Innovations in Microfinance

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This series showcases innovative microfinance programs from the February 2000 "Advancing Microfinance in Rural West Africa" conference held in Bamako, Mali. The programs emphasize reaching new frontiers in rural areas, particularly in West Africa. These notes are an investigation of innovative practices working in specific environments, not a general endorsement of financial products. We recommend institutions utilize these technical notes as introductory information. To learn more about this topic and its applicability to your program, please consult the bibliography at the end of the piece.

New Product Development for Microfinance

I. Introduction

Traditionally, most microfinance institutions (MFIs) have offered a uniform credit product for all of their customers (a "mono-product"). This traditional product usually relies on a stepped lending methodology where loan terms and conditions are set to minimize the risk and costs of the provider institution, as opposed to reflecting the needs and preferences of their clients.

This supply-driven, one-size-fits-all approach is now being replaced by a more market- and client-driven approach as a result of several factors:

- Added competition resulting from the entrance of formalized commercial banks into the microenterprise market;
- Increasing client dropout rates resulting from inflexibility or inappropriateness of current product offerings; and
- A more sophisticated clientele with more discriminating preferences.

Since the sustainability of MFIs depends on achieving a significant level of scale and portfolio growth, there has been greater impetus on the part of MFIs, on the one hand, to refine existing products to retain customers and, on the other, to introduce products and services to attract new clients.

Although this shift in approach, from providing "microenterprise credit" to "a range of financial services to low-income clients," is a positive sign that the market for financial services to the unbanked population is deepening, over-eagerness to introduce new products into the market without proper due diligence and internal preparation could lead to deleterious results that threaten the long-term viability of the MFI.

This technical note is the first in a series of briefs on how MFIs have developed new products to expand their outreach into rural areas, particularly West Africa. The current rural financial market development approach envisages the provision of "reasonably priced and durable financial intermediation services that are demanded by customers." The challenge lies in the ability of MFIs to balance between providing appropriate services and achieving financial viability.

This brief provides a general road map for the new product development process, with illustrative examples of how MFIs all over the world have tackled this process and the challenges they faced. It is not meant to be a comprehensive guide to new product development.[1] The accompanying briefs in the series profile specific products, such as leasing and insurance, with a discussion of the methodology, institutional structure, institutional benefits, and challenges of these product offerings.

II. "What" Is a Product?

A product, broadly defined, is anything that satisfies a customer's need. The product can be a way for an institution to position itself strategically within the market as well as with its clientele. A product can be considered in three component parts:

- Core product—the reason *why* the customer wants to pay to receive the benefit (e.g., financial security) or to fulfill a certain need (e.g., investment capital).

- Actual product—the specific features, such as terms and conditions of the loans, that characterize *what* the customer is buying.

- Augmented product—*how* the customer receives the product—e.g., how the loan is delivered and processed.

III. "When" Should an MFI Explore New Product Development?

Because product development is a process that requires a substantial amount of resources (human and capital) and time commitment, it might not be appropriate for all MFIs. Whether an MFI should consider new products depends on the institution's stage of development, the level of competition in the market in which it operates, and the needs of its clientele. Often, what is required is not necessarily the introduction of a completely new product but simply a readjustment or refinement of an existing product.

Institutional Readiness—walk before you run. An MFI should have an established credit product (i.e., its core product) and ensure that all the "fundamentals" are in place before moving on to offer additional products. These fundamentals include:

- **Governance structure and control.** The MFI should have a board of directors that has a clear strategic vision for the institution, is committed to market-driven strategies, and is able to provide the level of oversight needed to hold management accountable for performance.

- **Systems and operational procedures.** The MFI should have in place an appropriate management information system to handle its information and reporting requirements. The management information system should be able to record and track client data, portfolio performance, and cost structures. Policies and procedures for field and branch staff should be well defined, and appropriate internal controls should be in place to minimize the risk of fraud, waste, and abuse.

