# MFN Annual Meeting Summary

## 25th Anniversary of the MicroFinance Network: From Microcredit to Financial Inclusion - Madrid, 2019

“Feel proud and grateful. You can come in, but never leave!”

**María Otero**

# 2018-2019 evolution of MFI around the world

## Environmental Analysis

For the past five meetings, the first working session has been devoted to the analysis of the context that MFIs face in their different regions. The intention of this analysis is to identify the main factors that affect the business, as well as identify both the trends and consequent actions. From this starting point, the conversations have moved to internal aspects such as the strategy or organization of each MFI.

The methodology we have followed has been the same, which is based on the PESTLE thematic framework. As we know, this framework categorizes external factors into six types: Political, Economic, Social, Technology, Legal or Regulatory, and Environmental.

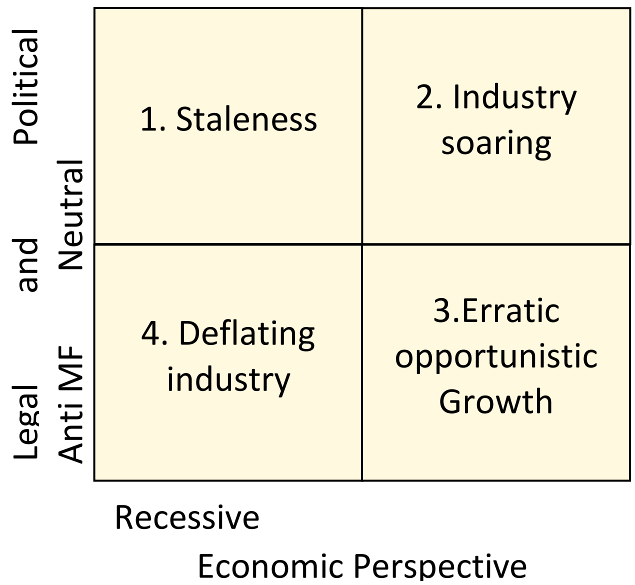
At the annual meeting in Madrid, due to the continuity of this contextual analysis, we could conclude that among all the different elements of the context, there are two main axes that explain to a greater extent the condition of each market or region. These two axes are the following:

a) **Economic Perspective**: Refers to the favorable or unfavorable economic context for financial inclusion. At the unfavorable extreme, there would be regions where economic conditions impede or slow the development of microfinance. At the opposite end would be those other regions whose economic situation favors the growth and proliferation of financial solutions for the base of the pyramid. The economic perspective depends on two factors: the *macroeconomic condition* of the region, and the *specific aspects of microfinance*, such as migration, the level of employment at the base of the pyramid, the degree of informality of the economy, etc.

b) **Legal and Political Supportiveness**: In this other axis would be the favorable or unfavorable regulatory and political factors for financial inclusion. At the lower end would be those regions with high uncertainty, in which the weakness of the institutional framework, as well as the volatility of the political positions prevent, directly or indirectly, the consolidation of the MFIs. At the top end would be those regions in which a state of institutional maturity has been reached both in the regulatory framework, the supervisory bodies, and in the support actors for microfinance. As the name suggests, Supportiveness depends on two factors: the *strength of the regulatory framework*, and the *political disposition* of rulers and legislators towards microfinance.

Contrary to what was thought five years ago, technological factors have been a leverage of development, but have not yet caused such disruptive effects as in traditional banking segments.

Based on these two axes, a Cartesian plane can be constructed that serves to map the situation of the different markets or regions.




In recent years, regions have evolved in different directions, the dominant vector being political uncertainty. Some of those that had remained in the second quadrant have experienced a setback, mainly due to the election of politicians of the populist court (vg. Gentera). In these cases, there is no change in the regulatory framework, but in the political disposition towards microfinance. In some other cases, economic conditions have maintained a favorable condition for microfinance that, despite a constant negative context, explain the growth (vg. BRAC).

If the biggest recessive factor is uncertainty, the main growth factor is the large number of people who still do not have access to financial services, or whose needs are still unsatisfied despite the existing supply.

