

- Manual and Reports -

Refining loan products to match partners needs

Understanding the Market of Annapurna to
reach untapped segments and better serve
current partners

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Abstract and Contents

Executive Summary	Study of Annapurna's Market, design of new products and procedures in order to best match loan products to partners' needs		
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1 Objectives of the paper

1.1 Targeted readers:

Other micro-finance providers (NGOs / commercial), donors and investors.

1.2 Summary

The objective of this paper is to push for a more client-oriented approach to micro-finance in slums, in order to reach the poorest segments of population and to best participate in their social integration along with their economic development. It aims at answering how to serve urban poor in the best manner.

This paper presents the results of an in-depth study of the needs and constraints of slum populations and the following refining of loan products in the areas of Pune covered by a micro-finance institution (MFI) called Annapurna. Annapurna is an NGO working in 80 slums of the city. A low market penetration in specific slum pockets triggered the need to better understand credit need dynamics in the slums. As a result, some major changes were required in terms of loan products and procedures to match the identified needs of slum dwellers.

You will find here explained the initial conditions in which Annapurna was operating (1 and 2), the objectives of the project (3), how and what were the results of the market study we conducted (4), finally the main changes introduced (5) and their expected impacts (6).

2 Original functioning and results of the program

2.1 The Micro-finance Model used by Annapurna was tailored to fit needs of urban poor in India

Annapurna created its own model from the experience of Self Helped Groups (SHGs) and Grameen Bank in Bangladesh. In this model, the organization provides individual loans through groups of 4 to 6 members. Groups are not only used for members to guarantee each other in. They are also the basic structure for collection, default management, re-loan and social activities conducted in the loan program (through committee meetings especially).

2.2 Geographic and organizational developments have generated new challenges

Historically, Annapurna worked to improve the status of women. It began to propose loans to men two years ago. The objective of this scope enlargement was to strengthen family development as a whole, in order to get more sustainable improvement in the condition of women. Male staff was hired in a separate team to provide loans to men, with a methodology inspired by Inter Aide, its main funder. Thus, two programs were conducted in parallel with different teams, but also different procedures and products.

Designed in two steps, this system was not optimally efficient because of overlapping responsibilities in promotion, confusion in products, low presence in each area and high traveling expenses. It was

therefore decided to merge the two programs. This required transferring partners from one team to another in order to rationalize geographical loan officers portfolios. It also required harmonizing Annapurna procedures and products.

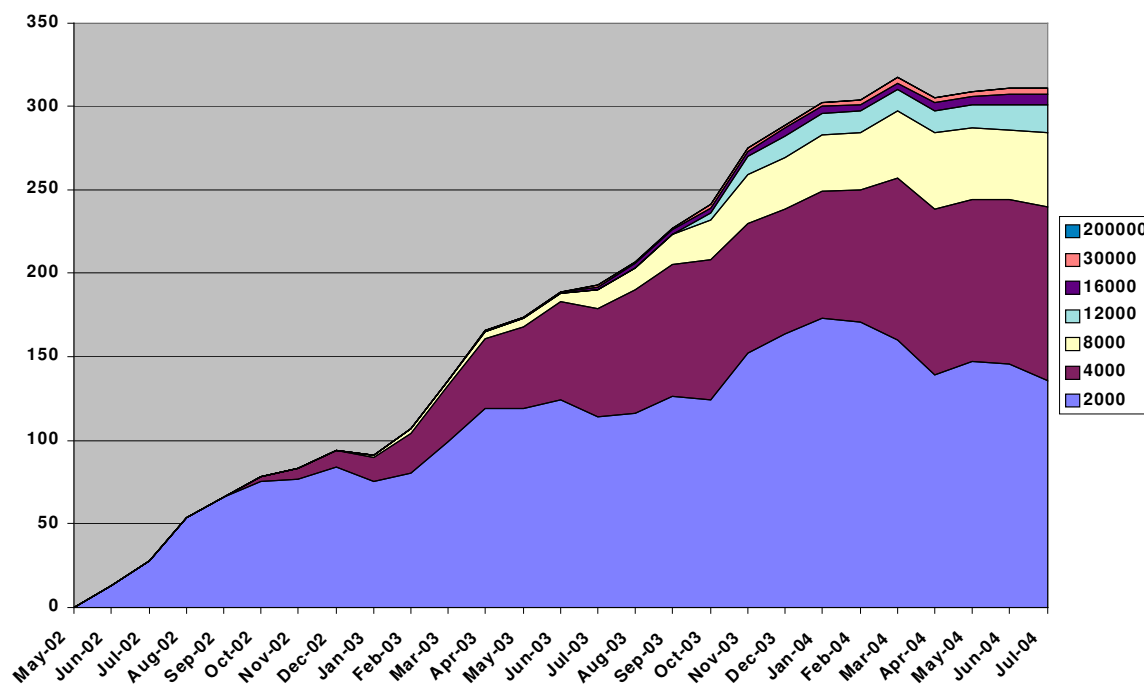
Moreover, as Annapurna developed micro-finance activities in new areas, it came to serve populations with different socio-economic features (higher poverty and less socio-economic integration).