1 MFIs that wish to obtain more detailed step-by-step instructions for undertaking this process should refer to "The MBP Guide to New Product Development," by Monica Brand (forthcoming).

- **Organizational structure.** The institution should have an open communications channel to allow ideas to flow vertically between management and the field, as well as horizontally across departments. The corporate culture should be an environment where innovation and experimentation are rewarded through properly designed incentives.

*It is important to remember that product development is a systematic process whose success depends on **awareness of market signals** and **institutional capacity** to (1) mobilize the appropriate resources during the design and testing phase and (2) operationalize the product once it has been launched.*

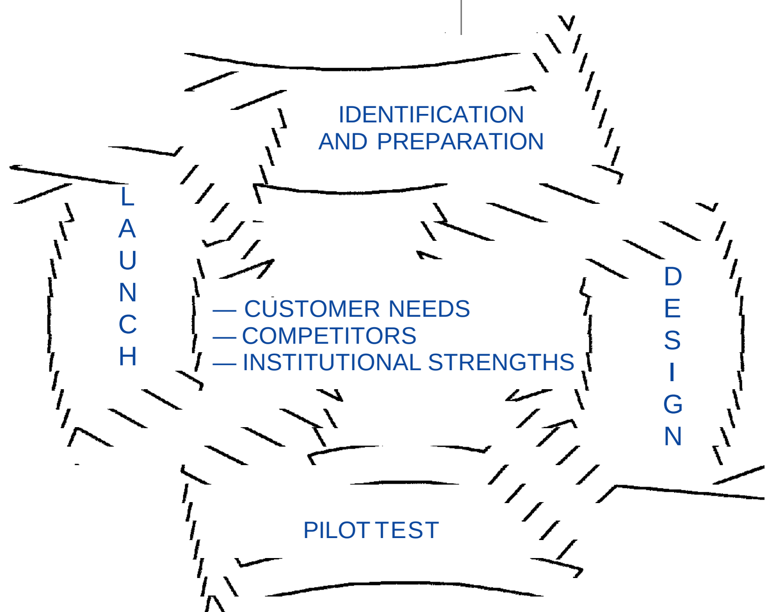
IV. "How" Is a New Product Developed?

New product development is a **process** that consists of four distinct phases:

Identification and preparation begin when the institution decides to formally investigate the development of a new product. The institution will mobilize staff and other resources to work on the development effort and create a work plan.

Design and development of a product prototype involve drafting the initial features and characteristics of the new idea. To design a prototype, the development team must understand client needs and the competitive landscape to determine what clients will buy.

Pilot testing of the prototype is an opportunity to offer the product to a sample group of clients to determine if these customers need, and will buy, the product. The results of the pilot test will help the organization determine if there is demand for the new product, modifications or changes to the terms and conditions that need to be made to make the product more appealing, and what features or processes need to be adjusted.



Product launch involves making the new product available to the organization's entire market. Introducing the new product to the bigger market assumes that the organization is confident that the characteristics and features of the product are in line with the needs of its clients and that the institution is prepared internally to incorporate a new line of business.

As shown in the diagram, three sources influence each phase of the product development process: customer needs, competitors, and institutional strengths. These sources should be considered in each phase of the process.

PHASE 1: IDENTIFICATION AND PREPARATION

The failure rate for introducing new financial products in conventional developed countries can be as high as 75 percent. Consequently, an MFI should identify opportunities before embarking on the product development process. These opportunities are manifested through a set of market signals—customers, competitors, and the environment—as well as the bottom line-driven motives of the institution.

The Customer Is Always Right. One of the simplest yet most effective methods by which an institution can learn about product needs is by listening more carefully to its clients. This can be done through direct feedback to loan officers, during group meetings, or through special focus group discussions with customers. An MFI also can gain valuable information by tracking reasons for client desertion or conducting client exit interviews.

