for front-line staff to achieve significant growth in the volumes of loans originated; and conducted a work and methods study to make continuous improvements on the loan origination, appraisal and recovery processes.

10/ 5/2 sales strategy

The CEO devised 10 / 5 / 2 sales strategy for the front line staff. For every loan advisor, for each working day, the targets translated into 10 prospects, 5 field calls, and 2 booked loans per day resulting in PHP. 800,000 in new loan bookings per month per Loan Advisor. These targets, with its mnemonic of 10 / 5 / 2 were easily communicated to front-line staff. Thus, loan advisors who would earlier think about their acquisition targets only in the last few days of the month now had a clear vision of how and what they should be doing. This strategy, within 4 months of its launch, helped the bank to achieve the highest-ever monthly disbursement in terms of value and volume in the months of March to August 2013.

One of the steps that had maXimum impact was delinking sales from other functions and creating specialised functions such as credit, operations and collections. This move reduced cost of client servicing, made the turnaround quicker, and reduced the risks of operational losses, fraud, and theft. *MicroSave* helped OK Bank to bring in more granularity and detail to the strategic business plan as the bank worked to delink sales from other functions through development of a tactical plan that included a staff hiring plan, key business assumptions, costing and budgeting.

- ***Quality:*** With an understanding that quality builds the bank's reputation, the bank is implementing a programme anchored on an enhancing customer service eXperience through continuous improvements on client relationship management. Another area

where operational excellence was translated into organisational culture was through the development of the marketing function. The advisory team worked alongside the CEO to build up the capacities of the marketing team through a structured approach that involved design and development of a comprehensive marketing and product development manual. As a result of institutionalising product development and the transfer of skills, the newly trained marketing team tested and translated the product concepts into prototypes, and eventually into products targeting the two distinct segments identified by the bank.

Impact

The table below shows the tangible outcomes of the strategy in last year, especially on business efficiency and productivity. There has not been significant growth in business per se; however, the bank has used this period to streamline systems, to control costs and to improve efficiency. While direct expenses have reduced by 30%, business income has grown over 70%. As the bank nears breakeven scale, it has ambitious targets for both business and efficiency parameters for 2016. The bank aims to increase its business by 3 -4 times from its existing levels and to achieve this with a tight control on cost of delivery.

Performance on key parameters and future projections

Parameter	2012	2013	%	2016*
Deposits (USD Million)	5.2	5.3	2	24.4
Loans (USD Million)	6.1	6.6	8	20.3
Total direct expenses (USD Million)	3.7	2.6	(30)	4.5
Business income (USD Million)	(1.3)	(0.3)	77	1.6
Business income/account	(18.1)	(4.7)	74	12.3
Business income/FTE	(3.2)	(0.9)	73	3.4
Customer net revenue/ expense	0.59	0.85	44	1.35

* Projected

Way forward

The bank has had its fair share of challenges. Operational inefficiencies in the pre 2012 years have left the bank with a dearth of funds for on-lending to complement its operational excellence drive. In addition, the bank has also faced challenges with human resources with growing attrition rates as a result of the difficulties involved in implementing the change management drive. Also, the bank needs to strengthen its top management with experienced professionals who can implement the strategic plan of the bank for 2014-16.

As it has been rightly said *the journey of a thousand miles begins with the first step* and in that context, the management at OK Bank has already taken significant strides, though there is still a long distance to be covered. This would require coordinated efforts of all the stakeholders i.e. management, board, funders and technical assistance partners. The CEO appropriately summarises the on-going efforts: *"Building a franchise on operational excellence takes a lifetime. It is a discipline and not a fad.*

OPERATIONS

Serving Depositors: Branch Infrastructure

David Cracknell

A key challenge for financial institutions serving the low-income market is how to optimise branch networks to serve high volumes of depositors - to provide high quality financial services at a low unit cost. This Briefing Note examines branch infrastructure for serving depositors. Briefing Note #39 considers managing for efficient transactions.[1]

The Importance of the Branch

The branch is one of the most critical components of any savings product – simply because it is so central to many aspects of delivering savings services. Products are usually delivered through a branch network. The extent, type and nature of the branch network sets operating cost parameters that must be covered through charging appropriate prices. The majority of staff are located within branches. Promotions occur through the branch network where customers and staff meet. The branch provides the clearest evidence of institutional stability - a strong corporate brand evidenced at branch level positively influences the position of the institution in the customers' mind, driving positive Word of Mouth. So what factors must the institution consider when determining its branch structure and locations?

Delivery Strategy

The institution first needs to assess which delivery strategy should be adopted for different locations. Strategies can include full branch, sub branch, an agency or a mobile banking service. A sub branch usually operates under the management of a full branch with significantly fewer staff. It performs the most common types of transactions and loan origination. An agency typically operates a restricted range of services one or two days per week, often on market days. Mobile banks can either be used to support agencies or can operate completely independently from vehicles. For example Equity Bank uses mobile banks to run agencies and to disburse loans to tea farmers.

Transforming micro-credit institutions face a particular challenge as credit based institutions select branch locations on the basis of very different criteria than deposit taking institutions. Older PRIDE offices in Uganda and Tanzania serve many thousands of borrowers every year. To control costs, many of these offices are located upstairs or in converted residential space. FINCA Uganda, located its offices out of town – to enable field staff to operate its peri-urban and rural Village Banking groups. However, deposit-taking branches need to be located for the convenience of depositors. They must be located to provide frequent, accessible, convenient service for existing and potential customers.

Branch Location

Determining where to operate is often a carefully considered compromise, in terms of which town and street.

Which Town: Selecting where to operate is usually done through conducting a macro level feasibility study that determines high potential towns that match the institution's mission and vision. The survey considers likely demand for financial services and proximity to existing branches. It examines the provision of competing financial services. Teba Bank in South Africa conducted a detailed survey using published socio-economic data to determine where their target customers lived and were underserved by existing financial institutions. Branch based costing can help determine which delivery best suits different locations.

[1] This Briefing Note is based on Cracknell, "Serving Depositors: Optimising Branch Based Banking", *MicroSave* (2005). It can be downloaded from *MicroSave*'s website www.*MicroSave*.net from the Studies section.

Which Street: In determining exact branch location the financial institution must assess multiple factors. It must assess the quality of the physical infrastructure of the branch (see below). It must study foot traffic flows around the town, the local transportation network to ensure that clients can reach the branch easily, the availability of utilities and the security of the surrounding area. Branches should be selected and designed to have potential for expansion. Equity Bank in Kenya negotiated with tenants who occupied the floor above their Nakuru branch, obtained their premises and converted them into a second banking hall.

Once branch location has been selected, the search is on for appropriate premises. This can be difficult outside regional centres due to the quality of construction: there may be a limited supply of buildings that are well located and physically strong enough to become a branch.

Appropriate Premises - Regulatory Requirements

The branch itself must meet the requirements of regulators if the branch is to be licensed. The following points have been abstracted from the Questionnaire on Premises in Uganda's Microfinance Deposit Taking Act.

Ownership of Premises: Is the property owned or leased, and if leased is the lease sufficiently long to produce economic returns? Has the landlord's approval been obtained for alterations?

Approvals: Have approvals been provided from local authorities, security companies and the electricitycompany?

Banking Hall: Does the banking hall suit the type of business to be undertaken in the premises?

Staff Operating Area: Is the space for each staff member adequate? Does the branch have appropriate toilets?

Lighting and Ventilation: Are these appropriate throughout the premises?

Outer Doors / Walls / Windows: Are the outer doors heavy duty, secured with two or more locks of good quality? Are the windows and glass partitions reinforced or made of anti-burglar or bulletproof glass?

Strong Room: If there is a strong room is it conveniently situated? Does it border outside walls? Is there sufficient space to cater for the need of the institution? Are duplicate keys stored off the premises? Is there dual control for entry?

Free Standing Safe: Is it fire proof? Is access to the safe and the room kept under the control of more than one person?

Cash Loading Area: Is it protected from public view and access? Is cash in transit protected by police / security firm? Are there security guards at the premises at all times?

Cashiers Till: Is it restricted to individual cashiers during working hours?

Alarm System: Is there an alarm system installed in the premises? If yes, is it connected to the police/security firm? Are switches located in the strong room, cashiers' cubicles and manager's office?

Emergency Plan: Is there an emergency plan? Is it documented? Are there fire extinguishers at appropriate places? Are they of an appropriate water/non-water type?

The Banking hALL

Hall Crafting a customer focused banking environment is essential to the successful delivery of mass-market deposit taking services. However, because most financial institutions operate from rented premises it can be difficult to create an ideal banking environment.

Space Allocation: A customer focused banking environment requires careful consideration of the allocation of space. The banking hall must be sufficiently large to accommodate peaks in transaction volume, during the day, month, or year. It should be large enough for queue management systems should these become necessary. There should be a sufficient number of teller stations to manage current and anticipated future transactions. There should be writing space for customers. There should be space to position customer service, account opening and sales desks in larger branches. The branch manager's office should be accessible to both staff and customers. Space requirements should be carefully integrated with the business processes of the bank. Where possible credit officers should not sit in the banking hall in order to offer privacy to customers seeking loans.

Customer Communications*:* A banking hall should be designed and managed to communicate with customers. Signage should be clear and concise and should be provided in a language that customers understand. Name tags should be worn – as this identifies bank employees and enables staff to be held accountable for their actions.

Posters and brochures should be used to prominently display product information and prices. Where possible photographs and graphics should be used to assist semi literate customers. Banking halls should be regularly inspected for out of date information.

Two-way feedback should be encouraged through wellpromoted suggestion boxes with responses to customers' suggestions clearly displayed nearby. Suggestion box responses should be supplemented by focus group discussions and customer surveys.

Facilitating Branch Based Sales

A branch should be a key focal point for sales – given that this is where customers and potential customers congregate. Sales desks placed in banking halls increase the visibility of highlighted products and can be especially important in the case of complex products that require detailed explanation.

In Conclusion

Infrastructure choices are critical long-term institutional decisions, which affect current and future service delivery. Making the right choices contributes to brand building, growth, customer service and profitability.

Serving Depositors: Managing Transactions

David Cracknell

A key challenge for many financial institutions serving the low-income market is how to optimise branch operations to serve high volumes of depositors – to provide high quality services at a low unit cost. This Briefing Note examines managing branch operations for efficient transactions. Briefing Note #38 examines branch infrastructure.[1]

Managing For Efficient Transactions

Efficient and effective delivery is key in providing customer focused services. An institution promotes efficient front office services through effective teller management, through peak load management, through identifying and removing process bottlenecks and through ensuring continuity of services.

