MicroSave India Focus Note 53

Tapping the Underserved: Formal and Semi-Formal Financial Institution Partnerships

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Introduction

Conceptually microfinance is a broader term used for the provision of variety of financial services like savings, credit, remittances, insurance, etc., but microfinance in India (for now at least) remains mostly synonymous with group lending products. A myriad of reasons including regulatory concerns prevent MFIs from offering other financial products, especially savings. However these reasons should not preclude MFIs from providing savings products and other financial services to clients. This would however, require a paradigm shift for MFIs in complete contrast to a mono-product credit offering. There are a few examples where MFIs offer a variety of financial products to meet diverse financial needs of their clients through strategic partnerships, thus breaking the traditional thinking of a mono-product mono-model. In IFNs 47 and 48, different types of savings products that Indian MFIs can offer were explored. This paper analyses the potential benefits these strategic partnerships can offer, the challenges one can face and how they work.

Why Partnerships To Offer Financial Services?

First and simply put – the poor need more than just credit. Collins et al. in "The Portfolios of the Poor" highlight how complex and diverse the requirements of the poor are. They extend beyond mono product micro-credit. Yet there are significant challenges for MFIs to offer other services beyond credit to their clients: 1) limited competence of staff, systems and infrastructure, such as the MIS; 2) a regulatory mandate that does not permit MFIs to offer products on their own like life insurance, remittances or savings products; and 3) implementation of a lean model that focuses on efficiency and total client numbers rather than depth of product take-up per client.

On the other hand, formal financial institutions (FFIs) have the products, but are not exactly clamouring to offer financial services directly to the poor for the following reasons: 1) they do not have a physical presence in the areas where the underserved are located, often in rural areas; 2) they do not have efficient systems in place that make it profitable to serve the poor, who need smaller sized products, and high frequency transactions; and 3) many FFI staff simply have the (wrong) impression that poor clients either cannot afford or desire their products. Most FFIs prefer to focus on the wealthy and middle class simply because it is much easier and profitable.

Thus MFIs face the challenge of not being able to offer certain products on their own, and FFIs lack the incentive to focus on the poor. Yet, MFIs have a very efficient distribution base, extensive outreach, good relationships with and knowledge of the poor; and FFIs have the technical know-how and regulatory mandate to offer complex financial instruments. So the question that arises is "Can they partner together to overcome the issues presented when they try it alone?"

MFIs' Interests	FFIs' Reasons
Meeting client needs (and mission fulfilment).	Meeting regulatory (priority sector) mandates from the RBI or IRDA.
Improving customer loyalty/stickiness and creating an additional revenue stream.	Creating additional revenue and a new market that may evolve into a highly profitable segment once the high-end client segment is saturated.
Diversifying product risk and differentiating themselves from competition as growth slows.	Fulfilling Corporate Social Responsibility (CSR) mandates and benefitting from positive PR coverage.

Some FFIs are already "getting it". Birla Sunlife Insurance and ICICI Prudential have started separate verticals especially dedicated to micro-insurance, and LIC India and TATA AIG are following suit.

Potential Products

IFN 48 covered many of the savings products MFIs could explore, such as the banking correspondent (BC) model for bank-based savings accounts, money market mutual funds, life insurance and pensions; all through partnerships. However, there are other types of financial products that can be offered to serve the needs of MFIs as well.

Meeting various financial needs of Microfinance clients		
Demands	**Products**	**FFIs**
Savings	Money Market Mutual Funds, savings under BC model	Asset Management companies, banks
Investments	Mutual Funds	Asset Management Companies
Insurance	Life and General Health, Livestock	Insurers
Payments	Bill payments, etc	Bill payment
Money Transfers	International Remittances Domestic Money Transfers	Money transfer companies/banks

In general, microfinance driven life insurance does not protect against sickness/disability or asset losses and thus presents scope for potential services beyond the basic credit-linked life insurance. VIMO SEWA partners with cooperatives, NGOs, insurers and hospitals to help to offering health insurance, for example.[1] BASIX, offers several insurance products through its partnerships with insurers, including livestock insurance.[2]

Money transfers/remittances are also a huge untapped market in India. Typical informal (and risky) channels can be substituted with MFIs that are positioned to offer efficient and trustworthy money transfer services to recipients, especially for remote areas. MFIs partnering with money transfer companies for international transfers, and banks for internal remittances could provide such services to the poor.[3] The Western Union-Spandana and EKO-SBI partnerships are already demonstrating this.

