# TAKING STOCK: THE EMERGING MARKET-LED MICROFINANCE AGENDA

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

These statements and question have become so common-place that they do not seem unusual. Just two years ago, they were considered marginal by the mainstream of the industry. Clients were of interest only as statistics measuring numbers reached or as the objects of impact measurement.

Why the change? Even the explanations are now familiar. Growth isn't what we had forecast – retention rates are lower than anticipated and attracting new entrants is getting harder. While many clients have remained loyal to their creditors, their mobility and their taking on multiple MFI (microfinance institution) loans is indicative of a product which is imperfect for many. Pure vanilla, the working capital loan, cannot meet all customers' financial services preferences as they change over the life cycle and with movement up and down the income scale.

With few formal alternatives and an ever-present demand for fungible cash, the customer makes do with what is on offer. Sometimes it fits, other times it doesn't. Then clients vote with their feet. 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.

Refocusing on clients highlights three key questions that still need to be answered:

- Who do microfinance institutions reach and who do they not reach?
- How do the poor use financial services?
- How do we increase the poor's access to financial services to serve their needs better?

Some answers to these questions are already apparent. We know that the majority of microfinance clients locate just above and below the poverty line and that targeted programmes have been more effective at reaching a greater proportion of poorer clients. We also find that:

- Microenterprise development is only one use of microfinance. Credit is used for a wide range of purposes among them home improvements, education fees and health expenses. All are activities which might be better met with more appropriate or finely tuned products. All are uses that contribute to achieving of the millennium development goals;

- Current MFI products and services are limited in their flexibility when clients urgently need a lump sum of cash when faced with a crisis, life cycle event, emergency, or opportunities as they present themselves.

The answers to our three questions clearly inform the demand side of microfinance and will contribute to the increased efficiency of service delivery. In turn, this information should suggest ways to increase the scale and depth of outreach.

The demand and supply sides of the microfinance equation finally 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 us closer to microfinance as a business and away from the prescriptions of a mainly donor-funded sector. This emerging new market-led agenda for microfinance emphasizes the integration of customers' voices into the design and delivery of products and services by MFIs. Attention focuses on three components, the client-product nexus, linkages between clients and institutions and the client's financial landscape.

The *client-product nexus* moves away from an institutional approach to clients characterized by 'catch as catch can' 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.

Discussions of market segmentation highlight the potential of attracting 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. 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 that facilitate the payment of school fees.

*Institution-client linkages* involve creating operational mechanisms that enable the generation 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 supports systemized client data collection by front-line staff. Simple and clear reporting systems allow the flow of client information up to management. They 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. In this emerging paradigm, the base of stakeholders vested in change is broadened. Those who tend to be the most disenfranchised, the loan officer and clients, can gain a voice. The result can be improved financial performance resulting from higher staff productivity and a lowering of transaction costs for the financial service provider and consumer alike.

The *client financial landscape* challenges the belief among many MFIs that they are the ‘only game in town.’ Microfinance credit rarely exceeds more than 50% of clients’ debt portfolios. Many clients simultaneously belong to informal financial institutions such as ROSCAS or savings clubs that deliver lump sums of cash at regular intervals. In addition, many of the poor remain linked to that long history of projects intended to increase the poor’s 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.

Two years ago this market-led microfinance seemed totally out of sync with the mainstream of the microfinance industry. Today product development is a hot topic, and the integration of client data into the management information system is being reviewed by many MFIs. The importance of institutional-client linkages and the client’s financial landscape is beginning to be recognized. Institutions that have internalized this client focus find that the adoption of these new systems takes time, but the operational benefits eventually 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.

The current call is for microfinance institutions 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 refining products and services that will attract and retain them.