Teller Management

Teller Screening: Banks like Equity Bank in Kenya screen prospective tellers for basic computer competency before employment to ensure entry speed and accuracy.

Teller Experience: Teller experience is a critical factor in processing transactions quickly. In many cases an experienced teller can process double the number of transactions per day than an inexperienced teller. Reasons for this include the higher level of supervision required for inexperienced tellers and the time taken to develop proficiency in counting money. To reduce supervision delays in physically passing documents between the front and back office Centenary Rural Development Bank in Uganda introduced online supervision.

Teller Positions: Teller positions should be designed for efficiency, to provide sufficient space for computer equipment and to count cash. Where budgets allow, counting machines can be introduced to count high volumes of notes or coins.

Teller Performance Monitoring: Financial institutions should monitor the performance of tellers at an individual and at a branch level, both from efficiency and accuracy perspectives. Performance trends should be measured over time and any anomalies investigated. Qualitative measures may also be necessary to investigate the length of queues and the average time spent by a customer in the branch.

Incentive Schemes: To motivate performance Staff Incentive Schemes for savings can be investigated.

These can be of tournament nature that rewards the best tellers in a branch or they can include branch-based incentives that measure collective performance.

Personnel Issues: As transaction volumes increase it becomes increasingly difficult to respond to the legitimate needs of tellers, in terms of lunch hours and vacations. Working through lunch hour risks lower productivity in the afternoon. However, leaving teller positions vacant risks not serving customers at the busiest time of day. In branches with few tellers, or a stable transaction volume throughout the year it can be difficult for staff to take vacations. Mitigation strategies include employing relief cashiers that operate in a particular region or city.

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[1] This Briefing Note is based on Cracknell, "Serving Depositors: Optimising Branch Based Banking", *MicroSave* (2005). It can be downloaded from *MicroSave*'s website www.*MicroSave*.net from the Studies section.

Managing Peak Activity Levels

A typical front office environment has highly irregular levels of activity, especially so given the large number of small transactions prevalent in mass-market deposit taking. Peak loads are affected by a series of factors.

Product Range: An institutions' chosen product range is a key determinant of transaction volumes. Salary accounts create monthly peaks in activity, with customers withdrawing funds over the month end. School fee payments create peaks in activity prior to each school term.
Banking hours: Extending banking hours is extremely beneficial for customers. In response to customer demand, Equity Bank in Kenya extended banking hours by an extra thirty minutes per day and introduced banking on Saturday.

Manual Procedures: As savings volumes grow, manual procedures become challenging. Postal Savings Banks operating manual passbooks provide slow service to customers due to supervision, reconciliation and internal control procedures.

Customer Communications: Understanding the drivers of customer queries enables an institution to remove queries from queues. Equity Bank uses Salary Boards, which display when salaries have been processed from large employers around that branch. Other strategies include directing queries through signage to customer service desks, and providing answers to frequently asked questions in a visual or printed form. Customer Service Officers and Security Guards should also be used to assist customers.

Queuing Systems: Single point queuing systems can be used in larger branches to ensure that queues are not prevented from moving by an individual customer enquiry.

Staffing Levels: Staffing levels should be matched to anticipated activity levels wherever possible. This means during busiest periods that all teller windows are occupied for the longest time. Part time tellers are sometimes used, but make quality control challenging. Training tellers in multiple skills, like marketing and market research, can allow an institution to justify employing additional tellers to cover peak periods.

Specific Extensions of Banking Hours: Where peak activities can be predicted, specific extensions of banking hours may be possible - for example, during month ends or the payment of school fees.

Banking Hall Design: Wherever possible the design of the banking hall should facilitate high volumes of transactions. See Briefing Note # 38 - Serving Depositors: Branch Infrastructure.

Technology

Banking System: Technology offers solutions to decongest banking halls, firstly through using computerised banking systems, secondly through networking individual branches, and thirdly through introducing multiple points of access through mobile banking or cash machines. Cash dispensers are already being used in some microfinance programmes, such as PRODEM in Bolivia or through Ferlo MEPS in Senegal. It is important to continuously monitor the percentage of time that cash dispensers are online so that remedial action can be taken quickly.

Banking systems should also be designed to facilitate high volume transactions. Reducing the keystrokes required for each transaction through careful system design can save seconds per transaction and thus hours per day. The banking system should be scalable - system performance should not decline rapidly as the number of accounts on the system increases.

Process Bottlenecks

Often slow transactions are caused by process related bottlenecks. These often occur due to the organic growth of procedures over time, or the unchecked requirement to increase internal control. Process bottlenecks need to be carefully analysed and removed wherever possible. This can be done through systematic process mapping.[2] Common process bottlenecks include:

Account Opening: Extensive account opening requirements help protect financial institutions against fraud and money laundering, but can penalise poorer or illiterate clients who make frequent trips to open an account.

Teller Limits and Supervisor Approvals: Low teller limits strengthen internal control, but add directly to total transaction time. Careful examination of approval cut off points should be made.

Passbook or Card Issue or Replacement: Centralised issue and replacement of passbooks and cards can lead to delays where there is poor handling of source documents, insufficient production capacity, or extensive batching of passbooks and cards prior to processing or delivery.

End of Day Processes: Extensive end of day procedures make it more difficult to extend banking hours and make staff work longer hours than necessary.

Ensuring Continuity of Services

Continuity of services is extremely important. Advertising a new quick and flexible savings account can be rapidly undermined if the service goes down every time there is a power failure. Back up power supplies should be the first line of defence. When this fails there should be contingency plans for manual procedures. Lastly, there should be disaster recovery systems in place, which are appropriate to the size and nature of financial institution.

Critical Support Functions

Optimising branch operations requires continual support in a number of key strategic areas.

Operations: An operations department develops and maintains appropriate infrastructure and provides close supervision of branches on a day-to-day basis.

Information Technology: An information technology department ensures that an appropriate banking solution is chosen and maintained. In association with operations, finance and marketing it ensures that reporting requirements essential for managing operations are met.

[2] See "Champagne et. al., "Process Mapping Toolkit for MFIs". *MicroSave* (2004). It can be downloaded from *MicroSave*'s website www.*MicroSave*.net from the Studies section.

Branch Based Costing: The profitability of a branch network is assessed, maintained and expanded through product and branch based costing.

Marketing: A customer focused marketing department drives effective brand management, customer communications and supports branch based sales. It monitors service levels through customer surveys and focus group discussions.

In Conclusion

Managing for efficient transactions, implies making a series of strategic choices relating to managing tellers and peak activity levels. Critical support is required from Head Office. The decisions taken will have a direct impact on institutional profitability.

Branch Based Marketing

George Waweru

Branches are the initial contact point between most financial institutions and their customers. In the right circumstances branches can take the lead in identifying prospective customers, determining their needs and matching products/services to these needs. This is the essence of branch based marketing.

However, in many financial institutions there is a split between the Operations and Marketing departments, which impedes branch based marketing. Operations tends to focus on the how of business; "how" we do banking safely, while Marketing advocates the "why" delivering valued services to customers. This split is stereotyped in a high level centralised marketing function coordinated from Head Office perpetually struggling to gain recognition.

Most centralised marketing functions have few staff so there is a very practical limit on how much person-toperson marketing they can do. The tendency, therefore, is to prioritise advertising media as a way to market both the institution and products. This tendency is compounded by many marketing staff in developing countries having a background in Fast Moving Consumer Goods marketing, which has a very different focus than that of marketing financial services.

Advertising alone is often not adequate to influence a customers' buying decision, and is often regarded by sceptical customers as self-promotion. Advertising should be complemented with other forms of the Marketing Communication Mix[1] for instance Personal Selling, Direct Marketing, Sales Promotion and Public Relations. Research by *MicroSave* in Uganda showed that the biggest single factor influencing decisions on financial services were the opinions of friends and relations; so called "word of mouth marketing[2]." Branches present opportunities to complement the efforts of centralised marketing functions by conducting marketing activities that build positive word of mouth in local often semiliterate communities.

Effective branch based marketing calls on coordination between the Operations department which controls the activities of the majority of staff and the marketing function. Cooperation can be encouraged through the creation of Service Level Agreements (SLAs) between the operations and marketing functions which clearly define expectations of the two departments and requirements for support. A clear case of this cooperation is the Branch Manager who plays a pivotal role in the success of branch based marketing by ensuring staff and resources are mobilised for branch centred marketing activities.

For expanding retail operations and deposit taking microfinance programmes it is critical to build the image of the institution as a safe and secure place to save. As figures of authority Branch Managers are best positioned to market the institution via marketing to high value customers, to institutions and in one-to-many marketing. Furthermore, Branch Managers also control resources within the branch.

Key to leveraging the power of Branch Managers is ensuring that they are able to spend time marketing the institution and its services. Equity Bank in Kenya used delegation to allow Branch Managers greater flexibility. This can be reinforced by changing staff structures and

[1] See *MicroSave*'s Product Marketing Strategy Toolkit.
[2] Wright and Rippey, "The Competitive Environment in Uganda Synthesis"

even employing additional staff in larger branches to allow Branch Managers time to build relationships and market the institution.

Benefits of Branch Based Marketing

Institutions that have embraced and implemented branch based marketing as part of their strategic marketing have realised the following benefits:

- ***Increased Profits:*** Before opening the Nyeri branch, Equity Bank Branch Managers visited Nyeri for a week to meet local businesses/opinion leaders, and visited schools and other congregations. The branch broke even in record time.
- ***Enhanced Efficiency:*** Using slack periods during the middle of the month for branch based marketing.
- ***Increased Responsiveness:*** Much closer contact with customers and thereby detailed feedback on the institution and its products.
- ***More Customised Services:*** Improved opportunities for targeting product sales to customer needs and to cross sell multiple services to existing customers.
- ***Refined Monitoring:*** New opportunities and measures for analysing branch performance.

Successful Branch Based Marketing

Institutions successful in adopting branch based marketing have focused on the consistency and accuracy of marketing messages. Particular problems have been experienced within *MicroSave*'s Action Research Partners with teller knowledge of loan products and loan officers' knowledge of savings services. Customers do not make a distinction between the functions of staff and expect all bank staff to be able to respond to common queries.

Institutions using loan officers to sell savings services face additional challenges. Loan officers are often paid incentives based on the size and quality of their individual loan portfolios. To maximise income they market loans through savings accounts with the message "save with us, get a loan": a powerful marketing message but one that does not target the "net depositors" required to grow deposits. All staff must have common knowledge on products and services.
A key success factor in branch based marketing is to provide branches with budgets to conduct marketing activities. This can be very difficult for parastatal institutions such as Postal Savings Banks which have annual budget cycles, yet the returns can be significant.

