MicroSave India Focus Note 20

Institutional Culture and Transformation: From NGOs to Market-led MFIs

Matt Leonard
July 2009

Overview of Transformation

The transformation of microfinance NGOs into a more regulated legal form is seen as one of the most effective strategies for achieving scale and sustainability.[i] However, transformation requires a significant change in institutional culture, affecting stakeholders at all levels – from clients and field staff to managers and board members. This note focuses on the experiences of Indian NGO-MFIs, and looks at what to expect and how to manage the institutional culture shift that accompanies transformation.

Transformation in the Indian Context

Some of the largest and most successful MFIs in India have transformed from NGOs into regulated for-profit companies (SKS, SHARE, Spandana) or even banks (SEWA). However, a diverse group of smaller, nascent NGO-MFIs make up the large majority of MFIs in India and they are also increasingly opting for transformation. Transformation here refers to when an NGO retains its original legal status, but spins off a new entity (Section 25 Company or NBFC) dedicated exclusively to microfinance. In many instances, the NGO will continue to offer its existing services (e.g. SHG formation, health or business skills development) to microfinance clients. Meanwhile, armed with a stronger legal mandate, the new entity may begin to mobilise debt or equity financing from banks and investors. At the same time, it begins to forge a new relationship with clients – an ability to meet its promises.

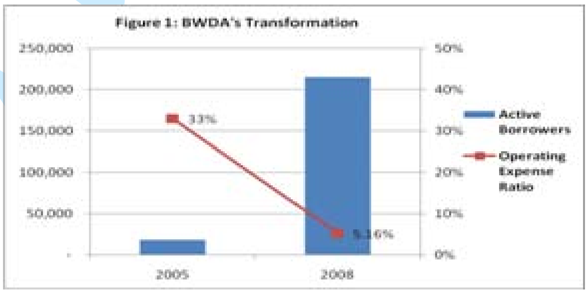
Common Challenges (and Ways to Overcome Them)

Building new systems and capacities, and enjoying greater access to capital, brings a range of new *cultural* challenges to an MFI. Institutional culture can be defined as a system of shared beliefs and values that develops within an organisation and guides the behaviour of its shareholders, management, staff and clients.[ii] There are two primary cultural shifts that take place in transforming MFIs, and which affect each stakeholder in different ways. One is moving from grant-funding into a much higher risk profile – e.g. accessing debt from banks, on-lending funds and ensuring repayments in order to meet its commitments. The second involves fostering an attitudinal and behavioural change throughout an organisation built on purely social foundations. Successfully managing these shifts requires patience, a gradualist approach, and the ability to link transformation to the achievement of one's mission.

Evolution of the Board

The Boards of most NGOs, typically composed of individuals from a social background, are often the hardest to convince of the necessity of transformation. Many are simply not familiar with the legal requirements or with how to steer a business efficiently, ensuring revenues are large enough to cover costs and drive expansion. Furthermore, non-profit Board members often are inherently suspicious of commercial enterprises and worry of mission drift (e.g. becoming "just another moneylender"). Such Directors view microfinance interest rates as exploitive of the poor and, even after transformation, may resist attempts to raise rates to a sustainable level.

However, the principal worry of most NGO Board members involves taking on greater liability. Moving from grants to debt-based funding necessitates a dramatic shift in Board culture. New risks and responsibilities (as a financial intermediary or as shareholders) force Directors to become more active in governance and oversight –particularly as accountability to outside stakeholders (banks, Registrar of Companies, Reserve Bank of India etc.) increases.



Effective communication and patience early on, both in and outside of meetings, is the key to bringing Board members along. Boards should understand that a well-run microfinance business will increase outreach to the poor and unbanked – and thereby reinforce the NGO's values and goals. Giving Board members a chance to interact with and learn from the experiences of other MFIs – in transformation workshops like the one hosted by *MicroSave* for its partners in northern India – can be a useful way to build the case for a new legal form. Trainings can also introduce Directors to new governance risks and responsibilities (transparency, oversight, portfolio and liquidity management, risk and internal control, etc.). It is often useful to bring in new Board members with competencies in areas like law and banking. BWDA – a large NGO promoting SHGs in Tamil Nadu – partially reconstituted its Board to include members with finance and legal backgrounds (including a former RBI Regional Governor) to spearhead its transformation to an NBFC. Ultimately, the Board has to be convinced that transformation will help and not hinder achievement of its mission – and then develop the capacity to guide an MFI.

