

WHY DONORS NEED TO UNDERSTAND PRODUCT DEVELOPMENT

Poor people need access to a wide range of financial services. They need financial services to seize business opportunities, to invest in home improvements, and to meet seasonal expenses like school fees and holiday celebrations. They also need financial services for life-cycle events, such as weddings and funerals, and to cope with emergencies like the illness of a wage-earner or a monsoon that wreaks havoc on their village.

Most microfinance institutions (MFIs) today offer the poor a limited range of financial services based on microcredit. Although it is not recommended that donors become directly involved in product development, donors need to understand the issue so that they can target and support client-responsive financial institutions. Donors can also disseminate information on new and innovative financial services for the poor.

What kinds of financial services do poor people already use?

The poor utilize a wide range of financial services—and have done so for centuries. Informal systems such as family and neighbor networks, moneylenders, savings clubs, rotating savings and credit associations, and mutual insurance societies are pervasive in nearly every developing country. Assets like animals or gold are used as a form of savings that the poor “withdraw” through sales when the need or opportunity arises. Cash buried in the back yard or stashed under a mattress remains a popular means to save. Small farmers obtain credit from input suppliers or commercial vendors. Poor people are also clients of formal institutions like financial cooperatives, post banks, and microfinance institutions (MFIs).

What are the limitations of financial services currently available to the poor?

Moneylenders charge exorbitant interest rates on loans. Buying inputs on credit is far more expensive than buying in cash. Local rotating savings and credit circles allow deposits and loans only at very specific time intervals and in strict amounts. A livestock “asset” such as a cow is not a divisible asset that can be sold to meet small cash needs—and it can get sick or die. Existing financial institutions, including microcredit MFIs, offer a limited range of fairly rigid financial products that are not always appropriate to the needs of the poor. Client satisfaction surveys of MFI customers, together with field research on market demand among the poor, suggest that they believe too few financial services are available and that terms are often inflexible. They seek a wide array of flexible services such as individual loans, deposit services, transfer payments, and insurance.

Why is product development important to donors?

Microfinance has historically focused on working capital loans for microenterprise development. Leading practitioners on every continent have developed effective credit methodologies: solidarity loans, Grameen-style group lending, village banking, and individual lending methodologies are the most well-known. Many donor projects have sought to replicate these methodologies with varying levels of success. But these projects have not succeeded in addressing the broader range of financial needs of the hundreds of millions of potential clients who remain unserved, whether or not they run successful enterprises.

The realization that many MFIs have not met the larger demand for financial services, combined with poor client retention rates and competition in some markets, has led donors and practitioners to concentrate on developing **new products** that are less supply-driven and more responsive to client needs.

What should donors know about product development?

- **Product development is not a donor activity.** Rather than dictate how and where products are delivered, donors should leave product development up to the managers of financial institutions. These managers best understand their clientele, market, and institutional capacities. Enthusiasm for new products should not lead donors to push financial institutions to offer new services or work in new regions before they are ready.

- **Refining products or introducing new products takes time and thought.** Institutions should follow a systematic product development process that includes analysis of institutional capacity, client-oriented market research, realistic product costing and pricing, pilot testing, and careful, phased roll-out.
- **Do not re-invent the wheel.** It is often less expensive and time-consuming to repackage and refine an existing product or a product developed by another institution than it is to engage in new product development.
- **Ensure that the financial provider has sufficient institutional capacity and commitment before it engages in product development.** Product development requires that an institution obtain full leadership commitment, allocate staff and systems to develop and manage the new product, and train relevant staff. Many MFIs have gotten into serious trouble by moving into insufficiently-supported new services. This is particularly true of group lenders who add individual loan products without developing a cadre of loan officers trained to analyze client cash flow.
- **Beware of product proliferation.** Tailoring products to too many individual market segments can create confusion among front-line staff, lead clients to switch from one product to another, and create overly complex delivery systems. Not all institutions need to offer all products themselves—in some cases, strategic partnerships can better ensure that diverse client needs are met. For instance, MFIs could partner with insurance companies to deliver appropriate insurance services to the poor.
- **Measure success with appropriate indicators.** Indicators of successful product development include a wider range of financial services used by more clients; increased stability and sustainability of financial institutions through portfolio diversification; greater client loyalty and retention; and better fund mobilization (for institutions legally able to collect deposits).

How can donors best support product development?

- Provide flexible innovation grants that enable a variety of institutions to experiment with refining or designing products based on client needs and preferences.
- Look for partners that explicitly seek feedback from clients when designing financial products. Support organizational changes necessary for market-led product development.
- Offer technical assistance and/or seed funding to institutions that are testing new products, particularly in challenging environments or among vulnerable populations—as long as these experiments aim toward development of financial services that are viable over the medium- to long-term.
- Take a patient, long-term approach to funding that rewards institutional performance and outreach.
- Support information exchange and learning among practitioners and donors to maximize replication of successful product development efforts.
- Invest in regional or global projects and networks that push the frontiers of product development.

MicroSave-Africa (East and Southern Africa) is an excellent example of a multi-donor program that supports product development. The organization assists financial institutions in developing new products and refining existing ones by combining primary field-level research with action research. The project works intensively on the ground with a selected group of financial institutions to develop a curriculum for in-depth, practical training and to disseminate information on the financial needs and preferences of the poor. Financial institutions working with *MicroSave-Africa*, such as Equity Building Society (EBS) in Kenya, have undergone a significant transformation into client-responsive, market-led organizations. EBS went from near bankruptcy 10 years ago to its current profitable position with 135,000 savers and 29,000 loan clients.

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Where to go for more information: Brand, Monica, *The MBP Guide to New Product Development*, (Wash., DC: ACCION International, 2001); Helms, Brigit, *CGAP Product Costing Tool*, draft version 1.3 (Wash., DC: CGAP, March 2002) at <http://www.cgap.org>; Small Enterprise and Education Promotion (SEEP) Network, *Learning from Clients: Assessment Tools for Microfinance Practitioners*, (Wash., DC: AIMS, 2000) at <http://www.mip.org>; Wright, Graham A. N., “Market Research and Client Responsive Product Development,” *MicroSave-Africa* Essay, 2001, at <http://www.microsave-africa.com>.