The continued use of this scheme will allow us to evaluate its validity as a predictor of the profitability and growth of MFIs and their markets.

## Competitive analysis

The discussion about the context naturally derived from the competitive analysis. It is in this aspect that the greatest differences between MFIs are observed, due to the different volume of attractiveness of each market and the consequent number of financial providers. That is, the largest and most developed markets have a volume of competitors that ensures access to financial services for the base of the pyramid. In each of the regions the important effect of the relative scale is observed, given that the largest MFI usually benefits from economies of scale. On the other hand, such MFI usually attracts the most attention before regulatory bodies.

In summary, the conclusions of the competitive context discussion are as follows:

- There is a **high potential for growth**, even in regions with high penetration of competitors, because the historical offer has consisted of standard and massive products. The greatest potential is explained by the **unmet needs** of current customers.
- **Coexistence of group and individual methodologies**, with different levels of evolution. A frequent pattern is that the methodology that initially proliferated in a region has become the dominant methodology, regardless of being group or individual.
- There is a **gradual but steady proliferation of technological and customer-centric initiatives** in all regions. Most of them have been undertaken by dominant MFIs, with the intention of lowering transaction costs or serving new (young) segments. These initiatives have not yet caused major disruptions, but this trend is expected to continue. New technological competitors are scarce and have not reached important insights.
- Regarding the **value proposition**, the dimensions that offer the greatest potential are **availability, ease of transaction and adaptation to specific needs**. Thus, there is the idea that it is possible to increase customer satisfaction and loyalty by reducing the pain of current services and products, such as the cost and time of transport, the speed of response or the customization of credits and insurance.
- The financial inclusion industry has not been characterized by capturing, analyzing and using the immense volume of transactional information it generates. This represents one of the biggest transformation reefs, since the transactional volume could generate very valuable information about the behavior of a little studied and known segment. The **potential value of this information** could change the economics of MFIs, through better assess the risk and serve the customers with differentiated offers for high volume segments.
- Finally, due to the significant operating cost of MFIs and the fact that our operations have a low level of automation, there is a huge potential for cost reduction and operational alignment, applicable to all links in the service network.

# Strategy and Leading Transformation

## Evolution of our strategic uneasiness from 2015 to 2019

Since the 2015 Annual meeting in Alexandria, MFN members have recognized the potential impact of the technology evolution megatrend and have taken actions to learn and adapt their MFIs. In these past years we have evolved in our understanding of the big picture of our industry. A first step (2016, Dhaka) was the recognition that the micro credit and microfinance industry exhibits signs of maturity but that, given the size of the market, there was still room for growth, and demanded innovation and efficiency. The second step was to go in depth in our understanding of the fintechs, their explosion in number (2017, London), and their potential impact on the micro finance value chain. We asked ourselves: are they "friends or foes”? and we interacted directly with several of them. The third step (Amsterdam 2018) was to explore the challenges to radically transform the MFIs business model: changes in customers and segments, value proposition, competition, and channels. Furthermore, we explored the overwhelming leadership challenges it generates. Such is the context in which we explored the current strategic state of the MFN member organizations in our annual meeting in Madrid.

This year (Madrid 2019) the analysis and discussion made more clear that:

1. Pursuing a radical change strategy is very risky given the external uncertainties of new IT based business models and the internal organizational challenges to transform the MFIs.
2. The traditional MFI business model still generating value and growth.
3. The MFIs need to become much more efficient and more customer centric.
4. Fintechs haven´t had yet the customer relationships and the capital to significantly impact the MFIs.

## Discussion

*Two generic strategies*

There is a constant struggle between the profits generated by the entrepreneurs that bring innovation to the market and the established companies that have developed capabilities to scale, generate market power, strengthen positioning, and generate barriers to entry. In the finance industry, emerging technologies, based on the internet, mobility, analytics, and the cloud offer great potential to provide better products and services to the market. However, we have observed two kinds of strategies carried by established companies: on one hand, some pursue the dream of creating the new "unicorn" via <u>disruptive</u> business models; on the other hand, others pursue incremental but constant improvements to an established business model.