Branch based marketing responds to opportunities. An institution cannot anticipate and plan for all marketing opportunities. The timing and location of many marketing opportunities is beyond the control of the branch; for example, agricultural shows, or when high net worth customers come into the branch. The person responsible for marketing at branch level must be aware of what's happening in the locality and well networked with feelers for gathering information in the local environment. The branch should also have adequate and appropriate promotional materials, not only brochures. At U-Trust in Uganda every branch has pull-up banners promoting the institution in the banking hall that can be easily moved to other local events as required.

[2] See "Champagne et. al., "Process Mapping Toolkit for MFIs". *MicroSave* (2004). It can be downloaded from *MicroSave*'s website www.*Micro-Save*.net from the Studies section.

Steps to Establish Branch Based Marketing

MicroSave's reviews suggest that many financial institutions that do not have formalised branch based marketing approaches, still practise rudimentary and adhoc forms of marketing. So what systematic steps can be taken to implement branch based marketing?

Training: An institution must build the capacity and skills of branch staff who are to undertake marketing activities. *MicroSave* Action Research Partners have performed training at institutional level for branch managers and branch marketing officers who in-turn have trained other branch staff during branch meetings. Branch staff needs to develop selling skills reinforced by superior product knowledge for all the banks' products.

Action Planning: After training staff from a particular branch, develop a branch based marketing plan that clearly details the specific marketing activities to be carried out, who is going to perform them, time lines and clear budgets for resources required. The finalised branch marketing plans should then be submitted to the Head Office marketing department for approval and revision so as to ensure they are in line with the overall strategic marketing plan. It is important for the institution to develop a standard template that can be used by all the branches for consistency and ease of consolidation.[3]

Implementation: Branch Managers should take the lead and ensure that the branch undertakes relevant branch marketing activities. The manager should also monitor customer levels in the banking hall and in case there is excess capacity in manpower for the normal branch operations these staff can be redeployed and used for branch marketing activities.

Monitoring and Review: It's vital to measure and monitor the branch performance in response to the various branch based marketing activities so that the plans can be revised accordingly and scarce resources can be deployed most effectively. The Head Office marketing function can develop a standard monitoring format in order to assess cost – effectiveness of activities.

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[3] See *MicroSave*'s Product Marketing Strategy Toolkit.

Some organisations have integrated branch performance into staff incentive and reward scheme. For example, Uganda Microfinance Limited has a branch based incentive scheme that is credited with significantly increasing deposit volumes.

Flexibility: The marketing plan for the branch must be flexible and enable it to exploit opportunities at very short notice.

Funding Branch Based Marketing

Branch based marketing can be affordable but effective. Some branch based marketing activities are conducted with a very small and minimal budgetary allocation for instance cross-selling in the banking hall or product of the week or month campaigns.

Conclusion

Branch based marketing can be very effective for mass market retail banking to low income groups. However, marketing does not work in a vacuum. Products and services need to be customer centric: actually meet identified customer needs. They need to be designed and delivered in an efficient and customer friendly manner to fully leverage the potential of branch based marketing.

Staff Incentive Schemes for Deposit Mobilisation

Mattias Grammling
and Martin Holtmann

Introduction

Staff incentive schemes for microfinance programmes (MFIs) usually focus on maximising the performance of the loan portfolio. Now that many MFIs are becoming licensed deposit taking institutions, how can staff incentive schemes be designed to encourage deposit mobilisation?

Deposit mobilisation is important for several reasons. The small entrepreneurs and salaried employees who form an MFI's typical clientele have a high demand for accessible and affordable deposit facilities. This is even true for very poor people, whose capacity and willingness to save are often underestimated. These locally mobilised funds help to reduce the dependence on (foreign) donors, and they mitigate exchange rate risks. Successful deposit mobilisation can help to increase an MFI's outreach dramatically, and the savings business that clients conduct with their bank can serve as a useful market research tool for later offering credit services to the same customers. This method has been used with considerable success by the credit union movement.

Successful Savings Mobilisation

The key for successful deposit mobilisation is trust – and trust in an institution can only be built if its staff members are also trustworthy. Hence, in order to mobilise savings, staff should be open and friendly to all clients, and they should be willing to work in a team. Good interpersonal skills are much more important for staff members in this area than are highly developed analytical skills or a background in economics or accounting.

Features of Staff Incentive Schemes for Savings

The fairness principle implies that there must be a clear relationship between the effort exerted on the job and the output variable that is used to calculate the bonus. In savings mobilisation, some clients may be actively "sought out" by extension workers, while others will simply walk into one of the branches. At the branch level, it is often a matter of chance who deals with the new customer; usually it is the next available desk officer or teller.

In savings mobilisation, it is often difficult to discern exactly what (and who) caused the customer to entrust the institution with his or her funds. And branch operations are usually organised in such a way that it is difficult to match the results achieved with each staff member's individual efforts.

Thus, rather than rewarding individual performance – which is difficult to measure and to match with the results that were achieved during a given period – it is much more useful to pay incentives based on team results. This can be done easily at the unit or branch level. The advantage of a team bonus is that it rewards good cooperation among all those who attend to savings clients, even if their individual actions are not directly related to generating a new deposit. This technique also avoids the problem of measuring individual performance.

In general, it is best to pay staff engaged in savings collection a generous base salary. Very often even the best efforts will not produce immediately tangible results in the form of new deposits. Thus the ratio of base salary to bonus as a percentage of total salary might be lower than the ratio for lending staff, e.g. closer to 70% and 30%, or even 80% and 20%. The mobilisation of savings is a longterm effort, and it requires the building of trust. Excessive bonuses based on short-term performance would send the wrong signal to the staff members involved.

There are some exceptions to these guidelines. For instance, some organisations want their loan officers (or field agents) not only to "sell" the lending products, but also to actively recruit depositors outside of the branches. In these cases it may make sense to pay individual bonuses based on the field agents' ability to generate deposits. However, we would need to make sure that there is a way of identifying the individual loan officer or field agent who solicited the deposit.

For instance, BURO, Tangail, a Bangladeshi NGO, had provided each village development worker with a small bonus for each new contractual savings account they opened in order to draw their attention to this specific product. While the scheme worked well and met its objectives at BURO, Tangail, it may not be the best solution for other MFIs because it does not include an incentive to keep existing customers happy. If bonuses are awarded only for bringing in new customers, staff members might find that providing good service to existing clients is not worthwhile. This means that we need to include more variables in our bonus formula.

Designing a Simple Bonus Formula

In order to incentivise staff to mobilise savings, we could provide them commissions both, on the net increase in the number of accounts (number of accounts opened less number of accounts closed during the period) and the savings balance. A team bonus could be calculated by:

Team bonus =
Net increase in the number of accounts during period *
$1 + Savings balance at end of period * 0.1%

Features of This Staff Incentive Scheme

If the commissions (in our example $1 for each increment in the number of outstanding accounts and 0.1% of the savings balance) were large enough, we could expect our staff to not only seek new clients but also to deliver a high customer service quality to retain existing clients.

With a simple scheme like this one, staff members engaged in deposit mobilisation and savings transactions actually feel rewarded for working harder. There would almost certainly be a positive effect on motivation, especially if there is already an incentive scheme in place for staff engaged in lending operations. The scheme is very simple, making it easy to understand and implement.

Variations and Extensions

The scheme presented here can be refined further. Examples include:

1. If there were different savings products, variable weights could be allocated to them to reflect the preferences of the MFI.
2. Other relevant products and services could be included (e.g. money transfer services, insurance policies).
3. Different commissions could be set for different (clusters of) branches to reflect local operational circumstances.

4. To prevent staff members from encouraging new accounts that will not be active, we could consider the net-increase in the number of active accounts instead of the net-increase in the number of accounts.
5. If management predicts that rewarding the “number of active accounts” might result in staff members encouraging customers to open new accounts with funds that they withdraw from their existing accounts, management might change this variable to “number of active savers.” 6. Although customers’ satisfaction is indirectly taken into account through the proxy variables of net increase in accounts and/or volumes outstanding, a more precise and direct measurement could be factored in.

The type of staff incentive scheme which fits best to a particular MFI largely depends on the incentive scheme’s objectives (e.g. as in the case of BURO, Tangail), processes and procedures, and other aspects of the organisation culture. For instance, SafeSave, an urban Bangladeshi cooperative had decided not to employ financial incentive schemes to mobilise savings to avoid loan officers “forcing“ their customers to save in order to get access to loans. And the case of KPOSB (see box below) demonstrates that staff incentives need to fit to the information and operational systems.

Distributing Group Bonus Pools

There are various ways of how the branch bonus pool can be distributed among branch staff. While the equal distribution is not only very simple but may also strengthen the team-spirit, the variable portion of the total salary is smaller for senior staff (e.g. branch mangers) – which they may perceive as unfair. Hence, where base salaries largely differ across individual staff members (and if this was desired), designers might alternatively think about distributing the branch bonus pool according to the base salaries. A mixture of these techniques is possible but would make the scheme more complex. If basic salaries differ within functional levels of staff (e.g. due to merit pay schemes), an equal distribution or a distribution according to the staff members’ formal position could decrease this gap. A more sophisticated way would include the distribution according to tournaments which are conducted between individual staff members. However, it will not always be possible to measure individual performance adequately and fair and the method could reduce team-spirit since it enhances competition among staff (and if high monetary rewards are involved in tournaments, they may not be perceived as “friendly” by staff).

> The Kenya Post Office Savings Bank (KPOSB) offers a number of savings products to around 1 million customers throughout the country. Since its passbooks are not domiciled, the institution cannot track customers back to particular branches, thus making it impossible to measure the achievements of particular outlets directly. As a second best solution, KPOSB has been thinking about rewarding the branch teams according to the number and amount of transactions, the number of accounts opened and closed as well as the volume deposited. Further differentiations within each of these performance measurement indicators and the use of weights assure that such a performance assessment reflects KPOSB’s preferences and is fair to the employees of all branches. Under that scheme, 70% of the branch bonus pool is distributed according to the basic salaries and 30% on the basis of individual achievements.

PRODUCTS

Mobilising Savings

Marguerite Robinson

and

Graham A.N. Wright

Introduction

Throughout time, all around the world, households have saved as insurance against emergencies, for religious and social obligations, for investment and for future consumption. The importance the poor attach to savings is also demonstrated by the many ingenious (but often costly) ways they find to save (Rutherford 1999). But for a variety of reasons, most informal mechanisms fail to meet the needs of the poor in a convenient, cost-effective and secure manner. As a consequence, when poor households' are provided a safe, easily accessible opportunity to save, their commitment to saving, and the amounts they manage to save, are remarkable.

