MONITOR **INCLUSIVE MARKETS**

Stretching the Fabric of MFI Networks

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In 2006, Monitor started its Inclusive Markets initiative in India that aims to catalyze market based solutions (MBSs) for creating social impact among the B60 (bottom 60% of the economic population). Our work strives to understand and scale up commercially viable business models that either engage the B60 as customers for socially beneficial products or as producers/suppliers in value-creating market opportunities.

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Stretching the Fabric of MFI Networks

MICROFINANCE INSTITUTIONS (MFIs) have realized considerable success in India by providing credit services to the poor in order to encourage them to pull themselves out of poverty. The growth of MFIs has drawn the attention of other organizations looking to provide goods and services to members of the "B60," (the bottom 60% of the income distribution). Some pilot projects that aim to use MFI networks to distribute non-financial products and services have taken place. Few have been successful, and most have stopped short of scale.

Monitor's research has examined previous and ongoing experiments with MFI channel expansion and has identified five models of leveraging MFI networks that show the greatest potential. We have shown that mode selection for a given product provider and MFI will be critical to the success of an expansion venture. We highlight the attributes of suitable products and provide examples matched against each of the five viable business models.

Finally, we present a series of key recommendations for organizations launching expansion ventures — both MFIs and product providers — that should help such initiatives to be both effective and impactful in the future.

INTRODUCTION

Microfinance institutions have proven, to the world's acclaim, that it is possible to create commercially sustainable enterprises that address the critical needs of the poor—at least for financial services. By providing farmers, rural households, and village entrepreneurs with a stable, legitimate, and affordable source of credit, microfinance[1] can help the poor meet their basic needs and build a better life. What began as a seemingly Quixotic effort by Grameen, BRAC, ACCION and a handful of other organizations has grown into a full-fledged industry, with tens of thousands of institutions serving roughly 200[2] million customers worldwide.

The remarkable success of microfinance in reaching the poor, and the stunningly broad scope of several of its leading exemplars in places like Bangladesh, is now raising a second hope, which is that the networks these institutions have created, and the credit they offer, may serve as a channel and a platform for the provision of many other critical goods and services to the poor. As many companies and not-for-profits have discovered, it is extremely difficult to offer products and services to low-income populations in a financially sustainable manner. Not only are the poor geographically hard to reach, and often expensive to reach using conventional models, but they often also lack the cash on hand to make purchases that would improve their lives over time. Microfinance institutions (MFIs) appear to provide a solution to both of these barriers. They help resolve the problem of insufficient cash flow by extending credit, and just as importantly, they constitute a ready-made distribution and marketing network. MFIs have built relationships and trust among the poor, which makes them a promising social as well as financial infrastructure through which customers can be reached.

In addition, at a more philosophical level, the success of MFIs in achieving "double bottom line" objectives has stimulated interested parties, investors, aid agencies, and others to look for other ways in which commercially sustainable approaches can be used to solve vexing social problems.

As such, many organizations, offering everything from crop insurance, to mobile phones, to water filters, are currently attempting to harness MFIs as distribution and financing channels for their products. In every case, there is considerable potential for both commercial viability and social impact. Nevertheless, most of these joint ventures in India have so far met with mixed results, and none have reached even moderate scale. While there is great promise in using microfinance institutions to establish market pathways to the poor, there are also considerable challenges that have not yet been properly studied or well understood.

1 While bank-linked Self Help Groups (SHGs) also create access to low cost credit for members, this report focuses on standalone microfinance institutions (using the Joint Liability Group model) only. Monitor has conducted a separate study on the viability of SHGs as distribution channel.

2 World Savings Bank Institute

As part of a broader, year-long study on market-based solutions in India[3], Monitor Group undertook an in-depth analysis of cooperative ventures between MFIs and other organizations seeking to provide goods and services to the B60[4]. These ventures varied widely in size, business model, and product type,[5] yielding a rich set of lessons regarding both the opportunities for synergy and the new risks that these relationships create. Profitably providing goods and services to the poor through or alongside microfinance remains a challenging goal. The recommendations in this paper chart a course that could benefit MFIs, their partners, and B60 communities alike.

THE OPPORTUNITY: CREDIT IS WORTH ITS WEIGHT IN GOLD

Microfinance institutions are spreading rapidly in India. Between 2002 and 2007, the industry saw a portfolio increase of 75% to 100% per year, and is currently estimated to reach more than 20 million customers[6]. While this is a relatively small proportion of the Indian population, in absolute terms this represents a phenomenal rate of growth for an industry that relies heavily on physical infrastructure and the availability of regional labour. Most of this growth has been focussed in Southern India, which is home to around 65% of microfinance customers, but MFIs are now also spreading to the North.

As the channels of microfinance reach deeper into the economic landscape, using them to deliver others goods and services to low-income populations becomes an ever more promising possibility. First, there are the huge operational benefits of accessing an existing distribution network instead of having to build one from scratch. Monitor's study of 350+ 'market-based solutions' (MBS) found multiple initiatives that aim to sell and distribute socially beneficial products (e.g., water filters, solar lanterns) to the B60; however, the cost to reach the B60 is often prohibitive, and is usually higher than the comparable cost for small durables manufacturers reaching India's broad middle class markets. In addition, the absence of existing organised channels to reach the B60 target segment meant that many MBSs felt they had to build their own distribution channel, regardless of whether it made any economic sense to do so.

