Partnerships in Microfinance

A discussion primer

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Summary

Alliances and partnerships have long played a prominent role in the business world, but have only recently begun to receive greater attention by the providers of microfinance services. In recent years, several innovative business models based on linkages between organizations, often supported by new technology innovation, show promise to substantially change the way financial services are delivered to the poor, both in terms of scale of outreach and increased diversity of services offered. But what are the implications of this for both the service providers and their clients? What are the pitfalls and constraints? And how might these best be managed?

As the microfinance industry matures, three trends that are already apparent are likely to continue and strengthen:

- greater integration of informal financial service providers into the formal financial sector;
- greater consolidation of retail service providers, with outreach of specific financial services (such as micro-credit) being dominated by fewer, larger providers;
- greater specialization of institutions within the sector, providing a wider range of financial and support services.

In this environment, the ability of institutions to manage their engagement with external parties, and to form complementary strategic alliances, will become increasingly important to their survival – both for those institutions directly providing financial services, as well as those that support the industry through financing, capacity building or ancillary services.

But forging and maintaining mutually beneficial alliances, in many cases with non-traditional partners, may require a different skill set than is currently present in traditional banks or micro-finance institutions (MFIs). How well equipped are current players in the industry to respond to these changes – especially the smaller MFIs?

The essence of a partnership approach is to bring together complementary resources and skills from diverse organizations, drawing on each partner's core strengths, to address complex problems that no one party could address as successfully by themselves. Two such problem areas in microfinance may be:

- rapid expansion in the outreach of sustainable financial services in remote or sparsely populated rural areas (the supply perspective), and
- maximizing the impact of these services on economic development, poverty reduction and the improvement of people's lives (the demand perspective).

There has traditionally been a degree of tension between these two perspectives in the history of the microfinance industry. Can partnership approaches help to bridge this gap? Can they also contribute to a new round of innovation in microfinance?



Further to this, partnerships are increasingly being entered into by MFIs to address core issues of expansion, including:

- Sourcing capital to expand the outreach of credit
- Diversifying financial services, and particularly provision of insurance or money transfer services.

Beyond microfinance, the concept of multi-stakeholder partnerships has rapidly gained influence as an approach to sustainable development and poverty reduction in other sectors such as such as extractive industries, water and sanitation, information and communication technologies and the environment. There is much that can be learned from experience in these sectors regarding the processes of building successful partnership arrangements between formal and informal private sector institutions (such as such as banks, MFIs, non-financial businesses, NGOs and Self-Help Groups), as well as with government, and helping to develop a more systematic approach to partnerships in microfinance.

Partnerships are not, however, a panacea: they are not appropriate in all circumstances, can carry significant risks, require a range of management skills which may not be present in all the partners, and can take far more time and resources to establish and maintain than may first appear. However, in appropriate circumstances, and when implemented well, they have shown substantial potential to develop innovative solutions to previously intractable problems.

Commercially-driven, business-to-business partnerships in microfinance are, and will continue to be, driven primarily by the market. However, rapid scaling up of partnership approaches in microfinance is unlikely to occur without active leadership by organizations and individuals in a position to facilitate the process, based on a sound understanding of the dynamics of the partnering process. Further, a commitment is needed to build the capacity of organizations, especially of small MFIs, to actively broker and enter into partnerships on an equitable basis.

In response to these challenges, the Banking With the Poor (BWTP) network, in partnership with Citigroup Foundation, and building on a research program of the Food and Agriculture Organisation (FAO) and Ford Foundation, has initiated a capacity building program in Asia that aims to increase awareness of the potentials and pitfalls of partnership and linkages approaches, and build the capacity of banks, MFIs and other organizations to explore opportunities for, build and maintain mutual beneficial partnerships.



What is a partnership, why do it, and when?