Savings have risen to the top of the microfinance community's agenda. Previously microfinance institutions (MFIs) viewed savings as the poor relation - Vogel's (1984) "forgotten half" - and typically extracted savings from clients through compulsory systems. There was a prevalent and powerful perception that "the poor cannot save", thus compulsory savings systems often required members to deposit small token amounts each week and levied more substantial amounts at source from loans. These compulsory savings were then often "locked-in" until members left the organisation. Compulsory savings generate a loan guarantee fund for the MFI, but drive up the effective cost of loans. By contrast, voluntary savings are a service from which clients can withdraw and (often but not always) on which they receive interest. This note focuses on voluntary savings services.

A substantial proportion of client exit from microfinance institutions is driven by the credit-only focus of these institutions. For example, in Bangladesh clients drop out in order to (1) collect the funds from their compulsory savings accounts, (2) to access microfinancial services where their savings are available in an emergency, (3) to access enhanced services from other MFIs, i.e. ones that offer a wider range of products. East African microfinance customers also drop out to collect the funds from their compulsory savings account (Wright, 2001).

Microfinance institutions can avoid some client exit by mobilising savings from the public which can be collected profitably on a large scale. Poor people need savings services because of emergencies, opportunities (which are often unexpected), to pay for lifecycle events associated with death or marriage, and to smooth payments of their consumption needs. People do not need loans all of the time, but they do need savings all of the time. (*MicroSave*'s "Market Research for MicroFinance Toolkit" can help MFIs research and understand these issues).

Savings as a Service and a Source Of Funds For Loans

To offer credit services, the microfinance institution selects borrowers that it trusts through business assessments, character assessments, cash flow analysis, or a combination of several tools. In savings mobilisation, however, it is the customer who must trust the MFI (Robinson, 1995).

To begin the process of introducing savings services, the MFI must always conduct market research and feasibility analyses. Once these tests are completed, the institution uses the information to design appropriate high-quality services, which are then tested in pilot projects (see *MicroSave*'s "Toolkit for Planning, Implementing and Monitoring Pilot-Tests"). The institution should publicize its instruments and services in locally appropriate ways.

Compulsory and voluntary savings are usually incompatible. However, some institutions have designed programs where a percentage or a value amount of savings are made available to customers, but once customers are allowed to remove part of their savings, they usually prefer complete voluntary savings mobilisation. Quality voluntary savings services will usually mobilise more than locked-in savings.

Savings Products

What is most important is not any particular savings product, but the combination of products available from the MFI, which each saver can customize for his or her particular needs. For largescale savings mobilisation to be viable and to finance substantial portfolios, savings must be mobilised from the public and not from the poor alone. This makes it possible to serve large numbers of small savers profitably. While the transaction costs of very small accounts make mobilising savings from the poor expensive, the larger account sizes of the non-poor raise the average account size and permit a combination of institutional profitability and wide outreach. This crosssubsidization is the only way that the poor can be served cost-effectively on a large scale. However, such practice requires special attention to ensure that the products are attractive to all potential savers.

Cost Issues

Contrary to popular opinion, mass savings mobilisation from the public need not be an expensive source of capital. Small savings, when captured as part of savings mobilisation, can be collected at relatively low financial costs. In addition, there are synergies created through the economies of scope between savings and lending.

Products' interest rates and fees can also be used to provide:
- Incentives to build up and maintain balances
- Disincentives to withdraw
- Revenue from transactions/ledger fees

Information costs and loan loss provisions are expected to be less when MFIs can draw on the deposit histories of potential borrowers to analyse their capacity to pay and creditworthiness. It is essential that MFIs cost their products to make informed pricing decisions. Costs of new products are difficult to determine in advance, so pilot-tests are needed to estimate cost accurately. Interest and fees charged should be carefully structured to give clients a choice between products with different ratios of liquidity and returns.

Some Basic Principles for MFIs in Large-Scale Savings Mobilisation

Profitable large-scale savings mobilisation is not a matter of adding a few products to a microcredit institution. It changes the institution fundamentally. MFIs should offer only a few carefully designed savings (and other) products. Too many products make branch management too complex and expensive and many products are not necessary for most clients.
- Large-scale savings mobilisation should be limited, except in highly unusual cases, to publicly regulated and supervised institutions that are legally permitted to mobilise public savings.

- Microcredit institutions introducing voluntary savings should pay particular attention to the preconditions required and to appropriate sequencing in terms of research, product development, pilot-testing and roll-out
- Products are necessary but not sufficient for profitable voluntary savings mobilisation from the public, as they are only one element in a much larger set of requirements (including MIS, training, marketing etc.) for the profitable large-scale mobilisation of savings.

Management, Organization and Human Resources

High quality, experienced, and committed governance and management are essential. The MFI should stop efforts to raise voluntary savings if these are not available. Management and staff training and incentives related to each step of the sequencing process are essential. Some managers and staff (especially middle managers) may object to, and in some cases refuse to implement, the necessary broadbased changes. This problem, where it arises, must be carefully and quickly dealt with (usually not easy). Because mobilising voluntary savings from the public will change the institution dramatically, management, organisation, internal supervision, liquidity management, and financial intermediation are likely to need fundamental restructuring.

Who Benefits from MFIs that Offer Voluntary Savings Mobilisation to the Public?

Clients benefit from savings services, since they need and demand the service. However, the MFI benefits too, for several reasons. First, clients are likely to be more satisfied and therefore more likely to repay their loans to maintain on-going access to the package of financial services. Second, savings provides microfinance institutions with an attractive source of capital: locally mobilised voluntary savings is potentially the largest and the most immediately available source of finance for many microcredit institutions. Small voluntary savings can result in large amounts of funds that are more stable than other funding sources. Third, the MFI receives additional income from loans made, investment of the new capital, and also from fees charged on savings transactions. The national economy also benefits as savings are brought out of the informal into the formal sector and made available for reinvestment.

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TWO PERSPECTIVES ON SAVINGS SERVICES[1]

Graham A.N. Wright

[1]**Wright,** Graham A.N., "A Critical Review of Savings Services in Africa and Elsewhere", *MicroSave* 2000 and **Fiebig,** Micheal et al. "Savings in the Context of Microfinance – State of Knowledge" in Hannig Alfred and Sylvia Wisniwski (Eds), "Challenges of Microsavings Mobilisation – Concepts and Views from the Field", GTZ 1999

Savings Products and Services from a Saver's Perspective

Balancing Convenience, Risk and Returns

It is clear that most poor people do not have access to formal sector banks for reasons that include the:

1. Geographic distance from the financial institution;
2. Terms and conditions governing the available financial services it offers;
3. Disrespectful manner in which the staff treat poor clients;
4. Intimidating appearance of the financial institution; and
5. Complexity of the paper work and the difficult process necessary to make a transaction.

The poor look for some system to provide the security and accessibility necessary to save. Acceptable degrees of security are relative, dependent on the available programme, and are never 100 per cent. Almost every poor person has been in, or knows of, a failed Rotating Savings and Credit Association [RoSCA] or crooked deposit collector, but the accessibility of a regular opportunity to save in a disciplined manner is what makes RoSCAs and deposit collectors so popular worldwide.

Access is markedly different from liquidity, and often considered more important by poor people who have little time to make their transactions. While many authors have stressed that "liquidity is the key to local savings mobilization", it is important to note that in many circumstances the poor have a strong "illiquidity preference". This "illiquidity preference" is in response to the poor's self-imposed need for structured and committed savings mechanisms that prohibit them from withdrawing in response to trivial needs and allow them to fend off the demands of marauding relatives requesting "loans" or assistance.

With the exception of successful Accumulating Savings and Credit Associations (ASCAs) and auction RoSCAs, the return on savings in the informal sector is rarely above zero. Often the poor pay to save through a conveniently accessible system such a deposit collector who visits daily to collect savings.

Managing Liquidity and Duration:

A Spectrum of Needs All families require funds for different purposes that vary with respect to the amount that is needed and the immediacy with which the funds must be made available.

Many emergencies or opportunities necessitate instant access to cash. This explains why almost all poor families keep some amount of emergency savings in the home, and why many do prefer highly liquid savings services. The "illiquidity preference" described above means that poor people have needs that require both liquid and illiquid services and those that save, often hold multiple accounts to do so. Similarly, poor people often use a strategy of "targeted savings", including some highly illiquid savings, (notably, in the absence of alternatives, MFIs' compulsory savings) to build-up large lump sums of money to purchase significant capital assets such as land and houses.

Compulsory, Locked-In Savings

The poor require little compulsion to save. They simply want a reasonable mechanism to do so and the assurance that they will be able to access those savings as needed. Indeed, there is evidence that compulsory savings, particularly those that are deducted from the loans

issued, are simply viewed by clients as part of the cost of the credit. Some clients use these compulsory savings systems to build up useful, longterm lump sums of money. However, it is possible that well designed open access savings accounts and contractual savings agreement schemes could give clients the option of setting these funds aside. Furthermore, such systems would not force the clients to leave the MFI, or reduce their ability to access loans, if they need to liquidate their savings.

Designing Savings Products and Services from an MFI's Perspective

Balancing Convenience and Returns

As seen above, when deciding on savings services, poor people look for a mix of accessibility, security, liquidity and (ideally but not crucially) returns. The financial institution's perspective is almost the mirror opposite of that of the client. Financial institutions would like to maintain a few branches in densely populated areas to maximise the number of clients per branch and facilitate branch security. They would prefer to limit opening hours to allow the opportunity to keep up with the complex accounting and internal control procedures necessary to run a financial institution effectively, and to facilitate physical security arrangements. They would like to see large deposits made for as long as possible with a minimum of withdrawals so that the transaction and liquidity management costs are kept to a minimum and the funds available for on-lending are maximised. And of course, the profit-maximising goal of a financial institution encourages the payment of as little interest as possible. Nonetheless, there are many MFIs that offer micro-savings services on a profitable basis.

Managing the Costs of Small Savings Accounts

One of the chief fears voiced by MFIs revolves around the potential difficulties involved in dealing with the many small transactions often associated with the providing savings services to the poor. While this is indeed likely to be the case, several important observations should be made:

1. Generally, the majority of the transactions will be deposits. Indeed the poor are often remarkably unwilling to make withdrawals. However they do want to know that they could withdraw if a pressing need arose;
2. Poor people have a multiplicity of needs and are not always looking for a highly liquid account to use on a regular basis; and
3. Savings accounts targeted for medium and longterm needs are particularly attractive to MFIs in search of capital for on-lending, and appropriately designed products can encourage these.