3 Market-based solutions are commercially sustainable ventures that engage low-income populations as consumers and producers. Monitor studied market-based solutions targeting the B60, or bottom 60% of the income pyramid in India (corresponding roughly to an income of Rs 6,000 or $150 per month).

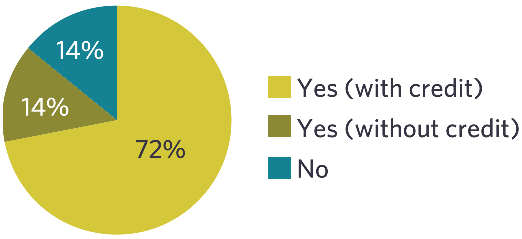
4 The lower 60% of India's income pyramid

5 The study focused on non-financial products, given the high level of attention and research that many Indian banks, insurance companies, and other financial institutions are already devoting to the provision of microinsurance and microsavings in addition to microcredit.

6 According to "The Bharat Micro Finance Report - Quick Data 2009", 2009

Second, by necessity, low-income microfinance borrowers show a distinct — if not surprising — preference for products that are sold on credit. In an informal survey[7] of B60 consumers who were already MFI borrowers, conducted in the village of Nalgonda in the state of Andra Pradesh, 72% of respondents said they would be interested in purchasing non-loan products from their local MFI — but only if those products were offered on credit (see below). Only 14% of respondents said they were willing to buy from an MFI without attached credit.

Figure 2: MFI Customer Survey — Would you purchase non-loan products from your local MFI? [7]



This willingness to buy on credit extends beyond current MFI customers. Farmers interviewed by Monitor in Uttar Pradesh complained that the main reason they could not purchase irrigation pumps was cashflow. Even though the pumps paid for themselves in only one cropping season, the upfront capital was unaffordable. However, 87% of them stated that they would buy the pumps if they were offered on credit. Sadly, MFIs are only just starting to extend into Uttar Pradesh, and such tie ups are yet to be established.

Thus the provision of credit solves a key problem of up-front ticket prices for small durables which would ordinarily be unaffordable for large swathes of the B60. Credit thus replaces large, up-front outlays with small periodic payments, allowing B60 consumers — whose cash flow tends to be not just low, but also irregular — to purchase products that would otherwise be unaffordable. Our focus groups suggested that credit is so important that it supersedes brand preference, with B60 customers indicating a strong motivation to forgo desired brands sold outright for less desired brands sold on credit.

MFIs, therefore, could be instrumental both in providing a distribution channel for non-financial products, and in enabling demand for them. Indeed, the examples from other countries — Bangladesh in particular, with initiatives like Grameen Phone — suggest that this ought to be a winning combination for serving the B60 in India.

But for all the theoretical reasons that make MFIs ideal distribution channels to serve the B60, why have so few joint ventures with other organizations reached any kind of meaningful scale

7 Monitor Inclusive Markets Analysis, February 2008

in India? Why do even the largest only reach a few thousand customers, out of the 20 million who could presumably be within their reach in India today? This paper presents a number of reasons why that has been the case, but it all begins with one: demand.

Market-based solutions work only if low-income populations actually perceive them as solutions, i.e., if they see them as the answer to a felt need. A well-meaning organization may decide that a certain population needs clean water, reading glasses, insurance, or some other beneficial product, but providing it through a market will only work if the population agrees. "Need," as understood by anyone other than the consumer, is not the same as demand and should not be confused with it. This is a recurring theme that emerged over and again in our research on MBSs that engage the B60 as customers.

For example, while B60 consumers want access to credit to finance their purchases, they also have marked preferences regarding which products they wish to buy. Eighty-five percent of respondents in a focus group of B60 Indian consumers said they would use credit to purchase "aspirational" or "non-productive" items such as televisions and kitchen cupboards, while only a small percentage expressed interest in purchasing productive/functional products that would contribute to their income or improve their health (see Table 1). Interest was especially low for "indirect benefit" products like insurance or water filters, whose benefits, though perhaps considerable, were not immediately and tangibly apparent to respondents.

As these figures show, demand is quite low for most of the socially beneficial products—like solar lanterns or water filters—currently being distributed in conjunction with MFI networks. This suggests that while social enterprises are using MFIs as physical distribution channels and as sources of credit for B60 consumers, simple distribution may not be enough; customer education and demand stimulation are important parts of the mix.

A second implication, on the purely commercial side of the spectrum, is that B60 customers want to use credit to buy assets that will not necessarily contribute to their ability to repay the associated loan. By enabling the purchase of such products, MFIs may significantly increase their credit risk, and, in some cases, may increase demand for consumption rather than just promoting livelihoods, which has been the historical focus for most MFIs. Just as in the developed world, credit in the developing world can be a mixed blessing.

Table 1: B60 Customer Preferences[8]

PRODUCT TYPE	EXAMPLES	CUSTOMER PERCEPTIONS	CUSTOMERS INTERESTED[9]
Aspirational / Non-productive	• Televisions • Gold coins • Kitchen cupboards	"If SKS gave me a loan for television I would buy it immediately. Finding the money to pay it back wouldn't be a problem if I had 50 weeks to repay it fully." "We want gold on credit. Everyone in our village does."	85%
Functional	• Fertilizer • Livestock • Motorcycles	"I do need fertilizer and I get it from the same middleman who buys my crop, but he charges too much. The only reason I get it from him is that he gives it on credit." "I can only afford cattle because I have a dairy loan. I want other products to be offered in the same way."	15%
"Indirect" Benefit [10]	• Insurance • Water Filters • Solar Lanterns	"I don't want weather insurance as I don't trust the way they measure. What if the rain on my field is different from the rain they measure at the BASIX office?" "I didn't know anything about insurance before my loan, but I liked the idea when it was explained and now I've taken out insurance on both my buffaloes."	<10%

Consequently, MFIs and product marketers intending to use this channel must tread cautiously and not assume that any socially beneficial product, just because it is offered by an MFI with credit, will magically find its way into customers' hands.