### *What are the main risks and opportunities of each strategy?*

The choice of strategy has deep effects on the ability of the MFIs to adapt to the new context, serve the market, and remain relevant in the long term. Disruptive technologies can have unimaginable upside and they are usually developed by entrepreneurs that emerge as the "last man standing" among thousands of others who pursued unsuccessfully a new solution. Developing this kind of business models is extremely hard. Bringing the ideas to the market from concept to execution requires a unique combination of leadership, organizational, and technical skills in a context where the external environment will generate a ruthless attrition of most of the competitors.

In the last few years we have been exploring the threats of the new fintech business models to the MFIs. We have monitored and explored how fintechs are evolving and we have observed that serious competitors have not entered and disrupted the market. However, we do observe the advance achieved by traditional banks that are incorporating fintech technologies in their business models, have achieved significant efficiencies, and are offering solutions that increase customer satisfaction and loyalty to the brand. Similarly, MFIs recognize their inherent high transaction costs, the regulation risk those incentivize and, consequently, the strategic need to radically increase efficiencies. Several MFIs are already incorporating, each in some degree, technological solutions. These observable results show less risk and tangible benefits.

### *From uneasiness to capturing the digital opportunities*

These patterns in the finance industry and the MFI´s direct experiences of the last few years suggest that they have the opportunity to generate immense value focusing on pursuing an incremental but relentless improvement strategy. Building on our last year´s analysis we concluded also that and incremental strategy simplifies the transformational leadership challenges. Thus, the digital revolution has shown how difficult is to make long term predictions on specific technologies; in contrast, digital value opportunities are evident on the short term.

Therefore, there seems consensus on a recommendation: work on the present to secure the future. The digital revolution: internet, mobility, analytics, cloud, security enables the possibility, as some financial institutions are demonstrating, of reducing transaction costs, better serve the needs and experience of the customers, and increase financial inclusion. Along with other elements these two variables can be the foundation to solidify the MFI´s positioning and relevance in the microfinance industry.

### *The stickiness of the MFI´s strategy*

*Cultural inertia or "culture eats strategy for lunch".* Do MFIs have really a choice? Mature organizations tend to continue their current trajectory. Radical change processes are the most challenging managerial processes. First, the core asset of the MFIs is their people and changing their values, behaviors, knowledge and skills is extremely difficult. Second, understanding what new fintech business model will be the winner is very complex. Third, setting direction and generating a shared vision and path with commitment from the board and the top management team is extremely challenging. Finally, close knit organizations generate commitments among the members that cement the status quo and prevent new blood integrate and generate value.

This strategic commitment generates a small probability of success attempting radical transformations.

*MFI´s strategic commitments.* More specifically, MFIs have made huge economic commitments that support their current market positioning and capabilities: Building a proprietary distribution channel, developing fine-tuned credit methodologies, making large investments in banking systems, and building strong cultures that inhibit incorporating productive diversity. These assets have allowed scale economies, improve quality, and enable the firm to differentiate its products and services. However, these specific assets are less versatile and thus more difficult to adapt to a different business model.

### *Requirements of the efficiency/value strategy?*

The traditional financial institutions that are creating more value in the digital era have developed a deep understanding of the efficiency/value strategy and have developed the capabilities to implement it. This business strategy, as the hypothesis on how the institution is going to generate value, requires:

- A deep understanding of how new technologies and methodologies could impact the economic drivers of the business (transaction costs, AI scoring, credit distribution vs credit approval structures, data as a core asset). It implies building the cause-effect trees that identify the root drivers of critical KPIs. Without this understanding improvement projects cannot be prioritized and aligned to the strategy.
- A clear understanding of the customer problems and identification of the relevant segments. We have talked a lot about these two variables: 1) the diversity of customer profiles, especially in new generations, and 2) partially or totally unsatisfied needs in the customers of the base of the pyramid. As an example, we could find in the same solidarity group a 50 year old head of family mother and her 22 year old single digital-native daughter. Without this understanding there will be significant inefficiencies in fine tuning the value proposition and achieve differentiation and customer loyalty.
- A clear understanding of the digital vs. analog tradeoffs. On several occasions, we have discussed the need to dose the moments of contact to maintain the relationship with the customers, and at the same time to achieve higher operational efficiency. The same can be said about the role of the groups in solidarity methodology, or how to strengthen social ties inside them. It is very important to evaluate the role that technology will play in these dilemmas.