There are also important and often over looked, additional benefits of offering savings services to the poor. In addition to providing capital for on-lending, savings services can:

1. Develop the client base (of borrowers) for the future;
2. Obtain information on the clients' abilities to save and (by implication) repay loans;
3. Facilitate repayments when clients are unable to meet repayments out of current income; and
4. Encourage repayments, as clients want to maintain a good reputation and their access to future services. There are also many ways of minimising the costs of providing savings services, and possibly even deriving a profit from doing so. This can be done directly through carefully structured pricing to encourage savers to maximise deposits and minimise withdrawals. MFIs can elect to pay interest only on accounts with balances above

a certain minimum. In view of the clear evidence that poor people are willing to pay for convenient savings services MFIs can charge fees for specific savings services. In order to reduce withdrawals, MFIs could limit the number of withdrawals per period, set minimum withdrawal amounts, require notice to withdraw or charge for withdrawals made.

In addition to the pricing structure, the MFI can reduce costs through its organisational approaches and work methods. Finally, it is important that MFIs offering savings services seek up-market, higher-value savers to spread the costs and make the service cost-effective to run.

Synthesis and Conclusions

Two different strategies are pursued by outside agencies (be they development or private sector) and by poor people themselves as they seek to design and deliver financial services. The former tend to use a strategy of "permanence and growth" and look to create sustainable institutions that deliver financial services to an ever-increasing number of clients – such as MFIs, banks, and co-operatives. By contrast, poor people generally use a strategy of "replication and multiplication" and look to create many small selfcontained, often self-liquidating, schemes – such as RoSCAs and Christmas clubs.

Permanence and growth institutions tend to encourage the long-term build-up of funds through relatively slow, but steady, saving, and are therefore extremely well suited for addressing longer-term savings needs. Replication and multiplication schemes tend to encourage the rapid accumulation and disbursement of funds and are therefore better suited to meeting shorter-term savings needs. There is increasing evidence that providing client-responsive financial services can both serve the needs of poor people while maintaining or in fact improving the sustainability and profitability of the MFIs.

There are no magic formulas for designing appropriate savings products for poor people: it requires market research and careful, systematic product development. But the rewards for the MFIs that undertake these exercises in terms of profits and client loyalty can be remarkable, and well worth the investment.

The Conditions Under Which Poor People Save

From Rutherford[2], 1996

1. they feel their savings are secure
2. they feel they can get access to their savings (as withdrawals or as loans)
3. they have the opportunity to save often and easily
4. they see the example of others saving regularly
5. they feel under some social pressure to save
6. they feel they own their savings (the savings are not owned by a group)
7. they feel the savings are growing (by interest rates or bonuses) and protected from inflation

[2]Rutherford, Stuart "A Critical Typology of Financial Services for the Poor", Action Aid and Oxfam, London 1996

Term Deposits: Rural Clientele Ask For More

Sonmani Choudhary

Term deposits[1] are one of the most common means of investment in rural sub-districts of Java. A majority of rural clients prefer term deposits in commercial and rural banks[2] because of the perceived guaranteed safety and assured return. This therefore also offers an inadequately realised growth potential for rural banks.

Of late, the majority of rural banks, despite their huge market potential, have witnessed a decrease in deposit mobilisation. They have been losing business to competitors, mostly commercial banks. Sometimes other savings or investment options available to the client are more appropriate, or convenient, than the products offered by the rural banks. For example, in the absence of a suitable savings product, a rural client may prefer to hold his/her surpluses in land, durables, crop inventory, livestock and jewellery. While the recent loss of business can be attributed to a number of factors, *MicroSave* market research clearly demonstrates that the mismatch between demand and product offering is one of the most important.

Of late, a growing number of rural banks have made renewed efforts to revive their deposit portfolio. This Note highlights the experiences of rural banks in mobilising term deposits, the issues and challenges they face, and the strategies adopted by them to revive their portfolio and growth.

Term Deposit Product: Does It Meet Client Demand

A steady growth in the number and amount of deposits at a bank sustains capital adequacy, improves crossselling opportunities and nurtures public confidence, and thus determines financial robustness of the institution. However, if growth falters it may indicate loss of faith in the bank, and eventually loss of clients and reduced profitability. *MicroSave*'s research studies have indicated that an increasing number of existing BPR customers have been either discontinuing or gradually reducing the volume of deposits they hold with rural banks. *MicroSave* studies in Java region[3] of Indonesia have revealed that the current deposit products offered by a number of rural banks are not appropriate to address the banking and short term investment needs of a range of clients thereby driving them to their competitors in the formal and informal sectors. Moreover, products offered by some commercial banks are also facing service quality issues like long queues, cumbersome cash withdrawal processes, and penalties charged upon early deposit withdrawal.

Rural clients place deposits to compensate for uneven income streams, manage unforeseen events, social and religious obligations and for future consumption. Quick access to their deposits is crucial for them to respond to emergencies and unanticipated investment opportunities. Moreover, the transaction costs (i.e. the cost of making a deposit and of liquidating it, the cost of travelling to the financial institution, the opportunity cost, and cost of paperwork) can be so high that a seemingly positive real rate of return appears negative, and a rural depositor therefore turns to either a local MFI or an informal means of savings.

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[1]'Term Deposit' product refers to term deposits received by the bank for a fixed period withdrawable only after the end of the fixed period. These deposits can be withdrawable prematurely but on prior notice. It includes recurring deposit and fixed deposit scheme.

[2]The term rural bank or BPR (Bank Perkreditan Rakyat) represent secondary banks in Indonesia, which are regulated and supervised by the central bank. They usually operate at the sub-district level. BPRs are locally based and mostly privately owned rural banks. They cater to lower to middle income clients; they are not part of the payments system; they face strict branching restrictions; and they are subject to different regulations than commercial banks.

[3]Java is an island of Indonesia. It is the world's most populous island, and one of the most densely-populated places on the globe. Java is the home of 60 percent of the Indonesian population. Java is divided into four provinces, West Java, Central Java, East Java, and Banten, and also two special districts, Jakarta and Yogyakarta. (Source: Wikipedia)

The demand for deposit products at a rural bank increases with the interest rate paid on those deposits. However rural clientele have their own mechanisms to compare rate of return with other informal means of arrangement. The interest on deposits paid by BPRs may seem attractive when compared to the interest paid on commercial banks' regular savings products. However, this benefit may be ignored as customers value the safety of the deposits more than anything else.

The age of a client has a big influence on his/her financial behaviour. In general, village youth prefers investment in assets and durables. Nonetheless, they may keep a small portion of their investment in a term deposit scheme to diversify their portfolio. But the pattern changes during retirement, when the investments allocated to term deposits rise significantly. Clients expect maximum return with security, ease of operation, and liquidity from the rural bank entrusted with these deposits. Many senior citizens also ask for quick personal loan facility against their deposits to meet immediate requirements such as medical expenses.

It is rare to find a BPR that offers special rates and facilities for senior citizens. While some do offer negotiable interest rates on the deposits these do not necessarily meet client expectations.

Issues And Challenges Faced By A Rural Bank

MicroSave studies identified that, in recent times, commercial banks have generally been more successful than rural banks in mobilising term deposits. This is because of a combination of factors such as grandiose branch offices, brand equity, and an exclusive marketing team to drive deposit mobilisation. *MicroSave*'s research also found that most rural depositors (existing, as well as new) were unaware of many of the products and services offered by both commercial and rural banks. They chose a commercial bank based on its corporate image and local presence.

The following are the key issues and challenges faced by a rural bank seeking to mobilise term deposits:

Lack of Focus: Rural banks generally focus inadequately on building their deposit portfolio. Marketing and promotion efforts are minimised, and efforts are often only directed at staff members and their close relatives or acquaintances. This is because deposit mobilisation in rural areas is a high volume but resource intensive affair. Thus, while it supports the sustainability of the bank by providing stable funds, there is often a trade-off between the money that can be earned on these funds and the relatively high mobilisation costs involved.

> KBPR Arta Kencana has vast experience in delivering deposit and savings services. In 2011, they opened a new branch in a new geography. KBPR sought *MicroSave* support to understand the market segment for term deposit products and help in setting up a marketing strategy to ensure sustained growth in coming years. Inter alia *MicroSave* helped KBPR to design a product brochure containing the range of products and services offered by the bank, and a section on future planning and banking. The section on future planning and social upliftment was included not only to create awareness, but also as an important strategy to market BPR in the long run.

Rural vs. Commercial Banks: BPRs are often compared with commercial banks on interest rates and services provided. In most cases rural banks offer higher interest rates

than commercial banks. Customers expect service delivery of a similar standard from both commercial and rural banks. Savings in both types of banks are secured and guaranteed by the government (under Lembaga Penjamin Simpanan-Indonesia Deposit Insurance Corporation), but people perceive savings to be more secure with a commercial bank. This acts as a major challenge for rural banks as they lose existing clients and face difficulty in attracting new ones, despite offering better interest rates (sometimes even negotiable interest rates), as well as the opportunity to win prizes through lottery schemes.

Inability to Use a Market Segmentation Strategy: Rural banks mostly do segmentation based on demographic parameters and ignore variables such as culture, socioeconomic, behaviour, usage pattern, service need and benefits sought by the clients. They also face difficulty in targeting post segmentation, i.e. which segment to choose for growth and profit. Some even identify the market, but find it difficult to decide on product and services that will attract and retain clients. BPRs often waste their resources trying to mobilise deposits from clients for whom deposits are of little importance. For example, those involved in daily businesses compare the return on deposits to the return on their businesses, and conclude that investing surpluses in the business is more attractive than depositing in a financial institution.

Lack of Adequate Performance Standards and Incentive Schemes: Rural banks that have been successful in deposit mobilisation are often characterised by clearly defined performance standards and incentive schemes to drive uptake.

Client segments are highly differentiated therefore it is important to identify them and develop specific strategies to target different groups. Segmentation of different groups allows a bank to adapt or refine products, services and communication/marketing to the requirements of each group – whether age, gender, livelihood, deposit size etc. In some cases this may require designing of new products for specific segments.

It is useful for rural banks to analyse their client databases in greater depth to more effectively orient marketing and cross selling efforts. *MicroSave* assisted a rural bank in dividing depositors into sub-segments such as:

- **Big depositors:** save in high volume, are more security conscious, compare interest rates offered, need facilities such as ATM, and prefer commercial banks.
- **Busy but regular depositor:** clients engaged fulltime in their business, prefer doorstep service.
- **Relationship:** a segment which depends on recommendations/suggestions from their close circle of friends. They typically prefer to stick to one institution rather than exploring possibilities elsewhere.

Conclusion:

Rural banks can develop an edge over commercial banks to capture term deposits. BPRs offer higher interest rates, lower minimum deposits, usually do not charge penalties on early withdrawals, and have convenient local offices. However, to develop and maintain a competitive edge BPRs need to understand their target segments and fine tune their products, services, and marketing efforts. This calls for better market intelligence as well as committed and capable institutional resources.