Additionally, the financial services industry in general, whether at the top or bottom of the pyramid, is rife with failed examples of banks, insurance companies and others trying to "cross-sell" financial services to their customers. MFIs in India have had similar experiences in trying to cross-sell even related financial services. BASIX is not an MFI but a livelihood promotion institution, and indeed a thought leader on how to address livelihoods for its customers. They are the most advanced example of selling non-credit financial services to their borrowers. And yet, after several years of selling insurance, it remains that only 1 out

8 Monitor Inclusive Markets Analysis, February 2008, Andhra Pradesh

9 Figures do not sum to 100% because categories were not mutually exclusive

10 Products that contribute in non-immediate or non-obvious ways to a consumer's wellbeing, and thus may require outreach and consumer education to be adopted.

of every 16 credit customers buys its most popular insurance product, livestock insurance[11]. And if it is this difficult to sell service products, then moving further outside of MFIs' core area of expertise suggests that it may be even trickier to sell tangible products and goods.

As such, we suggest that a more nuanced view is in order. We will detail such a view, but first it is valuable to consider a few of the more salient examples of distribution via MFIs that have been tried in the Indian marketplace to date.

CASE STUDIES: EXPANDING THE MFI CHANNEL

Monitor's year-long study in India revealed a number of attempts to channel market-based solutions through microfinance networks. Some were conducted by large companies seeking to find new consumers for their products in the B60, while others were carried out by not-for-profits with a primarily social mandate. Various distribution methods and business models were tried, with varying success. The following case studies highlight the challenges as well as the potential opportunities involved in expanding MFI channels for both social and financial gain. Together, they reveal patterns and strategies that can create value for MFIs, the providers of goods and services, and B60 consumers.

1. HINDUSTAN UNILEVER WATER FILTERS

In 2008, Hindustan Unilever (HUL) partnered with a group of MFIs called the ACCESS Microfinance Alliance (AMA)[12], to sell its Pure-It water filters on credit to villagers in Andhra Pradesh. Hindustan Unilever (HUL) is India's largest manufacturer of fast-moving consumer goods, but even its considerable distribution network has not yet reached as deep into rural areas or the B60 as the company would like.

The filters, which cost approximately Rs.1800 (about US $45), are purchased in bulk by AMA branches and sold to households by AMA loan officers, who receive a commission per unit sold. Customers purchase the filter on credit and repay the loan in monthly instalments of Rs. 100. While most MFIs are structured as Non-Banking Finance Companies, and thus prohibited by Indian law from

11 From BASIX financial reports, 2007

12 ACCESS is a loose federation of about 110 MFIs with a reach of more than 2 million clients (about half of which are active borrowers).

directly buying and selling goods, the participating MFIs in the ACCESS Alliance are all small, non-governmental organizations which have the right to do so.

The model met with some initial success. The village centre meetings were a good venue for loan officers to demonstrate the use of the product, make sales, and collect payments. Within six months of operation, the program had sold 1,500 water filters through 11 separate MFIs. Nevertheless, the plan encountered significant challenges in operational terms. First, the working capital required for ACCESS to maintain an inventory of filters and cover distribution costs proved to be a critical barrier to further expansion. Second, the filters themselves are somewhat bulky, which makes them hard to transport in significant numbers. AMA's loan officers were forced to use local auto-rickshaws to distribute the filters, which is a costly and non-scalable approach. Even once the filters had been distributed, after-sales service requirements (for example, ensuring that consumers replaced cleaning cartridges regularly) were extremely taxing for a channel that had been designed for intangible financial products.

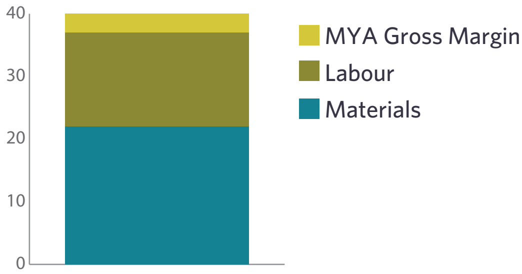
AMA jumped into a world where it had to transport, track and distribute somewhat bulky physical products, simultaneously taking on a number of new costs and responsibilities that differed from its core loan-making business. Although the program was a valuable learning experience, and has since been modified to reduce some of the burden on loan officers (by transferring some marketing and distribution responsibilities to HUL representatives), it underscores that MFIs should not underestimate the challenges of taking a direct role as traders or distributors of third-party products. HUL, for its part, continues to find new channels, like MFIs, to distribute their product, although not necessarily with the channel taking the complete fulfilment and delivery role.

2. MOKSHA-YUG AGARBATTI MANUFACTURING

Moksha-Yug Access (MYA), a microfinance and rural development institution, noticed that about 1 in 8 of its MFI borrowers were women who also rolled *agarbatis*—the incense sticks employed in many Indian households and temples. Overall, agarbatis are a reasonably sized market in India—some 50 billion sticks are sold each year, amounting to about $260M in sales. The organization decided to engage a number of women in the state of Karnataka, provide them with raw materials and pay them a weekly wage to roll the incense sticks, which MYA then sold in bulk and as finished products to a large manufacturer and distributor of *agarbatis*. In effect, MYA took on responsibility for most of the production supply chain, aside from the task of actually rolling the sticks. This was conceptually a sound approach, as they were providing product into a well-established market with demand and linkages to the players at the top of the supply chain.