MFIs can also offer payment services for clients to pay their utility bills, as well as purchases of train and bus tickets, allowing clients to avoid long waits. There are several potential partners in India in this space who have expressed interest in working with MFIs, such as mChek, Beam/Suvidha, Oxigen, Pine Labs/One Desk, etc. mChek in particular is partnering with a few MFIs to integrate banking services and bill payments for the rural and urban poor through a mobile platform.

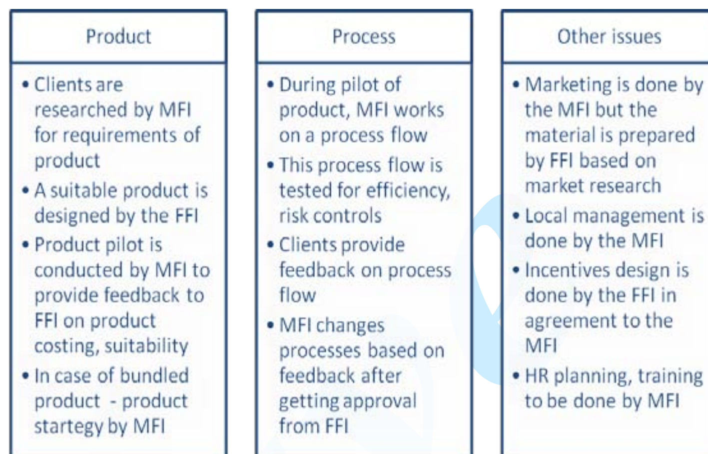
Challenges in Partnerships

Forming partnerships, however, is not easy, and must be done with care. Some of the challenges are:

MFIs	FFIs
Weak, unsophisticated MIS might lead to poor client tracking and management	Often fail to take into consideration client needs and just offer a stripped down product from the current offering.
Adding new products requires additional staff resources and capacity building inputs	At times offers products solely to meet regulatory requirements of serving the excluded (and stop once the minimum is reached).
Incentives alignment; deviation of staff's attention from selling the core product of the MFI; after-sales servicing issues and debates over commissions.	Due to a lack of understanding of the low and middle income market, often tend to misjudge the market and are not able to read the true potential.
Often client (and staff) awareness are low and only seen as additional costs (not benefits).	Impatience of the FFIs' stakeholders force them to stop the business before it reaches fruition
Shifting loyalties of MFIs from one service provider to other	Poor servicing of services/claims post-signing up of clients

How Do Such Partnerships Work?

FFI-MFI partnerships to cross-sell financial products are essentially centred on the MFIs' clients who are willing and able to buy products. The relationship can be elaborated as detailed in the diagram below:



The partner FFIs should: a) design products demanded by clients; and b) note the revenue potential from volumes and not just profits per capita. MFIs on the other hand should: a) work on client awareness/marketing modules; b) partner with FFIs that are truly focussed on client needs (and not just regulatory mandates); and c) seamlessly assimilate the new product offerings with their existing credit products. MFIs and FFIs at the very least must communicate frequently about roles, responsibilities and about changes to the field staff directly involved. A legally binding service contract helps in reducing conflicts between the partners. For instance, ICICI Bank's Business Correspondent model has a descriptive contract, defining roles and responsibilities and based on the assessment of risks and situations – mitigation strategies.

Conclusion

MFIs know the requirements of poor people very well, and partnerships between MFIs and FFIs could further financial inclusion, through offering savings, insurance and other financial services products apart from credit. Addressing this section of the society will not only help FFIs move beyond the saturation point for their products and services in the high-end market they are serving, but can also provide them, and their MFI partners, significant opportunities to add to their bottom lines. While such partnerships may be marred by incongruent and asymmetric visions amongst the partners, the key to overcome the challenges is by choosing partners carefully and having a clear understanding of the roles and responsibilities of each partner (and their capacities).

[1] http://www.sewainsurance.org/vimosewa4.htm
[2] http://69.89.31.196/~basixind/index.php?option=com_content&task=view&id=181&Itemid=198
[3] See *MicroSave*'s IFN 28: "Exploring Domestic Remittances as a New Line of Business for Indian MFIs" for more information.