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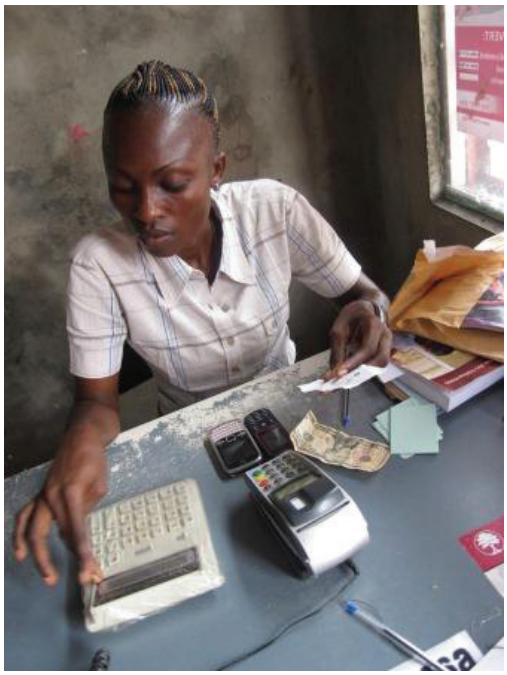
Breaking Free of the Branch: Designing Alternative Delivery Channel Projects for Microfinance Banks in Africa

Nearly 80 percent of adults in Sub-Saharan Africa do not have an account with a formal financial institution. Despite recent well-publicized successes in increasing financial inclusion in a small number of African markets, such as Kenya, hundreds of millions of African adults still lack access to affordable financial services. In response to this need, IFC and The MasterCard Foundation partnered to introduce alternative delivery channels in IFC's key microfinance partners in Africa. Although the partnership is still at an early stage, this SmartLesson distills some general lessons from two of the first alternative delivery channel engagements. These lessons may be useful for other IFC teams in structuring such projects with microfinance clients.

Background

During the past seven years, IFC focused mainly on closing the access gap by supporting retail microfinance banks, which provide a strong platform for increased outreach. Until now, these banks have generally replicated the traditional branch-based banking model, an approach that is inherently slow and expensive to deploy in challenging African frontier markets. To achieve the necessary transformational outreach, IFC and our microfinance clients recognize that alternative delivery channels (ADCs)—including agent and mobile banking—are potentially powerful tools to scale outreach in the face of these unique challenges. However, because of a combination of low capacity, inherent risks, and high upfront costs, most microfinance banks operating in underserved markets have not yet taken advantage of the ADC model.



In January 2012, IFC and The MasterCard Foundation launched the $37.4 million Partnership for Financial Inclusion, with the goal of bringing financial services to an estimated 5.3 million people previously without banking services in Sub-Saharan Africa—within five years. The program aims to develop sustainable microfinance business models that

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can deliver large-scale low-cost banking services. To accelerate the development of low-cost mobile financial services, the program provides advisory assistance to mobile network operators, microfinance institutions, banks, and payments-systems providers.[1]

Through the partnership, IFC aims to scale up eight to ten of our strongest African microfinance clients—including key partners FINCA and MicroCred—by supporting the development of innovative new products, expansion into hard-to-reach locations, especially rural areas, and the deployment of new cost-effective alternative delivery channels.

Lessons Learned

Lesson 1: Upfront support is crucial for success.

The IFC Africa microfinance team intended its initial approach to microfinance channel engagements to be a relatively light-touch process: a full IFC team composed of the project leader and relevant specialists would conduct a due diligence mission and aim to get most of the way toward a detailed project implementation plan within a few days. However, the approach has changed substantially following lessons learned from our first ADC engagements under the partnership—including with FINCA DRC. After just one day of due diligence meetings with FINCA, the IFC team realized that even relatively mature microfinance clients such as FINCA DRC lack basic capacity when it comes to a channel project—which is understandable considering the nascent state of branchless banking globally.

Initial proposals from microfinance clients thus tend to be either 1) overly ambitious, as the client underestimates the level of resources and capacity necessary to implement a project, as with FINCA (see Box 1) or 2) overly conservative, as the client is unwilling to commit to specific targets, given a lack of direct experience with the ADC. As a result, most microfinance institutions will require substantial expert input and upfront advisory support well before beginning to draft an implementation plan. They will need assistance in defining the magnitude of the project, the broad strategic priorities, and the specific activities to be covered under the project, as well as in thinking through the practical aspects of the plan in detail.

As a result of these early lessons, IFC now uses a revised client-engagement strategy for channel projects that incorporates significant early-stage advisory support: before even conducting initial due diligence, the IFC project team now asks the client to complete a detailed questionnaire that helps the client think through the necessary strategic, financial, and operational aspects of mobile and agent channel development—and to ultimately be more prepared to engage with the IFC team during due diligence.

Box 1: FINCA DRC

Although FINCA DRC's alternative delivery channel strategy is still ambitious, it is modest in scope compared to FINCA's initial proposal during due diligence discussions with IFC. In addition to developing an agent network, FINCA DRC's original plans included the following:

- a costly branch expansion ($200,000 per branch in infrastructure investment alone) that would almost double the physical branch infrastructure;
- a mobile banking channel, with the aim of directly integrating FINCA with the e-wallet of a mobile network operator; and
- a card-based channel—likely in partnership with a bank—to give FINCA clients access to one of the Democratic Republic of Congo's proprietary ATM networks and to allow them to transact when abroad (mainly for clients running trading businesses).