- *In Brazil and India, commercial and State banks are forming alliances with a range of non-traditional partners, including post offices, retail outlets and other non-financial partners, self-help groups and community institutions to greatly expand their outreach in rural areas.*

- *In Uganda, specialists from the IT industry, microfinance and rural development drawn from the private sector, government and NGOs came together to develop technology tools to assist MFIs improve outreach to isolated rural clients more cost effectively.*

- *While in countries across Asia, MFIs have formed linked with Banks and other sources of funds to expand credit outreach, or with economic and social service providers to help manage their credit risks as well as extend the social and economic impact of their services.*

These are only a few examples of the many ways linkages are being used to extend the reach and impact of microfinance. The potential of these collaborations are gaining increasing attention from microfinance industry and the development world more generally[ii]. The objectives and nature of the linkages are diverse, as are the range of partners - including banks, MFIs, NGOs, community associations, government agencies and other entities in both finance and non-finance sectors.

What is a multi-stakeholder partnership?

*The term 'partnership' describes a range of different relationships, and has arguably become overused. In this discussion, an idealized, **multi-stakeholder partnership** in microfinance could be defined as follows:*

*An alliance among two or more **diverse parties** - which may include banks, other businesses, public agencies, MFIs, NGOs or community groups – in which partners commit resources to achieve a **specific purpose.** This purpose would address **key challenges** that have not successfully been addressed by any one organization acting alone.*

*Partners combine their resources and competencies in a **complementary** and synergistic way, based on **what they do best.** Partnerships are based on principles of equity and transparency. Importantly, they imply a **sharing of both risks and benefits**, and achievement of the partnership goals in a way which is **mutually beneficial** to each of the partners and their clients.*

Incentives to enter into microfinance partnerships are diverse - depending on the underlying interests of the different partners - and these may go beyond immediate commercial gain. For example, the drivers of a partnership or alliance for one or more of the partners could include:

- Improving profitability
- Expanding outreach
- Diversifying products and sources of income
- Responding to client needs
- Improved public image
- Compliance with regulations
- Positioning in new markets or opportunities
- Reducing or sharing risks and costs
- Access to technical and financial resources
- Influencing sector policy
- Enhancing accountability and transparency, or
- Increasing social and developmental impact



But partnerships are not appropriate in all cases. They carry significant risks and can be difficult to establish and maintain. They work best in situations where single-organization approaches have struggled to achieve the desired goals. In the microfinance industry, two such situations could include:

1. <u>Outreach to remote rural areas</u>: Successfully scaling up access to financial services in rural areas has proven to be a challenge for the industry. It may require different business models that emphasise reduced transaction costs, new types of product and service, efficient means to interact with dispersed clients, upgraded physical infrastructure, and knowledge of the local rural economy. Providing for these conditions may imply costs and expertise that no individual organization has the resources and expertise to meet on its own, requiring organizations to enter into alliances.

2. <u>Addressing the "double bottom line"</u>: Impacting on poverty remains a major goal of many microfinance institutions, governments and donor agencies. Addressing this simultaneously with achieving profitability, or at least financial sustainability, is a challenge that few individual institutions have successfully achieved. Solutions may need to draw on several components, including: supportive policies and regulations; physical infrastructure; human capacity, both in terms of MFI management and skills to enable users to make use of services; and economic services to support enterprise development.

Further to this, business alliances between formal and informal financial organisations are increasingly being entered into to address core issues of business expansion, including:

- Increasing credit outreach (sourcing capital to allow this expansion (informal partner) and extending retail capacity (formal partner),

- Diversifying financial services, and particularly provision of insurance or money transfer services.

A full ***typology*** of these alliances and partnerships is beyond the scope of this paper, but they vary according to a number of parameters which affect the complexity of the ensuing partnership, including:

- Number, diversity and nature of partners involved in the partnership (e.g. two or more; formal vs. informal organisations; financial sector organisations vs. non-financial institutions etc.),

- Formality and depth of the involvement by each partner (e.g. contractual vs. informal agreements; one-off relationships vs. longer term formal alliances etc.),

- Objective of the partnership (e.g. whether the alliance is primarily commercially driven, developmental, or a combination of the two).





Building Successful Partnerships

Partnership success Factors

- *Mutually understood vision for the partnership, with clear goals, roles, responsibilities, objectives and ground rules established;*
- *Partners all bring an essential element to the table, which complement the others', and are based on each partner's core competencies*
- *Openness, transparency and clear communication to build trust, and mutual respect of differences in approach, objectives and interests*
- *Mutual benefit: the partners achieve their own as well as the common objectives;*
- *Strong support and champions for the partnership.*

Strategic alliances between firms have a long history in the business world, and there is much that can be drawn from this experience in structuring microfinance partnerships. Further to this, experiences in a range of non-financial sectors have begun to distil the factors that most contribute to, or detract from, the success of partnerships between diverse partners for the purposes of sustainable development (see boxes) [iii].