FIGURE 2: MOKSHA YUG ACCESS — FINANCIAL DETAILS OF AGARBATTI PROCUREMENT PILOT (2007)[13]

Wholesale Price – Break Up



By selling the incense sticks for Rs. 40 per kilogram, MYA sought to cover the costs of materials, provide the women in the pilot program with a weekly wage and make a gross margin of Rs 3 per kilo (see Figure 2 above). But the program failed. While MYA got a number of elements of the plan right, particularly the idea of "contract production" linked to buyers at the top of the supply chain, there were other problems in execution. MYA's thin margins were quickly dwarfed by the increased time and cost associated with the additional responsibilities placed on loan officers; the high costs of transportation; and an excessive waste of raw materials; it turned out that, being paid by the hour, the women lacked a financial incentive to produce more efficiently.

MYA took upon itself the burden of distributing raw materials, collecting the finished product, and managing the workflow, tasks for which the organization was not naturally suited. In addition, it proved difficult to find women who wanted to participate, with only thirty sustaining continued production through the pilot after one hundred were initially selected. The organization's capabilities, which were already under considerable strain, were tested even further by having to manage a dispersed labour force on a tiny budget.

The struggles experienced by Moksha-Yug, like those encountered by AMA, appear to be a result of overreaching by taking on too many new functions. In acting as procurement aggregators, or buying products from the B60 and selling them to companies upstream, MFIs are introducing an entirely new and parallel supply chain to their business — one, furthermore, which operates in the reverse direction. Trying to create these new operations while simultaneously maintaining an efficient loan-making business can outstrip the capabilities of MFIs and their branch offices. Nor are these difficulties limited to agarbati manufacturing. When BASIX, a large Indian MFI, partnered with PepsiCo to procure potatoes for the company's FritoLay division from its many potato-farming customers, the MFI faced exactly the same problems. Just like MYA, BASIX found it extremely challenging to manage the supply chain effectively.

13 Source: Moksha Yug Access interview, March 2008

3. SKS – MOBILE PHONES

SKS, currently the largest MFI in India[14], formed a partnership in 2008 with one of the world's largest mobile phone manufacturers. They developed a plan to sell mobile phones on credit through SKS branches, and also to provide mobile banking services to the B60. SKS loan officers acted as sales agents for the mobile phones, promoting them to customers during SKS centre meetings and other interactions.

Initially, the phones sold like hot cakes. The phenomenal spreading of mobile phones to the rural poor (between now and 2012, 120 million new users are expected to adopt wireless telephony in rural areas compared to about 62 million in the metros[15]) acted as a clear and present signal for product demand. With credit factored into the deal, the mobile proposition only became more attractive to the B60. SKS sold their first 1500 phones in their small scale pilot within the space of a couple of weeks, indicating that the tie-up would be very successful.

Repeated technical problems and user interface difficulties with the phones, however, soon overwhelmed SKS branches and created considerable dissatisfaction among customers, both with the "SKS mobiles" and with the organization's traditional loans. Since loan officers sold the phones directly to customers, they were in fact the face of the product, and implicitly became liable for its performance in the mind of the customers. Trust among B60 customers for SKS and their loan officers diminished, threatening the core loan-making business as well.

This initiative makes it dramatically clear that in opening their channels to other organizations, and selling third-party products, MFIs incur substantial risks to their brand. SKS exposed its brand to these risks with little or no control over the phones they were selling (which were provided by the manufacturer) or over the quality of service on those phones (which was provided by a major telecommunications company). When customers encountered difficulties, they blamed SKS. The lesson applies more broadly to any attempt by an MFI to act as a sales agent, a position that often leaves them powerless to control the risks they assume.

4. EMAMI PERSONAL CARE PRODUCTS

Emami, one of India's largest manufacturers of personal care products, teamed up with Spandana, a MFI with over three million customers[16], to enable women with low incomes to sell Emami's cosmetic products in their communities. Spandana aims to select local women, often from its own customer base, to participate in the program. These "microdealers" would

14 As of September 2008

15 Ernst and Young analysis, December 2008

16 As of September 2008

receive simple sales training from Emami, pick up product inventory from the local Spandana branch (where they had been delivered by Emami), and then sell them to villagers for a commission of 10-12%. Spandana would receive a 6-8% commission on the goods sold for "wholesale" distribution, as well as interest on the loans taken out by village entrepreneurs to finance their working capital.

Although the program has not yet fully launched, there are two factors that are likely to work in its favour. First and most critical is the product selection: cosmetics are high-margin, repeat-purchase, non-perishable products, as well as being small and easy to carry. This allows microdealers to transport them with little effort, and more importantly, to make multiple, regular transactions with a limited number of customers. This is essential for microdealers, who tend to work within a focused geographical area and to rely on sales commissions for a significant part of their income. A second factor in favour of the model is that it does not require a significant investment of time on the part of loan officers, which makes it effective from the perspective of the MFI, and affordable from that of the company providing the products. A third benefit is that it aligns well with the general income-generation focus of MFIs, who typically lend their customers funds to generate livelihoods in a variety of ways.