2.3 ... and resulted in low market penetration and low income.

2.3.1 Low market penetration

2.3.1.1 Few new members

Annapurna experienced lower promotion results as it grew. In two new areas especially (Market Yard and Padmavati), only 6 % of door-to-door promoted population was forming a group on the Jan-June 04 period, compared to 30 % as a target.



Possible explanations:

- No systematic promotion could be conducted in areas with larger needs, since teams did not have permanent presence in any area (organizational problem).
- But where promotion was conducted, there was poor response from communities, unable or unwilling to use our financial assistance.
 - o Inappropriate promotion (training problem)
 - o Inappropriate product
 - o Inappropriate eligibility conditions

All these points probably explained Annapurna's low portfolio growth.

2.3.1.2 High drop-out ratios

Portfolio data analysis also highlighted low customers retention. Partners with more than 4 loans only accounted for 4 % of the loan portfolio. Average drop out ratio was as high as 60 % on average for loans given to men. It reached close to 80 % for the poorest segments of population.

If each partner had taken one additional loan before dropping out of the program, Annapurna would have received 240 000 Rs. more income as today (around 6 000 USD), which showed the high financial impact of drop-outs on the sustainability of the program.

In theory, several factors could explain such high drop-out ratios: high prices (interest rates), occupational profiles (no business population), unfitting loan amounts, unfitting loan installments, poor image resulting in low confidence in the organization, low client service (collection, guidance, customer relationship).

2.3.1.3 According to beneficiaries profiles

Regarding the customer base, the data analysis showed Annapurna was unable to serve lower and higher income partners (accounting respectively for 1 % and 6 % of total partners).

2.3.2 Low income of the organization... the impossible equation for sustainability.

As a consequence, with low 'customer'-retention and high promotion costs, the organization failed to achieve financial sustainability.

3 Objectives of the project

What is Annapurna's market? How to best help urban poor to grow out of poverty, how to create development dynamics both at the level of individuals, families, groups and communities... in a sustainable manner?

3.1 Access untapped beneficiaries and satisfy all our current customers

The objective was to reach the poorest through adapted products.

Assuming that the very poorest are bankable, the organization needed to find adequate products and services to give them access to finance... satisfying as well partners with higher income so to have a wide array of borrowers with balanced risk profiles and to give loans with higher return profitability, thanks to higher amounts.

Two quotations can further illustrate the difficulties the micro-finance sector has experienced until now in servicing the poorest segments of population:

' Micro-finance has tended to exclude those that cannot use the 'one-size-fits-all' services provided. The services that have been developed tend to meet the needs of a particular segment of the client market, and have led to the exclusion of those that cannot use or pay for these services. Increasingly it is being recognised that the poor are not an homogenous group and that products and their delivery need to be better tailored to the needs of different groups of clients. Organisations need to be more flexible and to provide services that are appropriate for a range of client markets, not just the 'middle poor'. In doing so they expand the scope of their market. Services that are better tailored to the needs of clients, lead to better performance and sustainability amongst clients, which in turn will lead to higher performance and sustainability for the MFI. This is a time of opportunity, and a time for a renewed commitment to developing services that reach a much greater range of clients, including the very poor.'

Anton Simanowitz, Ensuring Impact, August 2002, p. 5.

'Like many other development tools [micro-finance] has insufficiently penetrated the poorer strata of society. The poorest form the vast majority of those without access to primary health care and basic education; similarly, they are the majority of those without access to micro-finance.'