The difficulties involved in establishing and maintaining a successful partnership relate to the complexity of the partnership, both in terms of the number of partners involved, and the diversity in background of the partners. In a simple business-to-business partnerships involving two partners that work in the same sector and with the same motivation – such as between a bank and an investment fund, or between two MFIs – the difficulties are relatively straightforward to overcome.

Linkages between formal and informal institutions involve greater complexity.

While those involving parties from multiple parts of society (for example government regulators, commercial banks and NGOs) or different sectors (e.g. retail, IT and finance industries) – in which parties tend to speak different "languages" and have different motivations, are more complex still, and may require professional facilitation.

However, these latter types of partnerships, while difficult to build, also hold out greater promise for real innovation.

Constraints to successful partnerships

- *Lack of trust and mutual understanding by partners of each other's interests, and inability to overcome differences in modus operendi between organizations*
- *Lack of clarity in communication in respect to goals, roles, responsibilities and external accountability.*
- *Lack of the skills and competencies, within one or more of the partner organizations, which are needed to build effective partnerships: managerial, technical or attitudinal.*
- *Hostile external context: political, social and economic.*
- *Imbalances in levels of power or commitment between different partners, and imbalances in the levels of benefit.*
- *Underestimation of the time and resources required to build and establish the partnership.*



Where to go next? Commercially-driven, business-to-business partnerships in microfinance are, and will continue to be, driven primarily by the market. But not all potentially valuable partnerships fit this model, and in many cases the market cannot be relied upon to exclusively drive their formation. Rapid scaling up of partnership approaches in microfinance is unlikely to occur without active leadership by organizations and individuals in a position to facilitate the process, based on a sound understanding of the dynamics of the partnering process.

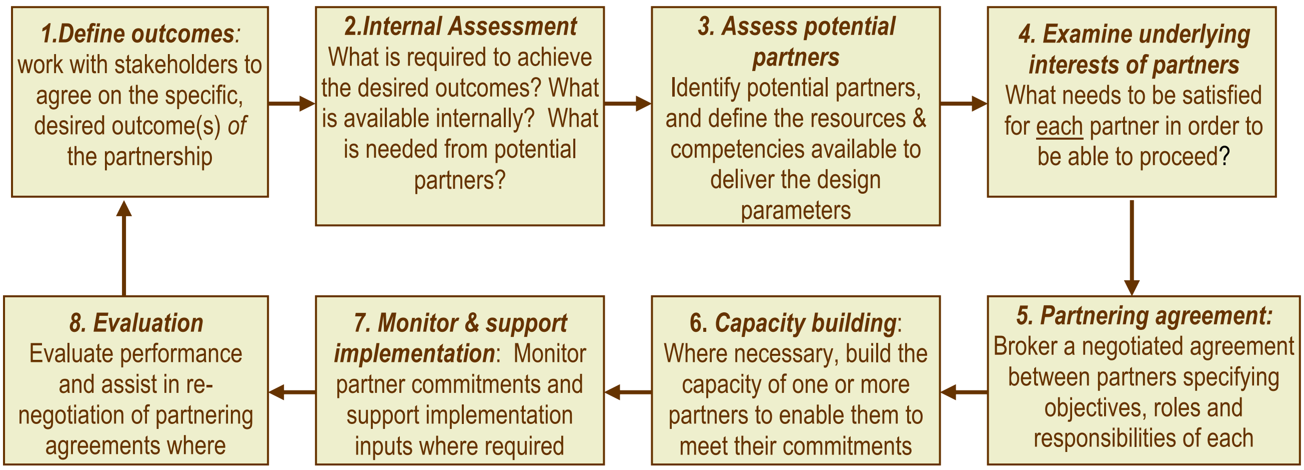
Further, a commitment is needed to build the capacity of organizations, especially of small MFIs, to actively broker and enter into partnerships on an equitable basis.

Capacity building: Forging and maintaining mutually beneficial alliances, in many cases with non-traditional partners, may require a different skill set than is currently present in traditional banks or micro-finance institutions (MFIs). How well equipped are current players in the industry to respond to these changes – especially the smaller MFIs?