While unexpected challenges may yet arise, the partnership between Spandana and Emami offers a promising glimpse of the role that MFIs can play as *microdealer facilitators* for suitable products. While not all products will be appropriate for this kind of network and activity, there may be a subset of socially beneficial products that fit the appropriate logistical and economic criteria. With the right products, the incentive structures could work very well: the MFI benefits by making more loans and by providing its customers with productive tools to work their way out of poverty, while companies benefit from a greater distribution network and the establishment of their brand in the community.

SUMMARY OF CASE STUDIES

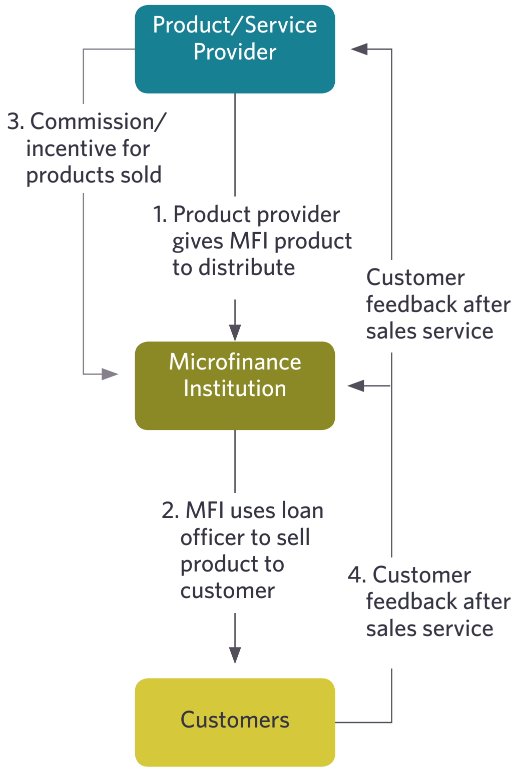
The case studies described above can be generalized into four different models for MFI channel expansion. These are summarized in Table 2, along with their benefits and challenges.

Table 2: Summary of Business Models

MODEL	BENEFITS TO MFI	CHALLENGES TO MFI	VIABILITY
MFI as Trader or Distributor (e.g. HUL & AMA)	Customer relationship with MFI is strengthened Allows low-income consumers to finance their purchase of products	Working capital and inventory costs Loan officer time and skill set Shift in management focus away from stable and profitable loan-making activities Limited logistics infrastructure Long-term servicing and maintenance of durable goods NBFCs are prohibited from trading	Low
MFI as Procurement Aggregator (e.g. MYA)	Customer relationship with MFI is strengthened through procurement activities Opportunity to provide financing for the purchase of inputs Increased incomes and livelihoods for MFI customers	MFIs lack strategic capabilities in procurement Loan officer time and skill set Limited logistics infrastructure Cost of holding and distributing goods	Low
MFI as Sales Agent (e.g. SKS Mobile Phones)	Customer relationship with MFI is strengthened Allows consumers to finance the purchase of products	Loan officer time and skill set Shift in management focus Limited logistics infrastructure Long-term servicing and maintenance of durable goods	Medium (for the right product mix)
MFI as Microdealer Facilitator (e.g. Emami & Spandana)	Customer relationship with MFI is strengthened through microdealer relationship Opportunity to finance microdealers MFI loan officers are not involved in the day-to-day work of selling products Increased incomes for microdealers	Economics must work for microdealers MFIs must be able to identify and recruit capable and motivated microdealers Limited logistics infrastructure to support even bulk orders from microdealers	High (for the right product mix)

VIABLE MODELS FOR MFI CHANNEL EXPANSION

Drawing from the case studies featured above, as well as from additional research in India, Monitor has developed five models that show promise for the successful expansion of MFI distribution channels, depending on the choice of product/service, partnerships, and other key factors. This section presents a general overview of their characteristics, followed by specific recommendations for companies, not-for-profits, and MFIs considering a joint arrangement. The models below have been listed in an approximate order of MFI involvement in the distribution process (most involved to least involved).



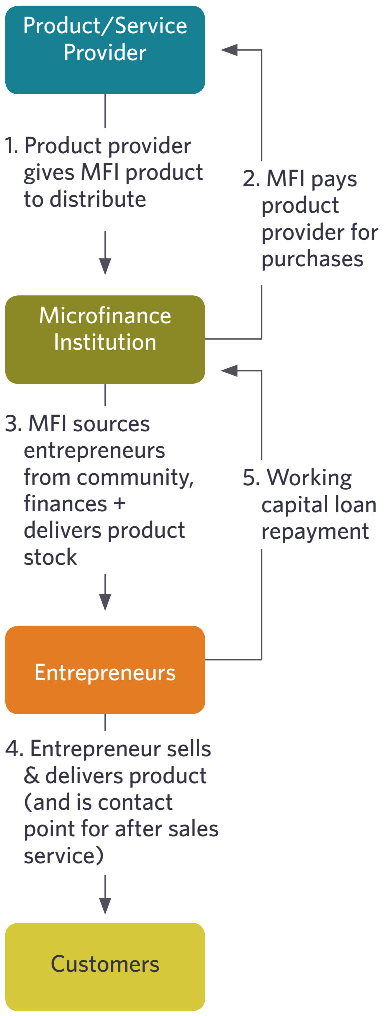
1. MFI AS SALES AGENT

In this model, MFIs act as sales agents for product or service providers, receiving a commission as a percentage of sales.