Professionalisation of Work Culture

One of the key challenges during the transformation phase is human resource management – and particularly the professionalisation of work culture. Changes – e.g. bringing in qualified outsiders, reorganising organisational structures, and introducing a more disciplined and professional work ethic – can significantly alter institutional culture. As the collegial atmosphere typical of many NGOs disappears, it is replaced by the pressure of targets, repayment and professional norms of discipline, timeliness and strict adherence to policies. A successful MFI requires staff to not only develop new habits and skills, but also to handle (and be responsible for) larger amounts of money than they may be comfortable with.

Meanwhile, because of a lack of trained and qualified personnel at senior levels – particularly in financial management, business planning and microfinance operations – new staff are often hired. This may cause existing staff to feel resentful or trapped at lower salaries and responsibilities. It often signifies another cultural shift: a new relationship between management and staff. As a new hierarchical staffing structure arises, field and branch staff may resist those who issue directives from the head office without understanding the realities of the field. Furthermore, whereas trust may have been the basis of management in the NGO, employees must adjust to new (and impersonal) internal control mechanisms – e.g. strict documentation and surprise checks. And finally, often lost in the push for greater efficiency is staff's ability to spend time with clients and help them to resolve problems.

Although each organisation must confront this transition in its own way, Mrs. Kalpana, CEO of Chaitanya, stresses the critical importance of focusing on HR from the beginning. She advises NGO-MFI leaders to plan in detail the HR development process of the new entity, from recruitment plans to alignment of training and incentive structures. Often, an NGO must first decide whether to hire new staff for its MFI, retrain old staff, or choose a mix of the two. Krushi, an NGO in Andhra Pradesh, successfully brought on entirely new staff when it began microfinance operations as a Section 25 company. However, Disha – a women's rights NGO operating in Uttar Pradesh – chose a more challenging route: retraining hard-working, loyal staff to assume senior positions, keeping existing field workers to look after SHGs, and hiring new staff to spearhead the scale up of joint-liability group operations. It can also be useful (but is often difficult) to keep HR policies and payscales consistent across both the NGO and MFI to avoid friction.

Ultimately, leading a successful evolution in work culture involves effectively communicating the link between transformation and tangible benefits to staff *and* clients. For instance, many of Disha's staff report that, despite the initial difficulty of new systems and norms, they can now schedule and use their time more efficiently. They have greater satisfaction as they witness clients enjoying greater access to credit, shorter meetings and timely disbursements. Staff at Chaitanya also feel increasing pride as operations expand to new districts. Furthermore, many at BWDA saw their salaries and responsibilities increased after transformation, as well as the availability of greater resources (computers, new branch offices, etc.). Some of the strategies that leaders employ to address staff anxiety about transformation include: team building activities, new training opportunities, staff meetings and newsletters that explain changes, build motivation and provide guidance.

Meeting Clients' Needs

Well run NGOs considering transformation may be reluctant to jeopardise the trust and credibility they have built over many years. Indeed, customers accustomed to a relationship of ease and informality may be unhappy as a culture of discipline, rules and formality is introduced. In the past, clients at Disha enjoyed the flexibility to make payments when and as they could. When BWDA's clients had a problem, they could directly visit the CEO. Now, clients at both often find that interactions with busy field staff are brief, senior managers are less accessible, payments must be on time and attendance at group meetings is mandatory. Furthermore, interest rates and fees may initially rise as newly transformed NGO-MFIs try to cover costs. Client satisfaction can thus decline initially. Some poor clients may even dropout or be pushed due to the new focus on ability to repay on time and joint liability.

A transforming NGO-MFI can address these issues by upholding its promise to provide regular, timely and appropriate financial services that help clients expand their businesses, smooth income fluctuations and reduce household vulnerability. They can do so by standardising processes and product offerings, building staff capacity, and creating more robust systems. These improvements, coupled with an enabling legal form, will help NGO-MFIs to attract, manage and disburse new funds to their clients. By putting in place stronger internal controls, MFIs can also ensure that clients are protected from error and fraud. Furthermore, if these NGO-MFIs develop a culture of customer service, solicit and respond to client feedback on products and services, then client satisfaction and loyalty will only increase. Finally, although fraught with its own set of risks, some transforming NGO-MFIs, like BWDA and Chaitanya, give clients an ownership stake in the new entity. Clients thereby can directly share in its profitability.

Conclusion

As stated above, one of the primary reasons for transformation is to expand access to finance for the poor. While an organisation's mission may not change dramatically, a significant shift in institutional culture is required to meet the demands of the new form. Transformation from a social to a more business-like environment cannot and should not happen suddenly – the shift should be gradual and incremental. MFI leadership should consult with stakeholders at all levels – Board, staff and clients – and build consensus for change before, during and after transformation. Ultimately, as NGOs transform successfully to market-led MFIs, they are often better able to grow, mobilise funds and meet the needs of the poor.

---

i and ii: Campion and White. 1999