To address this need, the Banking with the Poor (BWTP) network, in partnership with Citigroup Foundation, has initiated a capacity building program in Asia that aims to:

- increase awareness of the potentials and pitfalls of partnership and linkages approaches, and
- build the capacity of staff of banks, MFIs and other organizations to explore opportunities for, build and maintain mutual beneficial partnerships.

Systematic facilitation of partnerships: External, independent facilitation can also be helpful to speed up the process, increase the chances of success, and contribute to the building of necessary capacity. Many partnerships develop in an *ad hoc* manner, often beginning with a sponsoring partner who then brings in others on the basis of their existing knowledge and networks. However, a more systematic approach can help to ensure greater clarity in the objectives of the partnership, greater surety that the right players are brought to the table, and clearer agreement between partners on their roles and responsibilities. A facilitation process might look something like the below [iv]:



Case Study 1: ICICI Bank – MFI partnerships, India [v]

Context

Despite a comparatively well developed and regulated financial sector, a majority of the rural population of India still lack access to financial services. Government legislation requires all banks to lend at least 40% of their credit to the so-called "priority sector", which includes rural areas. India's public sector banks have strong welfare objectives, and there is a history of directed and subsidized credit to rural areas, which has had a mixed record of sustainability and impact while constraining the development of dedicated private micro-finance institutions (MFIs).

In the late 1980s, an NGO, MYRADA, pioneered the formation of Self-Help Groups (SHGs) based on traditional southern Indian savings and credit groups. In the early 1990s, the National Bank for Agriculture and Rural Development (NABARD) started encouraging banks to accept SHGs as customers, for both savings and loans, and by the end of 2004, SHGs had become the dominant delivery channel for micro-credit in India, in partnership with state-owned and private banks, as well as with unregulated MFIs.

Development Aims

Development aims are to expand access of rural people in India to flexible micro-credit and other financial services in a financially sustainable manner.

Partners and drivers

- ICICI Bank,
- 27+ micro-finance institutions including, for example, BASIX, PSS, SHARE, Spandana, BISWA
- CARE India.

ICICI Bank, India's second largest commercial bank, entered the microfinance market in 2002, motivated by priority sector targets, an internal desire "to be a leader in every field of banking", and the belief that new microfinance clients could eventually graduate into mainstream banking. But it lacked a branch structure to directly reach large numbers of rural clients. MFIs have been motivated by a desire to raise reliable sources of capital to expand credit outreach. CARE India's role was as a facilitator of the partnerships, primarily through building the capacity of some of the MFIs to enable them to better link with ICICI.



Partnering Process

Initially, ICICI followed a model of direct lending to SHGs, without any form of financial or management intermediation. However, this approach was later replaced by a unique partnership model with MFIs that provides direct loans to rural clients while providing for shared risk.

ICICI carefully selects partner MFIs with substantial outreach and high quality microfinance portfolios, but based primarily on their capacity to facilitate the relationships between the Bank and SHGs or individual borrowers – in terms of management capacity, quality of data reporting systems, competence of field staff and quality of training it provides to staff and clients. In many cases, these MFIs have had their capacity enhanced through a capacity building program run by CARE. MFIs share some of the credit risk through a range of mechanisms, including by providing first loss guarantees. In addition, they originate client accounts and recover loans in return for an agency fee. The bank provides the loan capital and monitors the loan accounts, which are provided directly from the bank to the client.

Outcomes

By early 2006, ICICI Bank had a portfolio of about $600 million in direct loans to some 300,000 microfinance customers under the partnership model, working with over 27 MFIs. Clients benefit by having easy access to small loans, at a rate that is slightly higher than other sources, but accessing the loans carries lower transaction costs, and larger loans are available. Partner MFIs benefit from training, from being acknowledged as effective MFIs, from increasing their client base, and from not being tied to one source of finance. The ICICI relationship is flexible and can be adjusted when required. ICICIs microfinance portfolio is growing much faster than other areas of the bank's operations, and is now fully justified internally on commercial, rather than social responsibility, grounds.