Building Customer Loyalty

- The Swaziland Business Trust offered an intermediate loan product with higher denominations and faster cycles for customers who had successfully made three consecutive rounds of loan payments.
- BancoSol of Bolivia developed individual loans and relaxed its solidarity group requirements in an effort to retain its stronger clients.

Know Your Market. Product ideas can be generated simply by watching closely economic, industry, and environmental trends. For example, during high inflation, clients will want to have access to liquid savings products. Another source of ideas is the MFI's competitors. An MFI should know who its competitors are and what products they are offering. Competitors can be a resource rather than a threat: an MFI can adapt or improve upon product features offered by its competitors.

Getting Ready—What It Takes. Internal preparation activities help ensure that (1) the product idea fits with the strategic vision and objectives of the MFI, (2) there is institutional buy-in to move forward and actualize the idea into a product, and (3) the appropriate resources (financial and human) are allocated to the process.

- **Institutional assessment.** First, an institution should determine whether and how the new product idea helps promote its mission, its competitive strategy, its financial goals, and its social impact. Once the MFI decides that the product idea would not detract from these goals and objectives, it then must assess its capacity to handle an additional product. Major factors that should be considered in this evaluation include staff skill level, delivery channels, management information systems, and training procedures. In addition, the institution should assess how the introduction of a new product would affect its overall portfolio risk and liquidity level. Such risk management considerations should be viewed in relation to the added customer benefit and profit gain from portfolio diversification.

Responding to the Market Environment

- The Rural Finance Facility in South Africa responded to housing shortages in its markets by offering a residential credit product for its customers.
- FINCA Uganda formed a partnership with a local commercial insurer to offer a life insurance product to its clients in response to the country's high mortality rate.

- **Assembling the team.** Introducing a new product requires a team effort. A new product development team has two major resources: (1) a **product champion** to oversee and guide the entire process, and to generate enthusiasm and build institutional support for the product, and (2) a **cross-functional team** of three to seven staff members to carry out the day-to-day tasks of product development. Each team member should bring a different type of expertise and skills to the process. The number of team members and the time devoted by each staff member will depend on the resources of the institution.

PHASE 2: DESIGN AND DEVELOPMENT

The first step for the new product development team is to design a *prototype*. A successful prototype is developed based on market intelligence that the institution gathers from its clients, its institutional experience, and the local environment. Once market research is completed, and the terms and conditions of the new product have been structured, the institution can finalize the prototype by taking into account cost considerations, financial projections, and regulatory and legal compliance.

Select Your Target Market. To address customer needs, an institution needs to get close to and understand its clients. Market segmentation is the process by which an institution can gather information about its clients and their needs. A market can be segmented by geography, demography (e.g., age, income, gender), business size, financing need (e.g., working capital versus fixed assets), and customer behavior (e.g., clients who care about price versus those who care about the quality of the service). Segmenting the market can identify niches where product needs are not being met and where clusters of clients exist that could serve as the target market for the prototype.

Mine Your Institutional Knowledge. The MFI itself, especially line staff such as loan officers and credit managers, represents an invaluable source of information about client needs. Studying current product offerings also can inform the MFI about customer preferences and behavior, such as which clients are price sensitive or which prefer certain loan features. In addition, company documents such as loan files, especially those who were declined, also can provide insight about potential market opportunities.

Know What the Competition Is Doing. The new product development team should pay close attention to price, packaging, and placement of competitive products in designing a prototype. Knowing what the competitor is offering, how the product is delivered, and how it is perceived by customers can help the institution shape its product in a way that differentiates it from the rest of the market.

Receiving Client Input. Soliciting direct client feedback on the prototype provides a reality check for the institution before it starts the next phase of the new product development process, the pilot test. A variety of methods exists to obtain input, including one-on-one interviews, focus group discussions, participatory rapid appraisals, sample surveys or questionnaires, and action research. Although these methods of primary data gathering provide valuable feedback, they also are labor- and cost-intensive. The MFI thus should ensure that adequate resources are allocated to this stage of the process.

