

MicroSave India Focus Note 8

What Does Competition Mean For Indian MFIs?

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In the last two years competition amongst microfinance institutions (MFIs) as well as with the Self Help Group (SHG) movement has emerged India. In Puri, Orissa, 7-8 MFIs co-exist and some of them have common set of clients and groups. In one of the groups visited, members were part of one MFI from 10am and were borrowing/repaying to another MFI from 10:30am without the group having to leave the meeting place! This represents an important change, since until 2005; most MFIs did not have to worry about competition. This period of low competition allowed MFIs the freedom to focus on the methodology and management systems necessary to reach scale and sustainability. But growing competition is not unique to India, indeed competition has been an important factor in several countries around the globe for many years. Bangladesh, Bolivia and Uganda are acknowledged to have particularly competitive environments. These market places offer an opportunity to learn about the effects of competition on microfinance institutions and their clients ... and draw lessons for the future of Indian microfinance.

In a competitive environment, microfinance institutions must shift their thinking to respond to different challenges¹:

Pre-Competitive Stage	Competitive Stage
<i>Objective:</i> To reach more people and to become financially viable.	<i>Objective:</i> To retain or increase market share, while remaining profitable
<i>Internal focus:</i> Developing the institution's internal capabilities and optimising efficiency.	<i>Internal issues remain important, but external focus is added:</i> Understanding the external environment and incorporating that understanding into business strategy. Issues like corporate branding, strategic marketing and governance gain importance.
<i>Driving motivation:</i> Access to funding.	<i>Driving motivation:</i> Attracting and retaining customers.
<i>Growth:</i> High growth possible. Some MFIs have doubled their portfolio annually for several successive years with no competition and abundant donor/bank funds.	<i>Growth:</i> Low growth, stagnation, or even portfolio shrinkage possible, even for large well-managed MFIs, as the experience in Bolivia and Bangladesh shows.
<i>Market assessment:</i> Little need to take the behaviour of other players into account.	<i>Market assessment:</i> Must study the behaviour of the clients, prospective clients, and competitors, or suffer grave consequences.
<i>Client demand:</i> Taken as given. Institutions can grow and be profitable with unchanging, unpopular products.	<i>Client demand:</i> Can evaporate quickly if competitors provide better service. Institutions that think strategically, satisfy customers' needs and desires, and innovate intelligently are likely to do well; others are likely to have hard times.

Indian microfinance has entered its "competitive stage" - the implications for MFIs and their clients are significant. The following reviews lessons learned in Bangladesh, Bolivia and Uganda to extract the implications for India.

Over Indebtedness?

In Bolivia, "The momentum of lending growth that propelled both the microfinance institutions and consumer lenders created a bidding war, with competitors vying for clients by offering larger loans, faster service, and lower interest rates. ... Over indebtedness was rampant, particularly common among the high proportion of clients who had borrowed from multiple microlenders at the same time" (Rhyne, 2002²). However, experience in Bangladesh shows, there are different drivers of over indebtedness. "It appears that for deficit households, distress management is the reason for multiple borrowing, while for better off households multiple borrowing is mostly opportunity driven. The main supply-side challenge is that the lending technology fails to distinguish between the two types of clients and offers uniform products"

¹ Based on a presentation by Elizabeth Rhyne to the MicroFinance Network in July 2001.

² Rhyne, Elizabeth, "Surviving the Crisis: Microfinance in Bolivia, 1999-2002", ACCION mimeo for Symposium on Financial Sector Development in Southeast Europe, Kreditanstalt für Wiederaufbau, 2002.

(Chaudhury and Matin, 2002³). This has significant implications for the Indian MFIs' response to over indebtedness. "Multiple-membership calls not only for creating arrangements such as credit bureaux, but also for more concrete advances in providing protective financial services while diversifying the range of promotional ones. In this sense, it is an opportunity as much as a challenge" (Chaudhury and Matin, 2002).

Demanding/Discerning Clients

As clients gain access to greater choice, so they become more demanding and discerning, and many chose to leave the group-based lending institutions in preference for individual lending-focused institutions. In India, we may see the fast tracking of the individual lending approach with the entry of Non-Banking Finance Companies into the microfinance market segment. Furthermore, under highly stressful or competitive conditions, the operational principles of group guarantee may even increase portfolio at risk. Groups may "unzip"⁴ and the entire group, burdened by excessive or multiple default, sees no further hope for continuing loans and elects to default *en masse*. "It is this risk that drives MFI field workers to continue to give loans to the good payers in the longer established groups - after all they have developed a long credit history - and thus to negate the group guarantee principle. And it is for this reason that, despite all the rhetoric, the effectiveness of the group guarantee principle is limited to the first few loan cycles" (Wright, 2000⁵).

MicroSave's work on competitive environment in Uganda (Wright and Rippey 2004⁶) unambiguously demonstrated the strong negative feelings that many Ugandan group members have towards group-based loans. In Uganda, MFIs were compelled to move towards individual lending-based methodologies, to respond to the challenge and opportunity presented by these client preferences ... in India Spandana, SKS and others are already moving in a similar direction.

Opportunities in Niche Markets

But even for MFIs focused on using the group-based lending methods, the performance of Pro Mujer and Crecer in Bolivia suggests that there is still a potential to serve niche markets. This approach may prove to be a necessary and important survival strategy for poverty-focused microcredit organisations in India as the competition heats up. Many rural areas, and lower-income clients, remain under-served ... as do many SME borrowers. Identifying and focusing on less contested market niches has proved a viable strategy as MFIs seek new approaches to serving both poorer clients and the small businesses previously excluded by targeting strategies. This move may also be reflected in India as MFIs move increasingly towards urban and individual lending, or in some instances, to serve remote rural areas.

Price-based Differentiation

When confined to the highly competitive market niche (typically working capital loans for market traders) perhaps the most obvious strategy for MFIs to adopt might be to differentiate themselves on the basis of price. This has indeed happened in Bangladesh where the interest rates on the standard one year MFI loans has been falling since the mid 1990s (Wright, 2000). Similarly, in Bolivia, "For the first time there was some evidence that at least some customers would switch institutions on the basis of price. ... Not only did yields fall over time, they narrowed, as institutions priced their services on a competitive basis rather than on the basis of their own internal cost factors" (Rhyne, 2002). The implications for the Indian market, where price is already such a politically charged issue, remains unclear ... but it is reasonable to suggest that prices are likely to fall.

Conclusion

Thus, it is clear that highly competitive environments present risks both for the MFIs and their clients. MFIs may adopt less stringent loan assessment or approval criteria; or be forced out of their traditional markets into new ones with higher risk profiles and cost structures; or may be forced to reduce the prices they charge in the more competitive market niches. Clients may be tempted into a situation of over indebtedness either by using the competition to negotiate faster access to larger loans from their financial service providers, or by accessing multiple loans from several providers. Clearly, this type of behaviour would be a source of great concern if it were happening in the Indian context.

³ Chaudhury, Iftekar A. and Imran Matin, "Dimensions and Dynamics of Microfinance Membership Overlap – A Micro Study from Bangladesh", *Journal of Small Enterprise Development*, Vol. 13 No.2, ITDG, London, 2002.

⁴ A term first coined by Rutherford during 1992.

⁵ Wright, Graham A.N., "MicroFinance Systems: Designing Quality Financial Services for the Poor", *University Press Ltd.*, Dhaka and *Zed Books*, London and New York, 2000.

⁶ Wright, Graham A.N. and Paul Rippey, "The Competitive Environment in Uganda: Implications for Microfinance Institutions and their Clients", *MicroSave*, Nairobi, 2003.