Case Study 2: Micro-development Finance Team, Uganda

Context

The microfinance industry in Uganda has historically served largely the urban or peri-urban poor, lacking the means to reach out effectively to those who live in isolated rural areas - especially those in sparsely populated regions, a case similar to many other countries.

Development Aims

The goal was to develop an international industry standard technology to assist microfinance institutions (MFIs) to improve outreach to isolated clients more cost effectively and to progress microfinance development.

Partners and drivers

Hewlett Packard (HP), the main driver, identified key partners for the initiative - including microfinance experts, business strategists and microfinance leaders from public and private institutions - to form a multi sector team, known as the Microdevelopment Finance Team (MFT), including:

- ACCION International,
- Bizcredit, e-change,
- FINCA International,
- Freedom from Hunger,
- Grameen Foundation USA, and
- PRIDE AFRICA.

The MFIs working in partnership with the MFT during the piloting phase in Uganda were:

- The Uganda Microfinance Union (UMU),
- The Foundation for Inter-national Community Assistance (FINCA),
- The Foundation for Credit Community Assistance (FOCCAS).

Partnering Process

HP initiated the MFT in 2002 – motivated by its business interest in the financial sector, a strong market for HP, as well as their e-Inclusion program which focused on developing new business opportunities in emerging markets.

Recognizing that microfinance was not their core area of expertise, HP determined that development of an IT-based microfinance solution could only be done in collaboration with the right partners with the right expertise. HP was able to provide access to, and gain the engagement of, other key participants in the private sector, particularly in the technology arena.

It was recognized from the outset that if each partner focused on attaining their own goals, they would only focus on a narrow part of the effort. A broad mission statement was therefore developed by the partners to provide a guiding vision that would enable each partner to achieve individual goals as well as develop a program that would address some of the most difficult problems in scaling up microfinance. Team members met in person quarterly, and held weekly conference calls. In addition a website was established to assist other people from partner organizations to become engaged. Through a website, people were welcomed to input comments, ideas, and innovations.

Outcomes

The team developed an IT solution, called Remote Transaction Solution (RTS), a combination of technology and a business process system that provides a cost-effective means of tracking loan information, even in rural areas with little or no local infrastructure. The system is composed of three modules:

a) market data and client profiles,
b) brand management systems, and
c) standardized reporting and information sharing.

In 2003 the solution was successfully tested in Uganda. A key learning from the pilot was that re-engineering of the entire loan process by the microfinance institution to take advantages of the opportunities that technology offers was as important, if not more important, than the technology innovation itself.

All partners agreed to make the RTS widely available - with no license fee - accessed via a source code license or a user licensed executable code to enable all players in the industry, especially smaller micro lenders without sufficient resources to obtain sophisticated software, to benefit from the core technology. One of the main lessons learned within this project was the importance of the guiding principles/mission statement, and the way that all partners agreed on larger goals rather than coming together with a number of more individualistic goals. In 2005 a permanent organization, Sevak Solutions, was established to extend the RTS tool to other countries. Challenges have included establishing legal consensus among partners, a resistance to change to implement new methods, and finding innovative local coordinators.



End Notes

[i] Adapted from material developed for a session at the Asia Microfinance Forum, Beijing, 2006

[ii] Examples include: FAO/Ford Foundation (See M. Pagura and M. Kirsten "Formal-Informal Financial Linkages: Lessons from developing countries"); World Bank (Gallardo J., M. Goldberg and B. Randhawa: Strategic Alliances to Scale Up Financial Services in Rural Areas, World Bank Working Paper No. 76, April 2006); and USAID (Miller-Wise, H. and J. Berry (2005) "Opening Markets through Strategic Partnerships: An analysis of the alliance between FIE and Pro Mujer, USAID microREPORT #25, February 2005))

[iii] Adapted from a range of sources, including The Partnering Initiative (thepartneringinitiative.org); WEF "Partnering for Success: Business perspectives on Multistakeholder Partnerships; GKP/FDC Multi-stakeholder Partnerships in ICT4D: an Issues Paper.

[iv] Adapted from Partnership Brokers Accreditation Scheme: Overseas Development Institute and International Business Leaders Forum

[v] Adapted from a case study written by Malcolm Harper and Marie Kirsten as part of the Ford Foundation sponsored study of links between banks and MFIs, carried out by the FAO)