Measuring Costs and Break-Even Sales Volume. Once the basic prototype has been formulated, the product development team must ensure that it can deliver it to the client cost-effectively. First, the team has to examine internal logistics and required systems to estimate costs and adjust product features accordingly. The costs should take into account such factors as the hiring and training of staff, management information systems, and marketing/promotion costs. Second, the team has to estimate revenue based on market share projections and product characteristics. These two sets of data are then used to calculate break-even sales volume. MFI management should analyze the

- **FINCA Uganda** conducted “intercept” interviews with people in shopping centers, at outdoor markets, and on busy street corners to determine the initial parameters of its insurance product.
- **Bank Rakyat Indonesia (BRI)** used social channels, such as churches, community groups, and trade associations, to obtain in-depth client feedback.
- **BancoSol in Bolivia** conducted focus group discussions with clients to determine how its products fared against competitors and to identify features to incorporate into its new individual loan product.

break-even sales volume in comparison to the potential market demand to determine the length of time it would take to reach the break-even sales volume and the availability of other revenue sources to cover the development costs of the product in the meantime.

Finalizing the prototype design will involve balancing cost and profitability considerations with customer service, competitive strategy, and risk. This can help the MFI determine the return goals and the type of information needed from the pilot test, the next phase of the product development process.

PHASE 3: THE PILOT TEST

A pilot test introduces the product prototype to a limited number of customers so that it can be determined whether the product's features meet market demands *before* the institution offers the product to a larger market. The pilot test helps ensure a certain level of market acceptance once the product is commercialized. Thus, the MFI should design the test in a way that will accurately capture customers' reactions.

Defining "Success." To determine whether the pilot test was successful, the institution has to identify performance indicators and establish targets for these indicators. Common performance indicators include:

- Volume—number of clients, level of sales, market share;
- Profitability—rate of return for product;
- Productivity—number of clients per loan officer; and
- Resource efficiency—money and/or time invested.

Setting Up—Where, How Many, and How Long? Critical elements of the pilot test are test sites, sample size, and duration. The **number of sites** should be manageable and easily accessible by the product development team. The location, or locations, for testing should represent a subset of the institution's target market for the product and must have the internal capacity to sell and monitor the product being tested. The number of customers involved in the test, or the **sample size**, should be large enough to ensure a reasonable level of confidence that the data reflect the broader target market, yet small enough so as not to make information gathering expensive or monitoring difficult. The **duration** of the pilot test will depend on the terms and structures of the product as well as market conditions. In deciding the time frame, the institution should consider the trade-off between cost and reliability of test results, the opportunity cost of being late to market versus prematurely entering the market, and the length of time needed for administrative and operational adjustments necessary for product implementation.

Preparing the Test Site. Critical operational functions of the institution must be prepared and equipped to handle the requirements of the new product or service. Each test site should put in place the **appropriate processes**, from the application process to policies and procedures as to how the product is evaluated, approved, and managed. The product development team has to ensure that the **management information system** can track and monitor client information, and produce reports. In addition, sales staff have to be trained to have a thorough understanding of the product and the procedures and policies for product delivery. A **marketing and promotional strategy** has to be developed, including promotional materials such as fact sheets and brochures, to generate interest and publicize the new offering.

Monitoring and Evaluating Results. Three major areas that the product development team should focus its monitoring efforts on are the delivery process, loan terms, and competitive response. The delivery process is monitored to assess the efficiency and timeliness of the application, approval, and disbursement processes. The reactions of clients to the terms and conditions of the product also is monitored to inform potential refinements and adjustments. The team should monitor whether the new product has resulted in a price war with the competition or whether it has cannibalized[2] other products in the institution's portfolio.

Once the information has been gathered, the product development team must evaluate whether commercializing the new product is worth the investment to the institution. The following evaluation criteria should be considered in arriving at a Go/No-Go decision.