While the MFI does not itself purchase the product from the provider, it remains responsible for some distribution tasks. For this reason, the model works best with lightweight and portable products, or even better, with "virtual" products like insurance or mobile phone minutes.

The sales agent model harnesses the reach, trust, and brand awareness that MFIs have built among B60 customers. But since this puts their brand on the line, MFIs must be especially careful in partnering with providers who are knowledgeable about customer needs and can provide reliable, high-quality products or services—and back end support if and when there is difficulty among users.

2. MFI AS MICRODEALER FACILITATOR



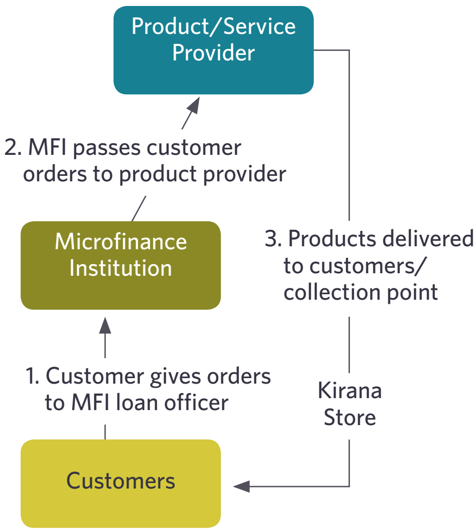
In this model, MFIs foster entrepreneurship by enabling their customers to become microdealers for partner products in their communities. The MFI provides entrepreneurs with access to products or services and with a relationship with the provider partner, who may give training. The MFI also provides financing for the entrepreneur's working capital.

As discussed previously, Spandana and Emami have used this model to distribute cosmetics and personal care products. BASIX has also attempted the microdealer model, assisting their customers in setting up small group franchises for selling agricultural input products like fertilizer and small farming equipment.

The primary beneficiaries of the microdealer model are the product providers, who instead of simply selling products to B60 customers, gain the opportunity to create sustainable microenterprises right inside a B60 community. These microenterprises serve to stimulate demand for a provider's products, and create a platform for "last mile" distribution.

The MFI benefits primarily from being able to extend loans for working capital to microdealers and, in time, increase their livelihoods and incomes. However, this added business opportunity may be relatively small compared with the MFI's overall portfolio, and requires more loan officer attention—at least initially—than a traditional MFI loan to, for instance, purchase a buffalo. This means that provider partners may need to further incentivize MFIs to adopt this model, for instance by offering a commission on product sales. In addition, if microentrepreneurs are to remain committed to the venture, they must be able reliably to earn a better living than by pursuing other activities. As seen with Spandana and Emami, the costs to the product provider of supplying these two key incentives can be large.

3. MFI AS CUSTOMER ORDER AGGREGATOR

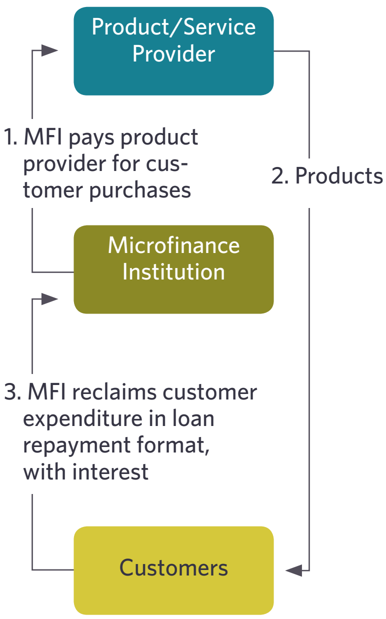


MFIs can serve to aggregate customer orders, leveraging their relationships and regular contact with customers, conducting product marketing, and passing larger orders on to providers who can then service them at lower cost.

In this model, the order aggregator need not take on the burden of distribution. The provider, potentially in coordination with local businesses, assumes the responsibility of delivering products and services to customers or to localised collection points.

The model is best suited for products with a high per-unit distribution cost (like home appliances or water filters), as this allows the provider to benefit the most from aggregate orders. It also works best with partners and in geographic regions with existing supply chains, given that the MFI is not assisting with product distribution.

4. MFI AS CONSUMER FINANCIER

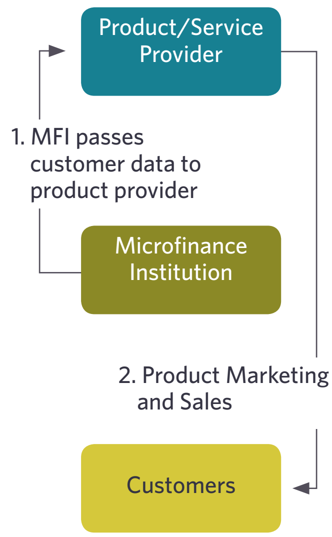


In what is by far the most common model, MFIs can act as financiers for customer purchases of household goods.

This model departs the least from the MFI's core business of issuing loans, but it does generate a new revenue opportunity by creating value for the product or service provider. As already noted, customer surveys indicate significant demand for goods that are offered in conjunction with credit. The model allows MFIs to harness this demand, while remaining focused on their loan-making activities. As in the Order Aggregator model, it is the provider who bears the burdens and costs of distribution.

Often, MFIs pursue this strategy in conjunction with one of the other models discussed in this section, for instance by acting both as a provider of consumer financing and as sales agent. This function, however, is one that MFIs do—and must continue to—weigh carefully, as many have appropriate concerns about overstimulating consumption and related indebtedness, rather than the more traditional productivity and income-oriented uses of MFI credit.

