MicroSave Briefing Note # 25

The Emerging Market-Led Microfinance Agenda

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Introduction

> *"We don't understand our clients."*
> *"We want to deliver more appropriate products and services to our clients."*
> *"How should we go about assessing our clients' preferences for financial services?"*

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

Why the change?
While many clients have remained loyal to their creditors, their mobility and assumption of multiple loans from several microfinance institutions (MFIs) indicates a mismatch between available products and client needs. With few formal alternatives and a constant demand for money, the customer makes do with what is on offer. Sometimes the product fits, other times it does not. Then clients vote with their feet[2]. They might leave for a competitor or just add the services of a competitor to their loan portfolio. A few exit the microfinance market altogether. To understand the disconnect we need to answer three key questions.

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

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

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

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

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

The Market-led Approach to Microfinance[3]
The demand and supply sides of the microfinance equation seem to be coming together. This creates an opportunity to integrate a market-led approach into what has been a largely supply-led or product-driven industry. It moves MFIs closer to operating like businesses and away from the prescriptions of a mainly donor-funded sector. This emerging new market-led agenda for microfinance integrates customers' voices into the design and delivery of products and services by MFIs[4]. Attention focuses on three components:

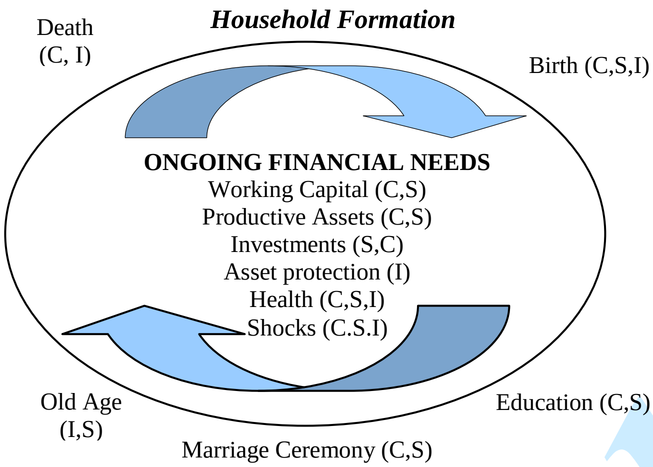
- the client-product nexus
- linkages between clients and institutions
- the client's financial landscape

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

[1] Monique Cohen is President of Microfinance Opportunities, a client focused microfinance resource centre. www.microfinanceopportunities.org. This note is based on the article "Making Microfinance More Client- Led". Journal of International Development. 14. 335-350 (2002)
[2] For more on client exits from microfinance institutions see the dropouts studies on the ***MicroSave*** website under the Study Programme section.
[3] See ***MicroSave's*** Briefing Notes numbers 18 and 19 available on the ***MicroSave*** website under the Briefing Notes section.
[4] For more on the market-led approach and client responsive product development see **Wright**, Graham A.N., "Market Research and Client Responsive Product Development", ***MicroSave***, 2001 – available on the ***MicroSave*** website under the Study Programme section.

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

Household Life Cycle Financial Needs



C= credit; S=savings; I=insurance

Institution-client linkages involve creating operational mechanisms to enable the creation and use of client data to inform product development, marketing or service delivery. For many MFIs, this means a shift away from their traditional mode of 'top down' information flows, the gathering of client data, if at all, by external resources and little integration of client data into information systems. The new paradigm encourages and supports systemized client data collection by front-line staff. Simple and clear reporting systems allow the flow of client information up to management[5] These changes also provide a basis for differentiating levels of decision making: minor actions that can be taken at the branch level, operational directives that require authorization by senior management and policy decisions necessitating board approval. This broadens the base of stakeholders vested in change. Those who tend to be the most disenfranchised, the loan officer and clients, gain a voice. The result can be improved financial performance resulting from higher staff productivity, reduced staff turnover and lower transaction costs for the financial service provider and consumer alike.

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

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

Conclusion

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

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

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

[5] See **McCord**, Michael "The Feedback Loop – A Process for Enhancing Responsiveness to Clients", ***MicroSave***, 2002. This paper is available on the ***MicroSave*** website under the Study Programme section.