Jonathan Morduch et Barbara Haley, Analysis of the Effects of Microfinance on Poverty Reduction, RESULTS Canada for ACDI (2001), p. 1.

3.2 Make beneficiaries progress on a development curve

3.2.1 Economic improvement

What are the financial needs of slums populations? The organization recognized the need to consider their partners in a dynamic way, and accompany them on a growth process. It means adapting the loans to the evolution of each partner to best help him at every stage of his development.

3.2.2 Community integration tools

What are the social needs of slums populations? Groups have been experienced as strong integration factors. For new-comers or excluded populations the economic field can be one entry point to the community. For that purpose, it needs to be tied with socializing activities. Thus, it seems important that not only MFI know about the business and the repayment of a partner, but the community as well, represented by (some of) its members. Along with its loans and savings, Annapurna has provided its beneficiaries with opportunities to discuss issues directly related to the loans as well as a wide range of other issues related to the community and society as a whole. Committee meetings gather all groups of an area every month. At the time of regular collection, members often discuss together while the loan officer gather payments and receipts. In that sense, group collection participates in building close relationships between the group members.

However, as seen in the SHG experiences, groups might create exclusion forces, especially at the time of their formation. Groups are closely linked to pre-existing relationships in the community, hence not including populations who are not otherwise strongly integrated. For that reasons, the group approach as developed by SHGs in rural India is less adapted to urban poor social structures, which are much weaker than in villages. To tackle this difference, Annapurna has asked its beneficiaries to form smaller groups compared to SHGs, with only 4 to 6 members.

3.3 ... with efficient and sustainable results

The objective is to cope with the overall risk of the activity through a balanced portfolio thanks to

- Borrowers' satisfaction and retention

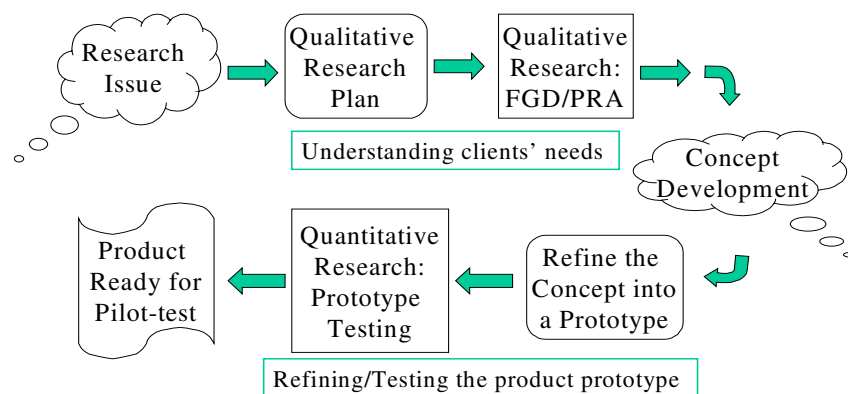
'MFIs typically break even on a customer only after the fourth or fifth loan.'

Brand and Gershick, 2000

- Interest rates reflecting various costs
- Collection frequencies adapted to real needs.

4 Understanding Annapurna's market

Market Research and Prototype Development Process Overview



MicroSave Africa Model

4.1 Market research

A qualitative market survey has been conducted with 11 people with the following main objectives: to understand who our beneficiaries and prospects are, what are their needs, to evaluate Annapurna's product satisfaction, to highlight potential improvements and to understand drop-out reasons.

For that purpose, we designed comprehensive questionnaires for Annapurna's beneficiaries and non-beneficiaries separately.

4.2 Results of the analysis

The survey highlighted three main needs for which slum dwellers require loans: Business, Housing and Education. Other needs like health, ceremonies (wedding, festivals, etc.) were not represented in the sample.

To finance these projects, surveyed persons expressed a high sensitivity to loan amounts and a low sensitivity to interest rates.

There was also great concern among low-income segments about the difficulty to form groups and to collectively go through the loan process (orientation meeting, group collections attendance to committee meetings).

The survey also highlighted low awareness of the population about the organization, its activities and products.

This can be explained by the two unmet needs identified in the survey: on the one side simple and individual loan application process, on the other side adapted (large enough) loan amounts. These needs (loan amounts / Interest rates) and constraints (difficulties to form active groups) are correlated with the level of income of families).