5. MFI AS CUSTOMER DATA OR ACCESS PROVIDER



MFIs are in regular contact with large groups of customers, and they also possess valuable data on their demographics, preferences, and credit-worthiness. This raises the possibility for MFIs to use their knowledge and their established relationships to assist partner organizations in reaching the B60. MFIs could charge for the provision of data and access, while partners would benefit from greater consumer awareness, improved relationships, and a possible growth in sales. Possible partners would include not just consumer goods manufacturers and service providers, but also NGOs and other providers of socially beneficial products and services.

The model is relatively "lightweight" from the perspective of MFIs, adding little in the way of costs or operational burdens. Providing data is primarily a back-office operation that can be performed from centralized headquarters rather than from branches in the field, while providing access to B60 customers relies on loan officer relationships that are already in place with villagers. Nevertheless, because the benefits to the provider are still unclear; this model may work best with providers who are already marketing and distributing products to B60 communities, and looking to fine-tune their approach. Additionally, the legal implications of sharing customer data in this way remain unclear, and borrower privacy issues would need to be addressed and respected[17].

To make these models work, MFIs and their partners must consider not only their organizational capabilities, but also whether the product or service they wish to provide is suitable. As seen in the case studies, selling water filters is an entirely different proposition from selling cosmetics. Using MFI networks for the delivery of other goods and services only makes sense when the product and the distribution model are complimentary. Table 3 identifies the attributes that a product must have in order to work with each of the models discussed above.

17 Monitor has not yet found examples of this model being used in India

Table 3: Selecting the right products for the expansion of MFI distribution channels

MODEL	SUITABLE PRODUCT ATTRIBUTES	EXAMPLE PRODUCTS
MFI as Sales Agent	Virtual or portable products having. low distribution and inventory costs Products that can be sold centrally, for instance at a village centre meeting	Insurance (currently sold via MFIs using this method) Prepaid phone cards
MFI as Microdealer Facilitator	High margin, repeat purchase goods Small enough to be distributed by a single person Low ticket price, to limit working capital requirements for the microdealer Goods that require minimal marketing expertise	Cosmetics and personal care products Healthcare products
MFI as Customer Order Aggregator	Products with high single-unit distribution costs due to bulk, weight, or other factors Goods with network demonstration effects, where a customer buys the product and as their neighbours see it work they also want it	Water filters Agricultural inputs Bicycles
MFI as Consumer Financier	Applicable to most products, but preferably productive assets so as to help limit the MFI's credit risk exposure	Livestock and farm equipment If combined with another model, the product must be suitable as well to the needs of the other model
MFI as Provider of Customer Data and Access	Customized products Products targeted at specific demographics, like livestock owners, wealthier B60 households, etc.	Insurance Agricultural products Home improvements (toilets, kitchen cupboards) Appliances

RECOMMENDATIONS FOR MFIS

Based on the case studies and strategic analysis presented in this report, MFIs thinking of partnering with product or service providers should consider the following lessons of the Monitor research.

Beware of taking on too much. MFIs start and grow primarily as credit institutions. While they work within the broader field of development, and interact with other kinds of organizations that are also oriented to initiatives in socioeconomic development, they should be cautious in gauging their ability to conduct activities not related to microfinance, such as procurement, product distribution, and product support.

Specifically, MFIs should assess their capabilities against those of other players in the new space they are considering. MFIs looking to sell certain categories of products to the B60 should look at other organizations selling those products. How do they manage inventory, distribution, and marketing? What are the sales incentives for agents in the field? Can the MFI serve the same customer segments with equal or greater efficiency?

Such comparisons introduce a critical external reference point for MFIs to measure their capabilities, enabling them to understand where they can truly add "system value" to a supply chain.

Don't underestimate how hard it is to sell products. MFIs can become accustomed to operating in a space where they are the only providers of a product for which there is high demand. That is because loans are almost always a "pull" product: their value is self-evident, which makes them generally desirable for most who can obtain them. Our research suggested that even in Andhra Pradesh, with multiple MFIs, SHGs, and bank-linked credit schemes operating, low-priced credit was still a scarcity good, which kept demand high even for those borrowing from multiple sources. MFIs may not enjoy such high demand for other products they choose to provide. For example, the value of water filters is indirect and poorly understood among B60 customers. Thus, selling them requires considerable customer education, at significant cost, to achieve even modest adoption rates.

Credit is always likely to be your most profitable product. Given that loans have proven to be a stable and profitable business, the bar should be set high for any additional ventures that may detract from an MFI's core business. Organizations must seriously consider whether the opportunities presented by a new venture (whether in terms of financial profit, social impact, or both) are large enough to warrant disturbing a proven business model that already generates substantial profits and social good. Operational risks can undermine an MFI's loan-making capabilities, while brand risk (stemming from consumer dissatisfaction) can undermine its most valuable asset: the high rate of loan repayment it achieves from its B60 customers[18]. Therefore, the incentives offered by potential partners should be high enough to justify diversification. The returns on credit—both financial and social—essentially create a hurdle rate against which MFIs should measure any prospective addition to the service offering.

Don't overburden your customers with excessive credit. As noted above, MFIs in India have traditionally operated in a credit environment that is underserved, interacting with customers who are not highly leveraged. This situation has contributed to the surprisingly low rates of default that greeted the MFI industry at its inception and that have continued to this day. By increasing the availability and use of credit among its customers, especially for the

18 From the experience of a number of MFIs, this 'brand risk' can affect repayment rates fro both the products being offered and for traditional credit products if the customer is an existing borrower

purchase of non-productive assets, MFIs may unwittingly encourage reckless borrowing and consumption, and damage the general credit environment in which they work.

