MicroSave India Focus Note #122

Transformation of Microfinance Institutions to Small Finance Banks: Differentiating Men from the Boys!

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In the last Note, we discussed capital restructuring challenges for MFIs transforming into Small Finance Banks (SFBs). SFBs will have to depend on their customers' deposits and shareholders' equity along with 'refinance' facilities from bulk lenders such as SIDBI and MUDRA Bank. We concluded that transformation will be an uphill task for SFBs as mobilising retail savings is extremely challenging. In this Note we discuss how SFBs can build a first class retail institution, focussed on low-income clients. We analyse the strategy that SFBs can adopt to meet the prospective challenges.

Advantage banks - but do the poor save with banks?

By and large, the poor place high levels of trust in banks and are willing to save with them. This is especially true for public sector banks as the implicit backing by the government further enhances confidence levels of rural low income segments. The flip side, of course, is that public sector banks may not always have the products or service quality to attract low income rural customers. The earlier efforts at financial inclusion through 'no-frills' bank accounts were clearly unsuccessful; only about 17% of accounts opened under financial inclusion had deposit balances. The Prime Minister's Jan Dhan Yojana fares better, but has a long way to go; 50.23% of a total of 170.8 million accounts have zero balance. We speculate that most of these zero balance accounts are in rural areas. It is ironic that the Life Insurance Corporation of India (LIC) is able to collect Rs.44,970 million ($692 million) in premium with an average of Rs.8,706 ($134) per policy from rural areas.[1] This shows that with suitable products, credible marketing and a strong distribution channel, rural markets do indeed have huge potential.

The dismal figures also corroborate the fact that the existing banking system does not offer a value proposition for rural low-income segments. This obviously presents an opportunity for SFBs to leverage savings that are currently made through LIC's endowment products. In addition, it is clear that much cash is stored under a mattress and locked into informal savings clubs/similar mechanisms. Prospective SFBs will need products and delivery processes that create an attractive value proposition for the target segment. Unlike credit which is a pull product, savings will see a gradual uptake, that too only if trust and ease of transaction are established upfront.

Brand makeover is essential to transform into a deposit taking institution

It takes time for a financial institution to gain trust especially if it offers liability products. This is even more important in case of low-income segments where incidents of fraud and loss of savings due to fly-by-night operators is high. Branding comprises of two components: i) institutional branding and ii) product branding. As MFIs, some institutions may have invested in positioning their brand as providers of credit. It will require a lot more effort to establish the brand as a full-service bank that is trustworthy as a custodian of precious savings. SFBs can learn from the example of *MicroSave*'s initial work with Faulu Kenya on rebranding. Similarly, when Equity Building Society transformed into Equity Bank in Kenya, it put a substantial amount of resources in the form of time, energy and money into branding. This paid off – Equity Bank grew about fourteen times in seven years after receiving its banking license.

MFIs transforming into SFBs have to deal with the following challenges, which can be overcome by effective re-branding and associated marketing:

- Stakeholders do not understand what the brand stands for. MFIs have established a deep rooted brand as being credit service providers. Thus unlearning and relearning for ex-customers will be a challenge.
- Universal and differentiated banks pose tough competition. Creating brand differentiation in such a market may prove to be challenging.

A checklist for brand re-engineering is as follows:

- Define customer's critical financial needs.

1 IRDA periodic disclosures, March 2015
2 Transforming microfinance in Kenya the experience of Faulu Kenya and Kenya Women Finance trust
3 *MicroSave* Corporate Brand and Identity Toolkit

- Explain how SFB addresses customer needs in the context of savings along with credit.
- Understand current brand position of the institution and its competition in the market.
- Define the brand's sweet spot.
- Ensure consistency of brand image in products, processes, systems and staff.

Stepwise Roadmap to Transformation:
The section below describes with examples, how to operationalise transformation, in a step wise manner:

1. **Develop products meeting the target market's needs:** Under Grameen II, deposit opportunities for both members and the public at large were greatly expanded. And so, by end of 2004 (two years after Grameen II started), the total deposits exceeded the value of loans outstanding for the first time in the bank's history. Grameen II offered four different types of savings accounts to fulfil diverse customer needs ranging from immediate (emergency needs) to long term requirements (like pension). As a result, it became a one stop shop to fulfil all the major savings requirements for customers and the public at large. SFBs can also learn from commitment saving schemes in Philippines, i-Wish account of ICICI, and other such schemes to bring more innovation in designing products. These products demonstrate that financial products should be designed to reflect the mental models and suit the needs and cash flows of the target segment.
A *MicroSave* study on savings behaviour found that the chief reasons why low income households save are marriage, education, construction of houses and medical expenses, in that order. *MicroSave* also found that most respondents had unplanned savings, which highlights the impact of seasonality in cash-flows. Thus, marketing of long-term, illiquid savings products during the harvest season and the provision of highly liquid savings accounts during planting/weeding seasons are a few tactics that SFBs should consider for rural markets.

2. **Ride on agent networks**: SFB customers can ride on the growing agent networks under PMJDY. The government wants an interoperable system servicing *Rupay* cards. Those who save will use *Rupay* cards (issued by SFBs for their account holders) to transact at ubiquitous agent networks, as well as *Rupay* enabled POS terminals, thus doing away with the need to keep cash for purchases.

3. **Convenience is the key to attracting savings:** SFBs can create convenient avenues/touch points to trigger customers to save regularly. Fortnight/monthly group meetings are clearly a good place to source savings. Similarly, pigmy deposit has a lot of potential. An example of a scheme which tries to capture surplus cash from households and businesses is the Syndicate Bank's Pigmy Deposit Scheme (see box).

4. **Complement savings with payments:** To date, customers receive limited benefits from saving in a bank account. To make any payment, first they visit withdrawal points (ATMs or branches), which makes the interface quite tedious and at times, costly. Recently banks have started issuing *RuPay* cards that could be used at *RuPay* enabled terminals to make payments. Similarly SFBs can also issue *RuPay* cards to offer the convenience of making payments through these cards. Currently the number of *RuPay* enabled terminals exceeds 1.08 million. *RuPay* is expected to be in all retail outlets by the year 2016. Once *RuPay* enabled terminals are present ubiquitously, they will complement savings perfectly.

Syndicate Bank's Pigmy Deposit

This deposit scheme suits the needs of those having small and irregular cash flows such as the poor who could be daily wage earners, traders, housewives, etc. The bank's roving authorised agents collect savings at clients' doorsteps. Savers make deposits at regular intervals according to their convenience.

5. **Invest in the human capital:** SFBs will need to invest significantly to equip their field staff with the skills to mobilise savings. Staff need to be trained on how to build trust and maintain the brand image. Instilling learning about how mishandling of savings products (or customers) ruins the brand image is of vital importance. Appropriate staff incentives schemes will have an important role to play in this.

It is safe to conclude that transformation of MFIs to SFBs is challenging - particularly since MFIs, until now, have only extended credit. In order to transform from "credit only" to "deposit mobilising" institutions, they will have to work on many areas. These, among others, include, i) designing appropriate products and processes; ii) finalisation of delivery strategy; iii) communication strategy to build demand for deposit products; iv) capacity building of the front line force; and v) regulatory compliance and risk management. There are multiple comparable examples in other markets where "credit only" organisations have successfully mobilised deposits. ASA in Bangladesh is a comparable and successful example in a similar cultural context. However, each entity will need to develop its own understanding of the context in which it operates, and the strategy that it must adopt.

[4] *MicroSave* Briefing Notes on Grameen II # 2 Member Savings by Stuart Rutherford