- **Financial viability.** Administering a diverse product line is a costly, complicated endeavor. Products or services that do not help cover the costs of running the institution may jeopardize its long-term viability. Consequently, there must be strong market prospects to ensure that the loss in short-term profits will be more than offset by expected revenues generated from capturing a larger share of the market.

- **Competitive considerations.** Financial projections and the product's ultimate commercial success are tied to the product's competitive position in the marketplace. Three factors determine the product's competitiveness—market share, product mix, and market position. **Market share** relates to the retention of customers, the capture of clients from the competition, and the luring of new clients who were previously unserved. **Product mix** looks at whether the new product complements or dilutes current offerings. An MFI should consider its **market position** when contemplating a product line expansion. For example, an MFI that is transforming into a formal financial institution may have to incorporate certain core products, such as savings accounts, so that potential clients can treat it seriously as a bank substitute. Or, an MFI may want to identify itself with a particular market segment, such as a village bank focusing on poverty alleviation. The important thing to remember is to have a coherent product mix and not try to be all things to all people.

- **Institutional capacity.** Introducing a new product is resource intensive and a potentially disruptive process for employees who are accustomed to certain operating procedures. A critical consideration in deciding whether to move forward with product development is the potential for internal collaboration and institutional change. Institutional capacity entails having a number of systems in place: **delivery channels** (physical infrastructure and communications channels) to market the product to the target customer group; **management information systems** to track the disbursement and collections, as well as monitor portfolio performance; and **human resources** who understand the terms and characteristics of the new product and who are able to sell and market the product.

The table below summarizes the potential outcomes of the pilot test phase using a Go/No-Go decision model.

OUTCOMES OF PILOT TEST

Option	Conclusions	Actions
NO	• Market demand insufficient • Institutional resistance strong	• Generate new product ideas/refinements • Build organizational support for expanded product line
GO	• Prototype well received • Positive institutional evaluation	• Proceed with commercialization

2 *Cannibalization* occurs when a new product diverts sales from a company's existing products so that revenue is displaced rather than created.

PHASE 4: PRODUCT LAUNCH AND COMMERCIALIZATION

Launching a new product or service requires as much preparation, calculation, and control as the pilot test phase. Launching the product too quickly could result in the institution's lack of capacity to efficiently deliver the new product, potentially reducing market acceptance of the product and damaging the institution's reputation. Launching the product too slowly increases the likelihood that competitors will develop and launch a similar product and capture the MFI's potential market.

Implementation Plan. It is important to plan when and how the institution will phase in the new product line at each branch office. The plan should take into account the institutional capacity needed to carry out the separate functions and tasks of marketing, processing, delivering, and managing the new product.

- **Human resource development.** As an MFI expands its product line, having an established **training program** can help ensure product consistency and quality control. Factors such as staff education level, attitude, and current workload must be analyzed to determine what type of training is most appropriate as well as the content of the training. In deciding which staff to train, the institution should analyze the benefits of employing specialized versus generalist loan officers. Generalist credit officers are able to offer clients a full menu of product options. They also allow the MFI to serve the needs of the microenterprise as it grows, without having to divide the portfolio among credit officers. Specializing would be appropriate when there is a unique type of underwriting or a specific target market associated with the product.

  An MFI can encourage a shift in attitudes through appropriately structured incentives. Well-designed incentives will institutionalize training and help senior management guide the focus of operations. Effective incentives are usually performance based and multiple, weighted and time limited, straightforward and reinforcing, balanced between individual and collective goals, and aligned with institutional targets.

  - Fundusz Mikro in Poland trains its credit officers in client interaction so they can assert authority while at the same time be friendly and helpful.
  - Instead of a formal training program, ASA in Bangladesh has new hires "shadow" a senior loan officer on the job for a week.
  - BancoSol in Bolivia chose product specialists for its individual loan products because the underwriting involved making calculations, such as ratio analysis and cash flow projections, that are not performed in solidarity group lending.