## Leading the Implementation strategy

"The rate at which individuals and organizations learn may become the only sustainable **competitive advantage** left"*[1]

Organizational learning methodologies have been evolving and are being successfully implemented by innovators. We have discussed how learning and adaptation is a superior strategy over long range planning in environments of high uncertainty. We have discussed these learning methodologies in London and Amsterdam. Given our discussion in Madrid, it becomes essential now for any MFI that wants gain competitive advantage to develop the capabilities to implement these fast learning methodologies: SCRUM-Agile, design thinking, business modeling, hypothesis driven experimentation for example.

These methodologies need:

- First, to be put into the service of the efficiency/value strategy to align projects with strategy and the efficient use of resources.
- Second, the methodologies and their inherent skills need to be pervasive, and operate under an integrated company-wide umbrella. They cannot be restricted to a few agile teams or projects, on the contrary, it needs to involve multidisciplinary teams from the top to the bottom of the organization to break any silos. Recognizing that these methodologies have the potential to drive cultural change and organizational alignment.
- Third, it requires substantial leadership to achieve organizational alignment of strategy, structure, people, processes and technologies. For example, traditional hierarchical, departmental structures generate silos that need to be broken by inter departmental empowered teams. Additionally, it requires also external leadership to generate strategic alliances that allow the integrations of critical capabilities and insertion of the MFI into the evolving financial ecosystem.

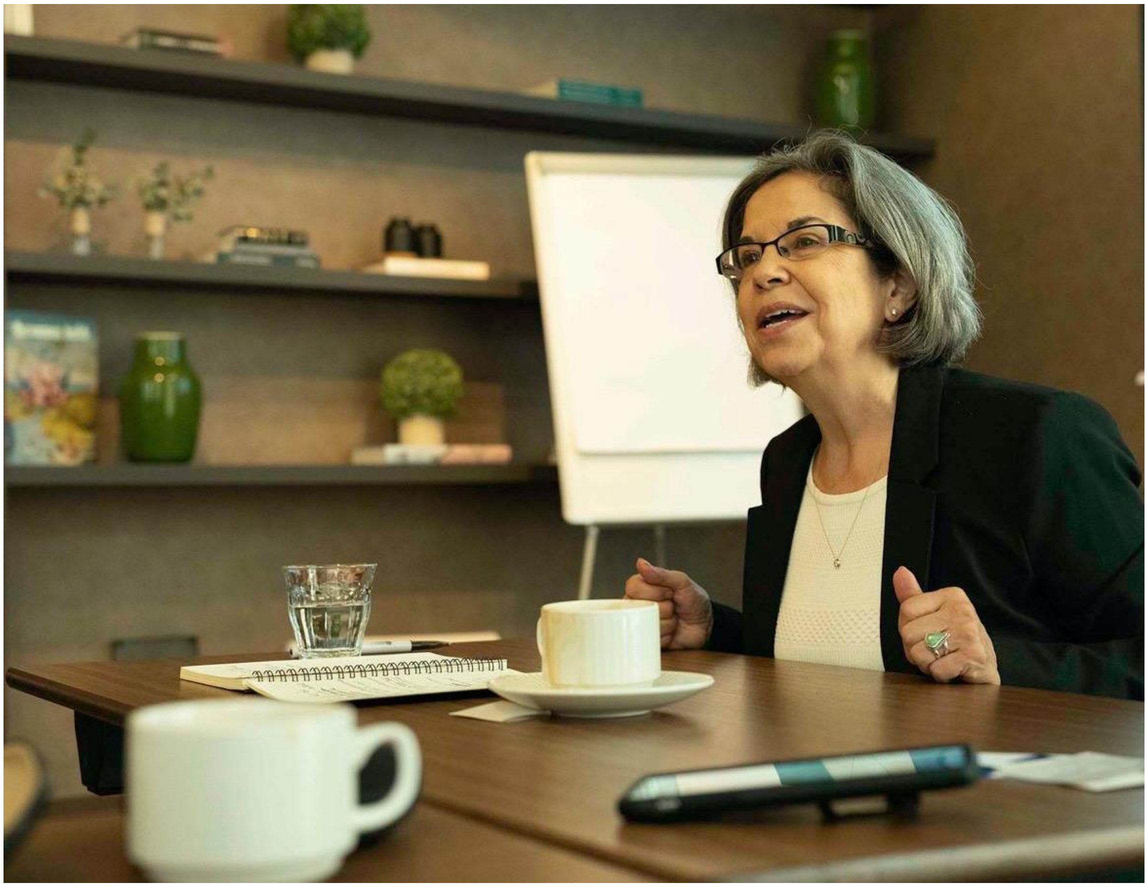
These lessons add to those insights we have gained in the previous meetings. In addition, Madrid annual meeting allowed us to observe a subtle but important change in the composition of the group. The arrival of new members allowed to broaden the focus of analysis, strengthen the climate of trust and, above all, incorporate the voices of a new generation of CEOs. Thus, echoing the first 25 years of the MFN, the Madrid meeting underlined the importance of the entrepreneurship spirit to face the high task of serving the base of the pyramid offering effective, efficient and innovative financial solutions.