4.2.1 Demand elasticity to prices is low

When asked whether they would deposit their installments at the branch office instead of home collection to get a reduced interest rate, none of the partners opted for the interest rate discount. This preference for home collection is a common feature to all segments. The result is all the clearer as the branch office was always less than 5 minutes walking distance from partners' houses. It shows the value they give to side services. It matches however other researches results.

'Although data on reasons as to choice of supplier are patchy, available information seems to show that, among paying customers, price is not as significant a factor in market competition as other considerations, such as the suppliers' reputation, locations, and products.'

Alexandra Overy Miehlsbradt, Report on the Outreach and Market Development Indicators Survey. Performance Measurement Framework for Business Development Services, USAID Microenterprise Best Practices Project Field Research.

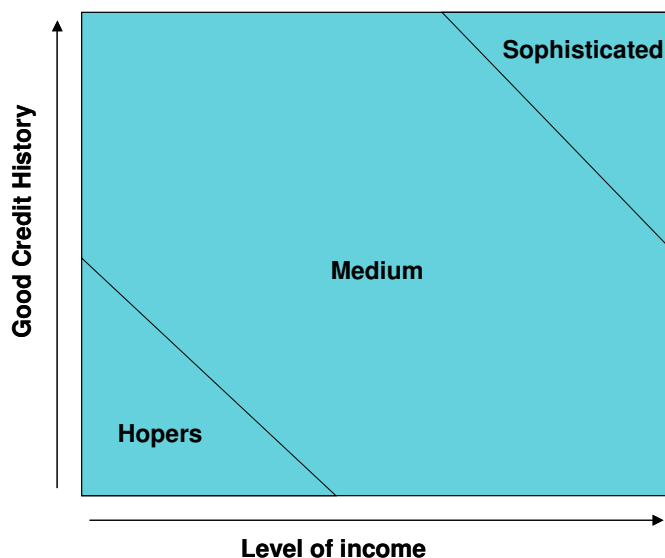
'Subsidized interest rates generally benefit only a small number of borrowers for a short period. Interest rate subsidies are an inappropriate use of donor or government funds because they distort markets and can encourage rent-seeking. Programs that target specific populations with subsidized interest rates have generally suffered low repayment rates, institutional dependency, and limited growth.'

Making sense of microcredit interest rates, DONOR BRIEF No. 6, September 2002, CGAP

4.3 Segmentation

Two major axes allowed to find homogeneous markets segments in terms of satisfaction, needs and constraints.

On the one side is the income, on the other side is the credit history of the family.



Segment	Criteria		Features
	Level of income	Credit history	

Hopers	1 - 2		Not well established in the community yet Strong will to uplift their situation. Generally un-aware of micro-finance services. Often rely on relatives money. No systematic Saving habits.
Medium	1 - 5 3 - 8	Yes No	It embraces a wide variety of profiles. Well established members in the community. Regular income and saving habits. Use a variety of Financial services such as money lenders and Bishi.
Sophisticated	5 - 8	Excellent	Well respected in their community (can be leaders). Excellent knowledge of Annapurna's services.

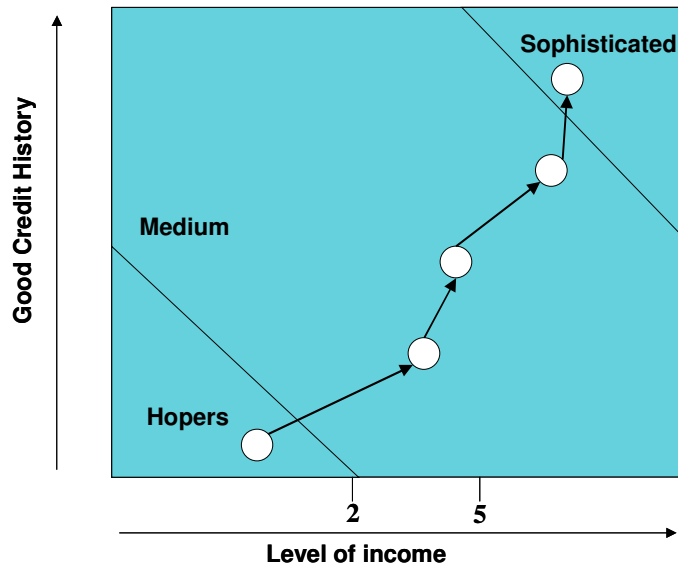
Needs and constraints are specific to each segment as described below:

Segment	Needs	Constraints
Hopers	Primary Need of improving income. Need of getting established in the community.	Difficult to form a group. Guarantors might be outside the community.
Medium	Upscale the business or working capital if entrepreneurs. Housing and Educational needs become important.	Generally satisfied with APS services.
Sophisticated	Major housing needs. Major upscale of the business. General consumption.	Require more flexibility. Require higher amount of loan.