How Saving Is Influenced by Behavioural Biases

Premasis Mukherjee,
Akhand Tiwari and
Anup Singh

Savings products and services have traditionally been designed assuming the normative theory of life cycle consumption smoothing over years.[1] This theory makes two assumptions about savers' rationality. One, that savers accumulate and then liquidate assets over years to maximise different lifetime utility functions; and second, having determined their optimum lifetime consumption patterns, households have sufficient willpower to save accordingly. However, the theory, from its origin, has not been able to explain several anomalies in savings behaviour. The questions that trouble savings service providers are:

- Why is it difficult for people to switch from informal savings schemes to formal savings mechanisms?
- Why people procrastinate to commit and start saving?
- Why people discontinue long term savings plans even after committing to them? and
- Why people tend to choose "fixed return" even at the cost of low or negative interest?

In this Note, starting with a generic model of mass-market savings, we delve deeper into the behavioural factors in play at several decision points on savings.

Mental Model of Mass-Market Savings Behaviour

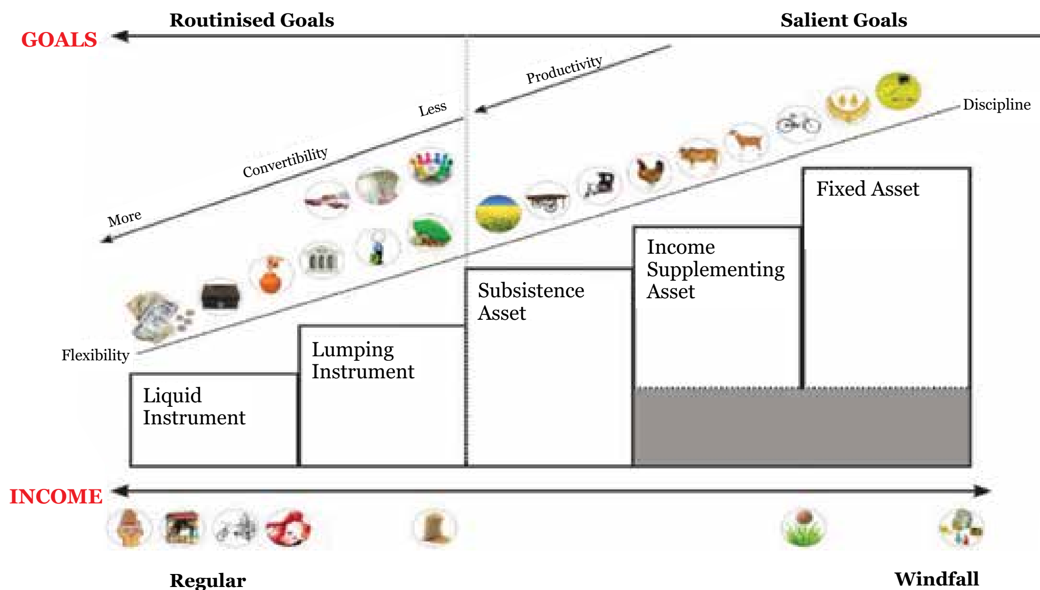
In *MicroSave*'s MetaMon research, we have seen that money management of the mass-market is governed by interaction between their income and goals as well as the instruments (saving/lumping/buffering) that help them convert income into goals. People's savings behaviour is a direct result of the way they perceive goals in their life, and how they manage income and expenses through a variety of lumping/buffering mechanisms.

Goal Function: Contrary to the normative theory of life cycle, the MetaMon research shows that for a large part of population, goals are not a function of time as much as they are a function of certainty of the event and its negotiability over competing goals (e.g. buying a TV vs. house reconstruction). There are certain goals that are immediate, regular and recurrent in nature. People generally fulfil these goals (or needs) through their routine income. However, there is a portfolio of goals that are less certain and are negotiable over each other. These goals are fulfilled depending on proximity of the event, social pressure/norm, and availability of money or temptation.

Beyond these, there is an amorphous category of "aspirational goals" (e.g. buying land), which are so distant in their mental model that these do not play any major role in the immediate money management strategies of people. This explains why schemes with pre-defined "final amount" are preferred over medium to long term savings programmes that are designed around certain fixed goal or event (e.g. marriage savings, house building savings etc.).[2]

Instrument Function: Since income patterns and goals are not always similar in frequency or magnitude, people use financial instruments as catalytic mechanisms to build up savings to fulfil their goals. These instruments are defined based on how easily they can be converted to liquid form in case of need, and how productive they are. There are some "lumping mechanisms" where people build up their savings in a disciplined (e.g. RoSCA or recurring deposit) or flexible (e.g. lock-box, piggy bank) way to create a lump-sum "windfall" income/cash inflow at a future date. The second category of instruments, also called "assets", are accumulated from any windfall income/cash inflow and are used either to augment regular income (e.g. a cow that gives milk regularly) or store value (e.g. jewellery, utensils) for emergency use or value appreciation.

[1] Modigliani, Franco, (1966) 'The Life Cycle Hypothesis of Saving, the Demand for Wealth and the Supply of Capital", Social Research.
[2] CGAP Focus Note 37, (2006), "Safe and Accessible: Bringing Poor Savers into the Formal Financial System".



Formal savings products or services will have more traction with clients, if they are aligned to this mental money management model. In other words, unless a formal savings product feels like and serves the purpose of cow, goat, hen, jewellery or any of the lumping mechanisms, low income clients will not naturally prefer choose and use them. While mental models explain preference for informal savings/lumping mechanisms over the formal ones, other predominant anomalies can be explained by other behavioural factors, as discussed in the next section.

Procrastination to Commit

Even if a well-designed savings product is offered, people generally show an aversion towards committing to save. Often, they defer the decision to start savings (especially long term savings) in spite of logical needs and availability of choices. Behavioural explanations of such behaviour are as follows:

Status Quo Bias and Hassle Factor: People are inclined to behavioural inertia and tend to not actively shift from their current practices of no, or informal, savings. Moreover, in products with the option to increase contribution over time, people tend to continue with initial contribution level even when their income, and thus ability to save, increases. The processes and documentation involved around formal savings schemes also work as a deterrent for people to shift from informal/ semi-formal mechanisms where processes are relatively smooth and hassle free.

Hyperbolic Discounting and Present Bias: People tend to prioritise their current liquidity needs over future requirements for lump-sums. This “present bias” restricts people from committing to savings even when they realise the substantial future benefit of doing so. Often, the regular contribution required to build such future lump-sum is so huge that people tend to feel intimidated by it. This feature is exploited by fly-by-night operators who promise unrealistically high returns where such contributionreturn disparity is not immediately visible.

Mental Accounting and Primacy: People generally associate a service provider with a typical product provision, as well as frequency, magnitude and duration of transactions involved with it. Accepting the provider in a different product category is psychologically

incongruent for them. Savings products are often offered to the massmarket by providers better known for other products and services (e.g. MFIs, better known for credit). Since they would have exhausted their mental "account" for the provider in the core service (e.g. credit), it becomes difficult for them to save any more with them. Even if they enrol, they tend save the minimal required amount as a proportion of usual transaction value with the same provider. For example, with most of the MFIs, the savings occurs as percentage of the loan instalment.[3]

Discontinuance of Committed Savings

Even if people commit and start saving, often medium to long term savings schemes lapse for want of continued contributions.[4] While lack of a clear goal often translates into lack of motivation, some of the other factors responsible for the phenomenon are discussed as follows:

Planning Fallacy: When convinced, people make timeinconsistent commitments towards regular savings, often overestimating their future well-being and regular income. This leads to over-commitment, which they find difficult to adhere to on a regular basis.

Non-Salience of Renewal Contribution: Through their incentive and marketing mechanisms, service providers try to "acquire" and "enrol" clients into medium to long term savings products. They assume that clients will discipline themselves into persistency. As a result, the importance of regular on-going contributions are not made as clear (and are not as immediate) as the first contribution. Hence, clients tend to not focus on fulfilling the commitment to regular payments. In other words, enrolment is made a "salient goal" to a client, but the regular contributions are not.

Choice of Fixed/No Return

Low income people seem to prefer savings products which offer fixed rather than variable return. This preference leads them to subscribe to schemes that offer minimal or even negative interest rates. The ambiguity about the final amount and aversion of associated loss explains only part of the trend. For low income people, the mechanism of disciplined, committed savings (e.g. in RoSCA or savings collectors) is of more importance than the expectation of returns. The need for the imposed discipline to save is such an intuitive preference for present-biased people that they are even willing to incur costs to use these services.

Conclusion

Financial inclusion is often defined as the process of shifting people's financial lives from informal to formal mechanisms. Though many research studies have demonstrated that low-income people have active and vibrant savings practices, providers across the globe continue to struggle to make formal savings products attractive to them.

As this Note highlights, in order to make this significant shift, a provider has to:

- Design products aligned to the mental money management model of the clientele;
- Help them commit to and start using formal savings mechanisms as tools in their daily life;
- Enable them to continue savings at regular intervals; and
- Assure clients of security of and return from it.

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[3] See *MicroSave* IFN 108, "How Can BC-MFIs Tap Household Savings?"
[4] Smith S., (2009), "Stopping short? Evidence on contributions to long-term savings from aggregate and micro data", LSE, London.

Design Considerations for Credit Scorecard for MSME Financing

Anup Singh and
Venkata N A

Background

Globally, micro, small and medium enterprises (MSMEs) play a crucial role in promoting economic development. However, one of the major challenges faced by MSMEs is the lack of access to finance. Financial institutions are wary of financing MSMEs and cite a variety of reasons for this, including lack of reliable financial information, poor financial record keeping and absence of credit history. Given the potential of the MSME sector, simple and effective risk models that look beyond audited financial statements are essential. A McKinsey2 study reports that 72% of banks use credit risk assessment models based on traditional information sources, and 69% banks reported lack of or poorly designed credit scorecards. In this Note, we suggest a fresh approach to MSME finance through the design of credit scorecards. We base our approach on practical experience based on our work in MSME finance across Africa and Asia.

