MicroSave Briefing Note # 40

Lessons from *MicroSave's* Action Research Programme (2004)

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Under its Action Research Programme, *MicroSave* learns and disseminates lessons relating to market-led microfinance. This note documents lessons learned during 2004. Lessons learned during 2001 to 2003 are documented in Briefing Note # 10, 20 and 30, and associated papers.

The Action Research Partners (ARPs) as of December 2004

Kenya – Kenya Post Office Savings Bank (KPOSB) and Equity Bank
Tanzania – Tanzania Postal Bank (TPB), PRIDE Tanzania and FINCA Tanzania
Uganda – Uganda Microfinance Union (UMU), U-Trust, Commercial Microfinance Limited (CMF)
South Africa – Teba Bank

FINCA Uganda, Centenary Rural Development Bank and Credit Indemnity are Associate ARPs and receive a lower level of support from *MicroSave*

Progress Using *MicroSave* Tools[1]

Process mapping: Detailed investigation of processes through mapping? requires commitment of resources, but generates high returns in the form of streamlined processes and improved risk management. Typically, where process mapping has not already been institutionalised, many quick wins are identified. After experiencing initial benefits most ARPs progressed over several months to map the majority of their key processes. CMF reworked their loan origination process significantly reducing the time taken to issue new loans. FINCA Uganda implemented a more efficient way of managing their village banking groups. Process mapping is especially powerful at reducing risk when combined with institutionalising operational risk management.

Risk management: Managing operational risk is at the heart of the Basel II accord and, therefore, central to banking in the future. The accord calls for the institutionalisation of operational risk management. Several of *MicroSave's* ARPs have implemented institutional and product risk analysis. However, experience has shown that institutionalising risk management is particularly challenging when managers of operational risks fail to understand risk management or actually contribute to operational risk through their actions.

Customer service: Although customer service can be improved through individual initiatives, to maintain and improve service levels during rapid growth an institution must develop a customer service strategy and action plan. The customer service strategy must institutionalise a range of customer centric performance measures. KPOSB, Equity and TPB have taken a first, but significant step in appointing a Customer Service Manager to develop their customer service strategy and action plan.

Branch based costing: Branch based costing influences future strategy and informs long-term decisions. UMU learned where it is making its maximum returns, and gained greater insight into break even levels for new branches. Branch based costing provides the basis on which branch-based staff incentive schemes can be developed and refined. In some cases branch-based costing systems are relatively simple extensions of product costing systems.

Pricing: Marketing texts provide lengthy illustrations of different pricing strategies. However, many of these strategies, such as loss leading, penetration pricing etc., are rarely practical for most financial institutions serving the low-income market. To price products first assess the cost of providing financial services; second examine the prices charged by the competition for similar products and third examine whether customer perceptions of the product justify premium pricing. When this approach is combined with transparent communication of pricing, the results can be significant. When Equity Bank re-priced its services in 2002, after performing market research it communicated these changes carefully. Deposit account sales increased ten-fold.

Pilot testing - loans: Even "safe" products carry product development risk. One ARP developed a salary loan but decided not to pilot test the product. As a result it underestimated the follow up required and the extent of monitoring necessary. Loan losses increased and were only brought under control through significant modifications to systems and processes.

Volume of recommendations arising from MicroSave tools: Working with *MicroSave* is an intensive activity for ARPs. Assignments across the range of *MicroSave* disciplines generate a significant volume of agreed recommendations. *MicroSave* operates by building capacity within ARPs to respond to change, rather than through direct implementation. However, the volume of recommendations can be difficult for larger institutions to respond to without project management skills.

[1] This section summarises the experience of different ARPs in implementing ***MicroSave*** toolkits, these toolkits are available on www.***MicroSave***.net under the toolkits section.

Institutionalising toolkits: ARPs face multiple challenges in institutionalising *MicroSave* toolkits, something *MicroSave* will study closely in future. Reasons are likely to include the volume of recommendations generated by *MicroSave*, combined with limited staff capacity and project management skills required to manage multiple initiatives. In other cases the sheer pace of change makes it difficult to implement anything that is not an immediate priority. In parastatal institutions where training is often viewed as a reward, it is possible that the wrong staff received training. In other cases there may be an expectation that *MicroSave* can provide the total solution, without the need for institutionalising every toolkit.

Systems

System usage: Many institutions fail to optimise their banking information system. Key reports that the banking system could generate are not being utilised. Reasons vary, either essential data was not captured when originating records, or reports were not generated, or the institution failed to consider how the system could be optimised. In other cases banking systems have failed to meet reporting requirements and have needed significant modification to produce reliable and accurate data. This is highly strategic issue, which *MicroSave* will continue to examine.

System capacity: In rapidly growing institutions system capacity must be considered significantly ahead of need, as it can take many months to introduce a new system. When Teba Bank upgraded their banking system; they found customisation took months longer than anticipated. Worse still, as banking systems fill to capacity, they slow down - each transaction takes longer. When Equity Bank experienced rapid growth they quickly realised that the existing version of their banking system would not be able to accommodate their ever-increasing growth.

Electronic Banking: *MicroSave* has considerable experience in electronic banking gained through working with Teba Bank, TPB and also CRDB Bank in Tanzania. From these assignments it is evident that institutions moving into electronic banking need to give much more thought than they do to understanding key behavioural assumptions underlying their electronic banking solution. For example, how often will customers make transactions of different types, and how can customer usage be increased?

Many solutions still fail to appreciate and build on the fact that "Cash is King" and that the requirement in the short to medium term is to make moving cash easier rather than to move rapidly to a cashless society. There is a requirement for more research and financial education around how to best integrate electronic banking solutions into the lives of low-income customers.

Institutional

Competitive Markets: In increasingly competitive markets it is difficult for institutions with a limited capital base to keep up with increasing pace of change, particularly when it comes to investing in information systems, new branch infrastructure or electronic banking. TPB after years of low profits and losses and low Treasury Bill rates - is faced with difficult choices of where to invest their limited available capital.

Institutional culture and heritage: The heritage of an institution has a huge influence on how it operates and how it responds to challenges. The marketing focus of Equity Bank drives growth even when the immediate need is for consolidation. Long embedded product champions within Postbanks fight on behalf of aging products. Institutional relationships within international networks such as FINCA frame how they respond to challenges.

Institutional Change: Given the influence of institutional culture, and a tendency to focus on immediate fire fighting rather than strategic issues *MicroSave* and its partners need to work on how to manage institutional change. Equity Bank is currently undergoing a change management process, and it is hoped that at least one of the Postbanks will start this process during 2005.

Strengthening marketing: ARPs faced multiple challenges as they struggled to develop responsive marketing functions. In some established institutions, marketing is largely focused on promotion rather than a broader, more strategic customer centric agenda. Other microfinance programmes have found it difficult to identify and recruit suitable staff.

A customer focused marketing department needs to continually perform customer focused research, yet frequently market research competencies get dispersed around an institution, through promotions, departures and transfers. Refresher training is one option; a second option is to develop in house training skills in market research.

For Postbanks a particular challenge is to develop branch based marketing competencies and for Head Offices to provide branches with the support they require to effectively market products. One approach may be to develop internal service level agreements between branches and marketing functions, which detail the support that can be expected from marketing along with branch responsibilities.