[1] Ray Stata, former chairman of Analog Devices, pioneer in creating learning organizations, 1995 edition of the The International Journal of Organizational Analysis

# A chat about 25 years of Financial Inclusion

## Panel - Quotes and Pictures

“Everything in life is about people. We wanted to use the commercial way, but we also wanted to push the social purpose in the middle of what we were trying to build. That is why we have to keep culture as our most valuable asset.”
**Carlos Labarthe Costas**



“At the beginning there were no flower arrangements, no big podiums. All was about the content, the discussions between friends, and the enormous urgency to transform the industry.
Our own lives have been transformed. I am so grateful for how I spent my life.
So, we have been agents of change in our own countries, fulfilled by our mission.”
**María Otero**

“What has remained the same after 25 years? Purpose, commitment, and a collegial learning attitude.

We all care about customers, but in operations, we only think about efficiency and scale. If we thought about the client, then our approach, our world view, and our mental mind-set would switch.”

**Elisabeth Rhyne**


“The customer must be at the centre, but that’s a moving target: we need to solve their real needs.”
**Motaz El Tabaa**


"A few years ago we talked about how to bring the MFN back. Well, it's back!"

**Shameran Abed**

# Appendix - The Hub Economy

Why are we in a Hub Economy? The rise of economic hubs is rooted 3 principles of digitization and network theory:

1. Moore´s Law: Computer processing power will double approximately every two years. It implies that performance improvements will continue to drive the use of digital tools and replace human activity.
2. Metcalf Law: The number of users drives the value of a network. This means that digital technology and open network connections enable significant growth in value across an economy.
3. Barabási principle: a highly connected hub carrying more and more economic transactions, generates increasing returns to scale in one sector and will enjoy crucial advantage when it connects to another sector.

Understanding the Hub Economy

- Understand and actively anticipate in the transformation of your industrial environment
- Drive innovation and operating model transformation to create a foundation for change and deepen/sustain differentiation
- Focus on digital business model innovation (leverage new digital opportunities for new revenue)
- Leverage partnerships, communities and crowds to rebalance competition and drive new opportunities
- Support a multiplatform economy (Google vs. Apple vs. Microsoft vs. Ant vs. Tencent)
- Understand and shape regulatory options
- Prepare for and help shape social impact

Changing the mindset

From growing and acquiring customers (replicating) to a deep understanding of the economics to identify the value drivers or economic engines of the business that change with the adoption of new technologies (analyzing, learning, changing)