One difficulty is to assess incomes with reliable results.

For that we created a new appointment with partners between every loan in order to assess the two sides of the partners' profile according to this new segment : what the satisfaction of the partner and the accuracy of the product to his needs / constraints, on a declarative mode. The second part studies the evolution of the partners' situation after the loan and the impact of the financial assistance. This approach concentrates directly on the main figures of the areas for which the loan was given : business, house, education as main purposes.

This form also allows to evaluate the progress of the partner on the path from hoppers to sophisticated needs:



5 New products and procedures design

5.1 Range of products

One product is specifically designed for each segment with:

- Adapted eligibility conditions to loans
- Tailored interest rates to increase both fidelity and risk coverage.
- Adapted loan disbursement meetings to have faster procedure for partners.

	Hopers	Medium	Sophisticated
Criteria	Level 1.2.3 Unable to form a group	Level 3.4.5 Able to form a group Little credit history	Level 6.7. Good credit history= 5 loans have been taken with credit history rated 4 or 5 In the reloan policy.
Purpose	Business, housing or education, old debts repayment and asset creation for family budget support only.		
Interest rate	Daily: 3% flat Weekly: 2.7 % flat	Weekly: 2,4% flat Monthly: 2,1% flat	Monthly: 0,99 % flat
Fees	150 Rs. (100Rs. For 1 st 1000Rs. loan) at the time of loan release.		
First Loan Amount	1 000 Rs.	2 000 Rs.	15 000 Rs.
Max. Loan Amount	2 000 Rs.	15 000 Rs.	35 000 Rs.
Compulsory savings	20%		
Savings before loan	100 Rs.		
Successive Loan progression	According to individual / group repayment history, business expansion and committee meetings attendance (reloan policy). Minimum of - Last loan * 2 - Savings * 5		
Collection frequency	Daily / Weekly	Weekly / Monthly	Monthly
Documents required	2 photos + Xerox of ration card		
To whom	Individuals	Individuals in groups of 4-10 members.	
Number of guarantors	2 (1 working person with Ration Card from the community).	3 (from the group)	
Family members Signature	1		
Committee meetings Attendance	1 every 2 months	1 every 3 months.	
Loan disbursement	1 every 2 weeks in Branch office		
Missed payment penalty	10 Rs. per collection		
Other obligations	Participation in the Family Security Fund : 100 Rs / year.		

5.2 Definition of interest rates

Interest rates needed to be redefined in order to reflect :

- the organization's cost of capital (interest rates used to be lower than market rates)
- the organization's costs of service (especially depending on the collection frequency)
- the risk (depending on the credit history)

Many resources are currently available on the Internet to help in calculating and defining interest rates. (see Bibliography resources from CGAP Publications).

5.3 New procedures

New products require procedures to monitor more closely the profile of partners in order to identify their position on the development curve.

New procedures thus include a stricter assessment of partners, through the introduction of forms to assess the overall development of a partner and his/her credit history.

6 Implications to monitor

Positive impacts:

- Reaching more the poorest.
- Increasing sustainability through more loans, more fidelity especially from the sophisticated segment (corresponding to higher profitability).

Negative impacts:

- Drop out of old partners in the short term due to increase in interest rates.
- Change in the organization culture resulting in human resources hindrances (resignations, decrease in motivation).
- Lack in fluidity in the transition from hoppers segment to medium segment. Group approach in not accepted.
- Organization's image is closer to a private bank, less links with the community.
- Organization culture more results oriented, less social-conscious.
- Less time for discussions with members.
- Less community building, less integration dynamics... The loan is limited to financial impacts.

Indicators

- Drop-out after first loan
- Drop-out at the time of re-loan for old partners
- Integration feeling from partners
- Structure of the client base according to the segmentation income / credit history.

Solution

- Strong focus is given to communication with and between partners to explain and discuss the changes and highlight the positive impacts.

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