- **Internal support systems.** In addition to human resource development, the MFI must also develop operational systems to support the new product line. The MFI's **management information system** should be able to process information about the new product. At a minimum, loan officers should track the hours spent working with different products on timesheets since salaries typically represent one of the largest costs. **Accountability and quality control systems** must be in place for scaled-up product implementation. Oversight can come in the form of portfolio reviews, performance evaluations, and credit policies and operational manuals. Lastly, adequate lines of **communication** should be established between headquarters and branches, between management and staff, and between customers and the MFI. Many MFIs use client visits or technical assistance as the main means of dialogue with customers. Familiarity with clients can also be forged through credit performance and daily portfolio reports.

The "4 Ps" of Marketing. An MFI should develop and implement a marketing strategy so it can capture and retain a broader market for the new product. This strategy revolves around Product, Price, Promotion, and Positioning (or Placement)—the four marketing Ps.

- **Product.** The pilot test enables the MFI to gauge market reaction to the prototype product. Based on the results of consumer feedback during the testing phase, the product development team can refine the features of the product so that it will appeal to the broader target market. The adjustments should take into account the previously mentioned component parts of the product—core product, actual product, and augmented product.

- **Price.** Pricing a product should take into account (1) the cost of delivering the product, (2) the customer's ability and willingness to pay, and (3) the competitor's pricing and the institution's own position in the market. **Cost recovery** is a key component of pricing, and the institution must take into consideration all related expenses over and above the cost of capital incurred to deliver a product. **Competitive considerations** are another key component. High prices are often associated with better quality, superior customer service, and professionalism, while lower prices can be confused with slower turnaround time, poor customer service, and lack of support services. The MFI should thus consider the way its pricing will affect how customers will perceive the product in relation to other products on the market.

- **Using service to augment a product.** ASA in Bangladesh has a limited choice of products but offers quick service targeted at clients who place a high priority on convenience.

- **Pricing for cost recovery.** Fundusz Mikro offered a discount if the borrower chose a group loan over individual credit. The interest rate charged on the loan would drop as the group size increased, reflecting the need for the institution to achieve volume and increase staff productivity to cover its fixed costs.

- **Promoting brand recognition.** BRI, BancoSol, and Banco Caja Social in Colombia hold periodic lotteries or raffles to generate deposits. These institutions also use an easily identifiable trademark or product symbol on their brochures and promotional materials.

- **Partnering to enhance delivery.** Swaziland Business Trust partnered with local banks to locate its debit card machines in their branches so that customers would have a safe place to carry out electronic transactions.

- **Promotion.** Promotions are the primary means of communicating a product's features to the market and building consumer awareness. Promotional activity can include advertising, publicity, and public relations. The promotional plan should be tailored to the target market. Print advertising, for example, would not be appropriate for an audience that is illiterate or speaks a local dialect.

- **Positioning/placement.** Placement involves how the product is delivered to customers. It refers both to the physical location (distribution) of the product and to its positioning in the market relative to competing products. In the first instance, the institution needs to evaluate whether the product is available in locations where clients have easy access and when clients need it. Some physical upgrades to the office may also be required; for example, an institution that is introducing savings products should add safety vaults to its branches to store deposits. In terms of market positioning, the MFI should decide whether it will position itself as a full service intermediary where clients have the convenience of one-stop shopping, or an efficient provider of a particular line of similar products aimed at a broader market.

TOP 10 LESSONS FOR SUCCESSFUL PRODUCT DEVELOPMENT

1. Solicit client feedback throughout the process to continually refine the product.
2. Expect problems to arise along the way.
3. Generate institutional buy-in early and continually throughout the product development process.
4. Test the product in actual market settings and expand slowly.
5. Make realistic cost revenue projections to prepare for the financial impact of adding another product.
6. Make sure systems have sufficient capacity and flexibility to manage and track new products.
7. Provide appropriate training and incentives to staff to ensure effective implementation.
8. Cancel the product if external or internal conditions are not conducive to new products.
9. Identify a product “champion” who will maintain momentum throughout the development process.
10. Create a client-centered institution.

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