

MicroSave India Focus Note # 25

Dinosaurs and Rabbits – Indian Microfinance Market Evolution

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October 2009

Background

No one really knows what happened to the dinosaurs. In their day they were the largest and most powerful creatures alive on the earth. Some scientists argue that the earth was struck by a meteorite and the dinosaurs wiped out in a cataclysmic mass extinction. Others say there is no evidence of a meteorite of the size required, and that the dinosaurs died out gradually. Everybody agrees that today they are dead. And mostly scientists agree that the most likely explanation for the disappearance of the dinosaurs is that somehow the environment changed and the dinosaurs failed to adapt. Over time they were replaced by warm blooded furry creatures - rabbits if you will - that were better suited to the new world.

In India today the world is changing - fast. The microfinance world is changing - very fast. In some places the meteor of competition has already struck the ground; in other places MFIs are breaking new ground in savings product innovation; and in still others there are interesting experiments in distribution technologies that will change the economics of microfinance for good.

Signs of Change in Kolar District Karnataka

There is growing consensus that the large-scale defaults in Kolar are, in the main, driven the over-indebtedness of a small, but influential, subset of MFIs' clientele. With the rapid emergence of competition, these clients have taken loans from 3-5 MFIs, and are now struggling to repay. In desperation they turned to their community leaders, who have sought to organise mass default.

In Bangladesh, most villages are served by ten or more MFIs of varying sizes and product offerings². And yet over indebtedness is limited, and repayments are largely made on time. The difference may lie in the speed at which the growth in competition emerged. In Kolar, villagers moved from having no source of reasonably-priced credit, to being able to access five or more MFI loans, in the space of a couple of years. For many of the self confident ones (many of whom became the group leaders), this was an opportunity, and temptation, they

were not able to refuse. And so they amassed as many loans as they could ... and are then discovered the implications and pain of being over indebted.

By contrast, in Bangladesh, it took over a decade for a fully competitive environment to emerge. As a result, Bangladeshi villagers were able to learn about, and gauge, their household debt-carrying capacity. They learnt this without falling into the type of large-scale, widespread over-indebtedness in Kolar, and possibly elsewhere in India.

What are the lessons from Kolar?

1. The idea that several MFIs lending Rs.10,000 each to a single client somehow diversifies or reduces risk is optimistic. This approach simply increases the transaction costs for the clients who have to sit in many meetings.
2. Many clients do indeed need loans greater than Rs.10,000 ... or indeed Rs.20,000; but some need less than Rs.10,000. It all depends on what is being financed.
3. It is hugely important for MFIs to understand their clients and their debt carrying capacity better. Group guarantee will not necessarily adequately reduce over-borrowing – particularly when it is often the influential group leaders that take multiple loans. Indeed group solidarity may even be used to instigate coordinated, mass default.
4. Understanding clients better will require MFIs to move quickly to cashflow-based individual lending; and many will leverage the potential of m-banking technology to make this cost effective.

Can the Traditional Microfinance Players Adapt?

Successful adaptation involves managing both the pace and degree of change. A small change undertaken quickly is not too challenging. A large change conducted over a long time might be more difficult, but would still be expected to be conducted successfully. After all that is the story of microfinance in Bangladesh. But what about very large

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² See [India Focus Note # 12](#), "Are There Lessons For India From Bangladesh?"

changes conducted very quickly? The challenge is daunting.

How Well Prepared are Traditional MFIs to Navigate Change?

Existing large players in India today by and large the share the same broad characteristics:

- Growth is by geographical expansion
- Product suite is dominated by a single product
- Distribution is carried out via one channel
- Their operating focus is efficiency
- Operations are strongly standardised
- They are very flat organisations
- Over 95% of the labour is devoted to operations
- Product feature trade-offs are in favour of the MFI

...all copied from an existing successful model.

And if you were to choose a set of capabilities to grow a single model very fast then this would be the right model. It is rather like having a fast powerful rocket, with only limited navigation equipment and engineering.

What if the Following were Required?

- Growth by wallet expansion of existing customers
- Multiple products
- Multiple channels
- Effectiveness but much less labour
- More complex profit centre-based structures
- Some staff focussed on market sensing, and product and channel innovation

...invented from first principles

It is fair to suggest that not only would the existing organisations lack the capabilities, but the essentially conservative culture of such an organisation around standardisation and simplicity (the very thing that powers the organisation for success today) would be like a ball and chain slowing change.

MFIs need four new capabilities on the same footing in terms of respect and influence within the organisation as operations currently enjoys today. These are:

1. Sensing
2. Learning
3. Design
4. Change implementation

... as well as operations.

1. *Sensing* is the capability to gather structured and reliable data from the external environment to assess changes in: client circumstances; client satisfaction;

product responsiveness to client needs; competition; and in technology available for reaching and transacting with clients.

2. *Learning* is the capability to understand the implications of the data captured through sensing. This implies that the organisation is able to discuss and debate the implications of the data, and arrive at a consensus view of what actions, if any, to take in the light of the data from the external environment.

3. *Design* is the capability to design and test changes to products and distribution structures, based on the consensus agreed on during the learning. It includes designing coherent business processes, systems, and organisation structures and people skills.

4. *Change implementation* is the capability to manage the changes required to implement new products: project planning and management; resource allocation; and management of the human factors surrounding the change.

Making the Change

Each of these capabilities is required for change in MFIs, products and channels. Of course undertaking major change takes time, and capital support. Capital participants in MFIs in India generally operate around two time frames. Either they are long term patient capital providers, with a strong interest in effective products to maintain strong engagement with clients; or they are short term participants looking to grow the size of single product players and exit within 2 to 3 years.

The second kind of capital providers are generally much less tolerant of time and effort spend on long term change, because it diverts resources and distracts management. But, of course, such changes may well be important to the medium term success of the organisation in the market. Alignment of capital provider time frames with market strategy appears to be very important and a strong consideration.

Conclusion

In summary, it is desirable that dinosaurs become warm blooded and furry ... and that agile, and successful bunnies emerge too. Because different clients have different needs and no one product or microfinance player is going to meet all needs. If microfinance is to deliver on its promise it must evolve and adapt in a way which meets clients' needs more effectively, as clients change, and as the world changes around them.