Benefits of an effective credit scorecard

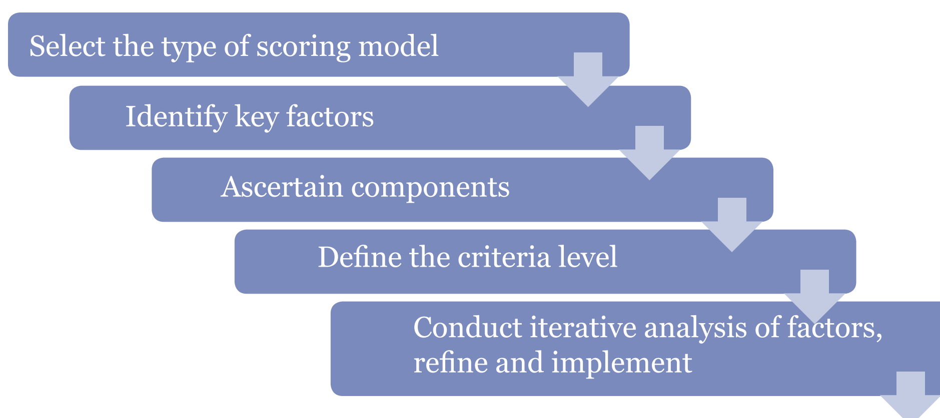
An effective credit scorecard is dynamic, linked to the MSME market and local economy, and enables the financial institution to enhance efficiency while managing portfolio risk effectively. The key benefits include:

- Segregating loan applications in to the three buckets of "approve", "reject" and "further analysis required";
- Enhancing efficiency of the screening process by reducing time taken for decision making;
- Ensuring consistent appraisal, evaluation and approval by reducing judgemental errors; and
- Enabling the financial institution to link interest rates to the risk profile of the applicant.

In our extensive experience with small banks and microfinance institutions offering MSME finance using a scorecard, the financial institutions were able to significantly reduce processing time, increase portfolio quality and productivity and enhance customer satisfaction.

Designing a simple, yet effective, credit scorecard3 for MSMEs

The core design principles for an effective credit scorecard are that is must be succinct, simple, quantitative, easy and fast to administer. The design can thus follow a five-step framework as below:



Select the type of scoring model

There are mainly two types of scoring models, namely, statistical and judgemental.

Attributes	Statistical	Judgemental
Data source	Past loans, specifically the loans that are delinquent or in default	Based on understanding and experiences of staff and institution
Model	Quantifies risks	Ranking model
Determination of factors	Using statistical tests	Brainstorming between key members of a working group
Process	Linear	Iterative
Skills required to design	Advanced statistical skills	Moderate
Adjustments	Fairly easy using statistical tests	Very hard to identify
Validation and simulation	Can be done	Cannot be done

Although a statistical model is preferable to a judgemental model because of its benefits, designing a statistical model is time consuming and needs complex statistical analysis of past loans, as well as a whole host of other indicators – savings history, industry for which the loan is being sought, experience/age/address of the borrower etc. Statistical models are based on estimation techniques such as logistic regression or probit to arrive at probability of default based on historical data and behaviour of a similar segment. Once the estimation model is statistically valid, it is used to predict behaviour of new clients by assessing client details on the model.

Thus, designing statistically modelled tools is only suggested when the financial institution has high quality. data on past loans and other related indicators, has access to expert statisticians to develop risk models and has a robust and flexible information technology system. We have seen very large banks struggle to implement effective statistical credit scoring models. So alternatives are often required.

In this Note, we explain the basics of judgemental credit scoring design, as it is one of the most practical approaches to design credit scorecards, and particularly suits smaller banks and microfinance institutions scaling up to MSME finance.

To develop a judgemental credit scorecard, expert judgment must be exercised in defining factors and components for the scorecard and assigning weights. The scorecard should mimic the actual loan underwriting process to make the tool practical and effective. The scorecard should have appropriate grades such as low, medium and high risk to differentiate between risk profile of the applicants, enhance processing speed, and to set lending policy and pricing decisions according to the risk profile of the borrower. To develop an effective scorecard, the financial institution will need to establish a working group, led by the Director-Credit.

Identify key factors

The working group may use the question, "What are the characteristics of a client who repays on a timely basis?" to zero-in on the key factors. Based on past experience and brainstorming, the working group should identify these characteristics or "key factors". Some of the outcomes from *MicroSave*'s previous engagements suggest that key factors include: past financial behaviour, client profile, primary sources of repayment, nature of business etc. To keep the tool simple, it is suggested that the working group should ideally focus on 3-5 key factors adequate to provide credible credit risk assessment. To reduce from a list of several factors, the group can run a priority ranking exercise. Once the factors are decided, the group may begin to assign weights. Usually the process of assigning weights is an iterative process and should be done keeping in mind the relative importance of the factors.

Ascertain components

For each key factor, the working group should ascertain components based on the ready availability of data, objectivity, ease of collection of information and relevance to the scorecard. For instance, for past financial behaviour as a factor, the components can be credit history and savings history. Once the working group has identified all the relevant components, they should assign weights to each of the components based on their relative importance. This will be an iterative process and for ease of assigning weights, the working group can take 100 as the absolute weight for all the factors.

Define the criteria level for each component

Once the working group has decided the factors and components, and assigned weights, they should define the criteria for assigning scores. A suggested approach is to use a numeric scale grading of 0 to 5. While zero can be assigned to all the cases where there is lack of or insufficient data or where the client's repayment performance is relatively poor, 5 can be awarded to best in class repayment performance. Based on the past data availability and experience of working group members, they can define the criteria and levels for performance. For example:

Factor	Component	Criteria (Score)
Past financial behaviour	Credit History	100% repayment on time for more than 2 loan cycles (5) 100% repayment on time for one cycle (4) Only one instalment defaulted (3) 2-3 instalments defaulted (2) More than 3 instalments defaulted (1) No loan records (0)

Conduct iterative analysis of factors, refine and implemen

Once the scorecard is ready, it should be tested alongside the existing appraisal systems, and the staff should continuously validate the accuracy and relevance of the scorecard. The feedback will help the working group to tweak and finalise the scorecard. *MicroSave*'s experience suggests that an effective credit scorecard is built on a series of iterative analyses of factors/indicators/predictors over a course of six to eight months of testing and refinement for the scorecard to achieve a level that mirrors traditional appraisal techniques.

Costs and benefits

When *MicroSave* supported a bank in Central Africa to do this, the total costs of design and implementation of credit scorecard were approximately US$11,500. Monetising the involvement of the CEO, Operations Head, SME Manager and Credit Analyst as well as external support for the design amounted to US$8,000. In the implementation phase, intermittent involvement from SME Manager and Credit Analyst to review and refine amounted to another US$3,500. The benefits far outweigh costs as the institution has doubled its productivity, managed portfolio quality better than what they experienced in their previous SME loans (nonperforming loans are now 0.98% of portfolio as against 9% before introduction of the scoring system) and increased customer satisfaction (on account of quicker turnaround of loan request – 2 weeks maximum) contributing to an increase in profits to the tune of US$90,000 in the first 10 months of implementation.

Conclusion

A judgemental scorecard developed using in-house experience and staff members' practical knowledge of credit risks for MSMEs, and refined based on a series of pilot-tests, has the potential to enhance efficiency of loan processing and underwriting. Utmost care and caution should be exercised in the design of the scorecard, and the financial institution should not short-cut the process of testing it out in parallel with its traditional underwriting to build a robust model. Credit scorecards have the potential to support financial institutions to enhance lending to the MSME sector while at the same time managing risks. However, it is important to note that credit scorecards are not silver bullets and it may not be able to predict default in all circumstances.

Developing Cash Flow Based Micro and Small Enterprises 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 micro and small enterprise 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 Succesful 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 fieldbased 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 micro and small enterprise 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 micro and small enterprise 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 minimize 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.

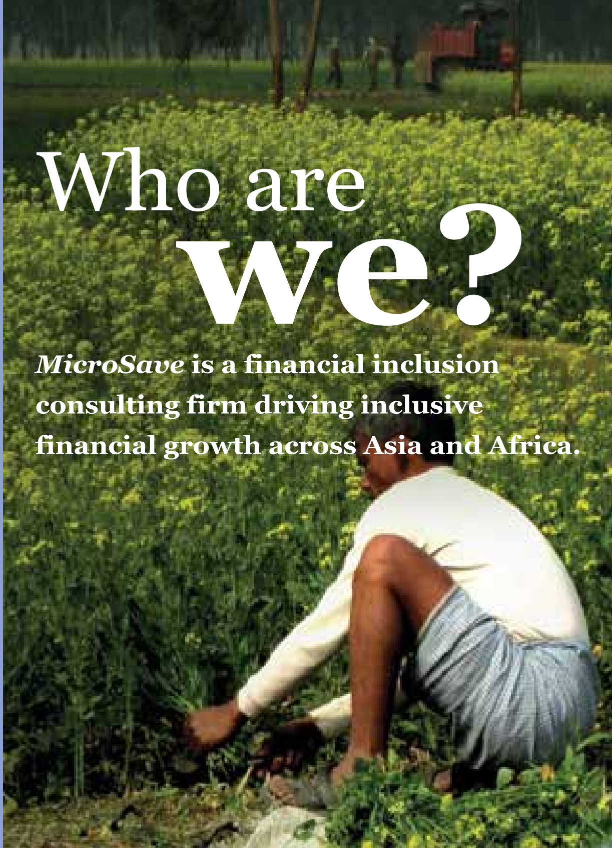
Managing Risks in Cash Flow Based Lending

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.

Market-led solutions for financial services

Corporate Brochure

MicroSave



Who are we?

***MicroSave* is a financial inclusion consulting firm driving inclusive financial growth across Asia and Africa.**

Who do we work with?

Influencers and decision-makers amongst financial service providers - banks, microfinance institutions (MFIs), mobile network operators (MNOs), cooperatives and governments, donor organisations (foundations, multilaterals, bilaterals) and other groups including regulators, industry networks, etc. who in some way or the other contribute to financial inclusion.

Where do we work?

We have implemented projects across **Africa, Asia and Latin America** including: Afghanistan, Argentina, Bangladesh, Cambodia, Cameroon, Cape Verde, China, Colombia, Democratic Republic of Congo, Egypt, Ethiopia, Fiji, Ghana, Haiti, India, Indonesia, Kenya, Lao PDR, Liberia, Malawi, Mexico, Morocco, Mozambique, Myanmar, Nepal, Nigeria, Pakistan, Papua New Guinea, Peru, Rwanda, Samoa, Sierra Leone, Solomon Islands, South Africa, South Sudan, Sri Lanka, Tanzania, Thailand, The Philippines, Timor-Leste, Tunisia, Uganda, Vietnam, Zambia and Zimbabwe.

What do **we** offer?

MicroSave offers consulting services in the areas of Inclusive Finance & Banking, Digital Financial Services; Micro, Small and Medium Enterprises and Private Sector Development.

2 Digital Financial Services

We offer consulting services to financial institutions, agent network managers, technology service providers, mobile network operators and government/government bodies to help them achieve financial inclusion. We also help clients design new business model architecture, implement solutions and improve systems to deliver financial products and services using digital platforms.