If the products are bad, you'll get the blame. As "owners" of the relationships with B60 customers, MFIs often become the face of products and services provided by partner organizations. This can expose the MFI to brand erosion or outright customer anger when products or services do not meet expectations. In 2003 and 2004, for instance, BASIX partnered with BP to sell solar lanterns through its loan officers. There was a one-year warranty on the products, but after it expired, BP withdrew from the area and left little infrastructure available for customers needing technical assistance. This had a very negative impact on the BASIX brand in the area. MFIs should consider establishing long-term service level agreements (SLAs), and before selecting a product and partner, they should perform product due diligence in the form of quality tests and pilot programs with customer groups. After the launch of a product, MFIs must actively monitor the operations of provider partners to ensure that customer experience remains positive, as the risks to the partners are not evenly shared.

Manage public perceptions of your activities. By helping their customers finance the purchase of productive assets like agricultural equipment or working capital for small businesses, MFIs are clearly aiming to help propel families to a higher standard of living. Not all products, however, are seen in an equally positive light. MFIs who have partnered with consumer goods manufacturers have been criticized for encouraging B60 households to take on the burden of debt to finance unproductive assets and "lifestyle products" like kitchen appliances, furniture and jewellery. Offering credit in a way that encourages the purchase of products that do not contribute to a household's future income can be seen to be in detriment of the community while enriching MFIs and their partners. Thus some MFIs, with a strong heritage of charity work, may rightly shy away from ventures involving the sales of non-productive assets. Others that have started their loan-making operations with more explicit commercial intentions may thus be more liable to consider a broader range of products.

Despite the pitfalls, there are opportunities to create significant social impact. Many MFIs have a strong social objective, and expanding their distribution channel to offer beneficial goods and services to the B60 can help further that objective. Indeed, for the first time in recent economic history in India, there is a fast-growing channel that is customized to reach the B60 where they are, has intensive and active relationships with them, and is tailored to their specific needs. Given the difficulty and cost in setting up other channels to reach this same population, the availability of MFIs as a shared channel for certain goods and services is a powerful opportunity when harnessed and incentivized properly. The opportunity for social impact lies not just in the products offered, but in manner in which they are provided. For example, creating livelihoods through the *microdealer facilitator* model may contribute more to the well-being of a community than merely selling it products. Likewise, providing customer education through centre meetings, as in the *customer order aggregator* model, can help spread knowledge and alleviate health problems.

RECOMMENDATIONS FOR PRODUCT AND SERVICE PROVIDERS

Partnering with an MFI is only a partial solution to the distribution challenge. Product and service providers often look to MFIs as a convenient point of entry into the B60 customer base. This view grossly underestimates the work left to be done in completing a supply chain to actually reach those customers. Providers must recognize the limited know-how and capacity among MFIs when it comes to sales, servicing, and many other activities that are integral to the provider's business. Neglecting distribution issues is one of the most common reasons why these partnerships fail. Providers must take an active role in supplementing the MFI's distribution activities, repurposing the provider's own distribution resources where needed, and applying the experience it has developed in serving other markets. Providers should ask similar questions to the ones they would ask before entering any other market. How will bulk orders be transported? Where will they be divided? How do products make their way to rural villages? How are they distributed within villages? How are the people involved in the distribution chain compensated and incentivized? Only by answering these questions, and by gaining an end-to-end understanding of how their products and services will be delivered, can providers overcome the challenges and uncertainty involved in serving this new group of customers in partnership with an MFI.

An MFI distribution channel can be expensive. In addition to the limited capabilities of MFIs in distributing non-loan products, providers should be aware of the costs of the channel overall. Successful ventures are those in which all parties are properly incentivized to commit resources to the channel. Providers should consider what incentives they must provide to MFIs, loan officers, village entrepreneurs, and any other parties involved in order for the channel to function efficiently. In some cases, the need to provide these incentives could be more costly than independently establishing new distribution channels or expanding those that already exist.

Credit can create massive demand for your product. Aside from providing ways to reduce distribution costs, partnering with an MFI can also generate sustainable opportunities for increasing revenues. Offering credit along with products and services has been shown to be a major draw for B60 customers, who often would otherwise lack the cash to make the purchase. There is thus a double potential benefit in partnering with an MFI. First, the MFI's brand can help encourage adoption of a provider's products and services among its B60 customers. And then, by linking these products and services to the MFI's lines of credit, providers may be able to access a considerably larger pool of demand than if they approached customers independently.

CONCLUSION

The remarkable success of MFIs in bringing credit to low-income populations has demonstrated that goods and services tailored to the B60 can help alleviate poverty as well as produce commercially sustainable enterprises that serve the B60. There are, however, a host of additional considerations for those looking to build on this success and provide other kinds of products through MFI networks.

By partnering with capable and committed providers, MFIs can make use of their established expertise, brand, and infrastructure to expand into additional spaces. However, one should not assume that "one size fits all" in business with the B60. The type of product chosen, the nature of the relationship between MFIs and providers, and the exact distribution, sales, and marketing models employed are all critical considerations that can burden or bolster a joint initiative.

> **Monitor Inclusive Markets** continues to work in the field of market based solutions. For more information and partnering opportunities, contact inclusivemarkets@monitor.com and see our website, www.mim.monitor.com.

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