Areas of **Expertise**

1 Inclusive Finance and Banking

We provide consulting services to banks and MFIs to develop strategies, build innovative products and services, and design delivery systems to cater to the unbanked and underbanked segments. We give technical assistance to help clients focus on impact and value creation supporting the double bottom line.

4 Private Sector Development

We engage with donors, multilateral agencies, governments, non-government organisations, banks, MFIs and community-based organisations for agriculture value chain development, water, sanitation and hygiene (WASH), energy and housing. We assist these institutions to assess markets; formulate strategies, develop, test and deliver financial and non-financial products and enhance staff capacity.

3 Micro, Small and Medium Enterprises

We expand access to finance for MSMEs, by supporting investors, financial institutions and enterprises. We build strategy, design business models, develop new products, manage risk, strengthen capacities, and optimise processes and systems.

Clients speak:

“MicroSave has made important contributions in the field of financial inclusion by successfully partnering with diverse stakeholders such as financial institutions, investors, donors, corporates and regulators for providing, what its corporate tagline claims, ‘Market-led solutions for financial services’.

Dr. K. C. Chakrabarty, Deputy Governor, Reserve Bank of India at the Stakeholders’ Workshop on Financial Literacy organized jointly by the UNDP, NABARD and *MicroSave* at Mumbai on February 4, 2013

“I got a lot of knowledge from this DFS course as well as more content to implement in our country. I would definitely recommend this course to others. If anyone wants to establish this business, they must take this course.”

Sadab Tabani, Senior Executive, Distribution & Retail Sales - Grameenphone (Bangladesh), alumni, *The Helix Institute of Digital Finance*

Product and Channel Innovation

We innovate products and delivery channels to increase sales, optimise costs, and improve efficiencies. We reduce risks associated with new product design and channel augmentation, using our flagship Market Insights for Innovations and Design (MI4ID) approach.

Strategy Development and Governance

We formulate strategies and business models, develop financial and tactical plans, facilitate development and establishment of institutional branding and strategic marketing. Advise clients on institutionalising best practices in governance.

Research

We conduct market research (informed by behavioural economics), undertake sectoral analysis, feasibility studies, competitor analysis and industry assessments. We also conduct in-depth research on customer needs, behaviour and perceptions to support policy reviews, innovation and the design of financial services.

Organisational Strengthening and Risk Management

We deliver solutions designed to strengthen products, processes, systems and policies. We support delivery optimisation and development of risk mitigation frameworks. We also help institutions setup HR structures, supported by staff incentives.

Dissemination

We are a financial inclusion knowledge-hub and an inspiration source globally. We have decades of hands-on experience in designing and developing financial services. Our knowledge and insights are packaged in the form of research publications, technical notes, blogs and videos.

Training and Workshops

We design, develop and deliver training courses and workshops on subjects including market research, digital financial services, banking, process analysis, management of microfinance institutions, MSME financing, water & sanitation product development, savings mobilisation, strategic marketing, entrepreneurship development, financial education and youth microfinance.

Investment and Donor Services

We support investors and donors to assess financial institutions and service providers by conducting thorough institutional and portfolio assessments and due-diligence. We deliver capital advisory services-valuation of institutions and capital structuring. We conduct impact studies, monitoring and evaluation for donors and investors to assess the impact of grants/investments.

We forge Long term associations that transform & build clients

In 2001 Equity Building Society in Kenya approached *MicroSave* to understand the reasons for low uptake of their credit products. The resulting research and re-structuring of the products put Equity on the path to transformation into a bank and subsequent listing on the Nairobi Stock Exchange. *MicroSave* walked every step of the way with Equity, supporting its product innovation, costing & pricing, business process re-engineering, risk management, strategic and product marketing, staff incentives, etc. Recently, we have worked with Equity Bank to implement its digital finance strategy, drawing up the blue-print for its agency channel, optimising agent network management, developing products, digitising value chains and strengthening customer service. Over these fourteen years of close collaboration, the bank's customer base has grown from 109,000 to more than 10 million in six countries and it remains the most respected and celebrated mass market bank in Africa.

We change financial landscape in countries where we work – Papua New Guinea (PNG) Example

Since 2011, we have been working on a long term project in PNG, with support from Asian Development Bank (ADB), AusAid, and Government of Papua New Guinea (GoPNG) to increase access to finance. Additionally, we have worked on several short term projects with multiple partners.

Gender

- Financial literacy training to 34,276 females.
- 1,220 person days training to female staffs of Participating Financial Institutions (PFIs).
- 147 participants attended the trainings and workshops conducted by regulation team of Microfinance Expansion Project (MEP).

Governance and Regulation

- Established Centre for Excellence in Financial Inclusion (CEFI), an apex national institution to coordinate all financial inclusion activities in PNG.
- For Bank of Papua New Guinea (BPNG), drafted regulations for microfinance services and guidelines for mobile banking.

Business development training

- Target to train 22,000 entrepreneurs in business development strategy by 2017.

Product development

- 27 new financial product concepts developed. 16 products are in pilot testing stage.

Financial capability training

- Trained 72,224 PNGians to enhance financial capability. 30% of participants have opened bank accounts post training.

Digital financial services

- Designed processes and pilot tested products for the digital financial services product of a leading bank in the country.

Supervision and training

- Enhanced customer centric market research capacities of 1,558 MFI staff, trained BPNG staff on supervision of MFIs and 'Saving and Loan societies' units.

We improve G2P programme designs and execution

We helped the Mahatma Gandhi National Rural Employment Gurantee Act (MGNREGA) payments become efficient and user friendly. Our work with Ministry of Rural Development, Government of Jharkhand, **saw an 87% decrease in the time taken (from 15 days to 2 days) to pay a MGNREGA beneficiary.** We assisted the Ministry to design processes and monitoring protocols. We mapped and documented the processes and trained front line staff to use alternate practices. **Our intervention has the potential to benefit about 2 million MGNREGA wage recipients who receive payments through Post Office in Jharkhand - and our methods will be expanded across India.**

We inform DFS providers in agent networks through cutting-edge research, knowledge based on global data

We co-founded* *The Helix Institute of Digital Finance*, in November 2013, to provide world-class training based on ANA data and knowledge to digital financial service providers. The training courses are designed explicitly for mobile network operators, banks, financial institutions and third party providers to enable them to increase the efficiency and profits of their digital finance business – thus facilitating more client-centric and sustainable delivery of financial services. **We have run nearly 20 training courses and trained over 300 participants from more than 115 digital finance roll-outs by institutions serving over 650 million customers in more than 30 developing countries.**

*The institute was established by *MicroSave*, with the Bill & Melinda Gates Foundation, the International Finance Corporation (IFC), and the UN Capital Development Fund (UNCDF).

We help providers offer responsible financial services

We help institutions achieve improved social performance ratings and client protection certifications. More importantly, we enable them to remain client- focussed and deliberate in putting their mission into practice. This creates a firm foundation for client loyalty and business growth. Our achievements: Trained > **150 people from 36 MFIs** in client service & protection, conducted social performance audits for **23 institutions,** and conducted client protection assessments for **9 MFIs.**

***MicroSave* partners with participants in financial services ecosystems to achieve sustainable performance improvements and unlock enduring value.**

MicroSave
Market-led solutions for financial services

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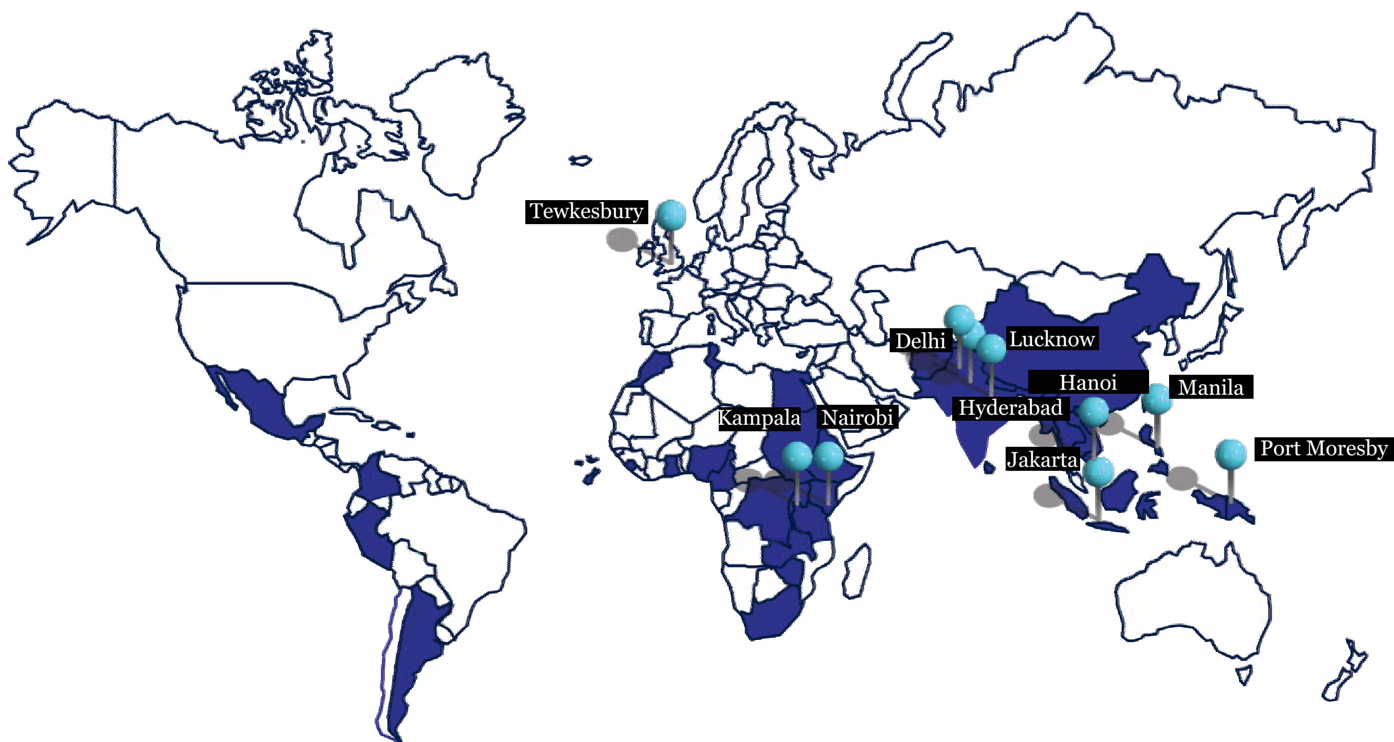

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