The proposal was clearly overly ambitious and likely to pull FINCA DRC in too many directions. In response, IFC provided specialist consultants to work with FINCA for two weeks onsite to develop a narrower plan that would reflect FINCA's real priorities. The resulting project, with a focus on building the savings outreach and an aggressive but realistic expansion of FINCA's agent network, has thus far exceeded the initial targets. As of May 2014, FINCA already had 173 agents operational, $21 million in deposits mobilized, and 51,000 transactions processed through FINCA agents monthly. Based on this early success, FINCA DRC has committed to an ambitious new target of becoming the Democratic Republic of Congo's first true mass-market financial institution and reaching over 1 million customers within five years.

1 For more information, go to www.ifc.org/financialinclusionafrica.

Depending on client capacity, IFC may also provide significant support—after the due diligence but before implementation—in developing the business case for the channel, including financial and operational projections. For FINCA, this involved sending a team of specialist staff and consultants for two weeks following the due diligence to develop a more realistic business case by working through the market-size and client-uptake assumptions, agent network rollout plan, and budget. (See Figure 1.)

Lesson 2: Keep your eye on the ball.

The novelty of channel implementations can make it easy for both IFC and the client to lose sight of the ultimate goal, and technical complexities can quickly overwhelm the client and dominate the design phase of the project. In both the FINCA and MicroCred projects, the IFC team spent significant time discussing the technical questions, such as point-of-sale solutions, switches, and integration with third-party payment providers. Also, both FINCA and MicroCred initially focused heavily on the channel potential for direct revenue from fees or other charges during due diligence and follow-up discussions. (See Box 2.)

However, it is equally important to remember that, for microfinance banks, an alternative delivery channel is a means to an end and generally not an end in itself. While the channel itself has naturally been an area of significant focus in our discussions with clients, it is equally critical to give sufficient attention to the bank's broader business strategy—and product overhaul, if relevant.

The discussions and project implementation plan should address the following key issues: which clients the bank wants to target with the channel; what type of savings, credit, or other products it may need to add or adapt to the channel; what volume of deposits, loans, or other business it can reasonably expect to mobilize; and how to grow its business through the right mix of products, promotion, places, and field activities—so the client can realize the core business benefits of the channel. The IFC team has reinforced this message during due diligence discussions and preimplementation advisory assistance; that's when discussions of the business case and financial projections provide a good forum for debating various scenarios and assumptions regarding the impact of the channel on the overall business of the bank.

Box 2: IFC's Channel Partnership with MicroCred in Africa

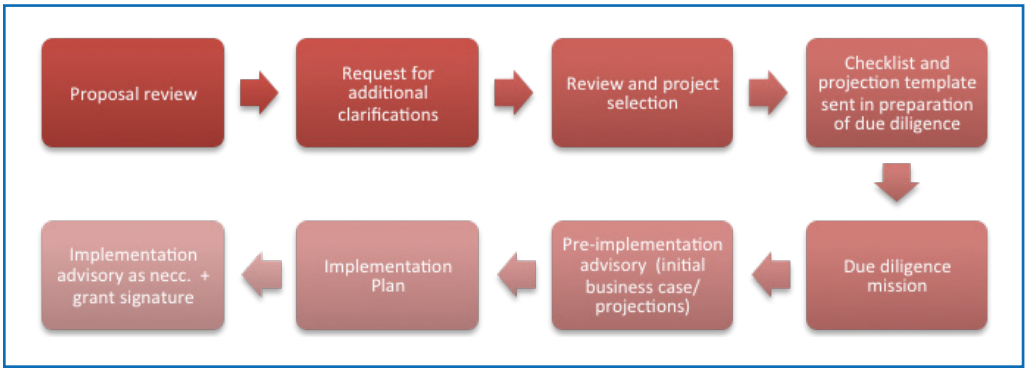
The following factors characterize the IFC-MicroCred channel partnership in Africa:

- The relationship leverages one of IFC's key greenfield network partners in Africa. MicroCred Senegal and MicroCred Madagascar, two of IFC's strongest greenfield clients, were selected through a competitive process by an IFC team composed of Advisory Services and Investment Services staff.
- In addition to support in business modeling and providing performance-based grants, IFC is delivering advisory services in the areas of strategic planning, agent network management, and network optimization.
- The partnership includes significant investment in capacity at the MicroCred Holding level—including a global director of channel development, who is responsible for the performance of all of the alternative delivery channels and will make lessons learned in Senegal and Madagascar available across the MicroCred network.

Lesson 3: Partnership is key.

There is a reason why "partnership" is the first word in the name of the IFC-MasterCard Foundation program. As already noted, branchless banking is still relatively new territory for almost all microfinance clients, and the investment required to roll out a new channel is daunting: a $2 million to $4 million initial outlay for staff and systems is not uncommon, with more than half of this outlay coming in the form of parallel contributions from the client. Microfinance institution clients require a true partnership with IFC to feel comfortable undertaking a channel project, and they want to share the risk of innovation proportionally. Without some assurance

Figure 1: Revised Approach to Client Engagement in Channel Projects



of continuing support, clients are unlikely to feel comfortable committing to outcome-related targets, which can be problematic when structuring the project. Moreover, given the many uncertainties inherent in such a new area, clients expect some degree of flexibility to refine and revise their approach based on early experience and lessons.

IFC has addressed the need for unambiguous partnership and risk-sharing in the structure of the project legal agreements: continuing advisory assistance in the form of a specific cooperation agreement, combined with grant support. In addition to the design-phase advisory support described above, IFC commits to provide advisory services during at least the first part of the implementation phase, to support the client's testing and refining of key assumptions made during the design phase. The details of this advisory assistance are formalized in a cooperation agreement—usually at the same time as the signing of a performance-based grant agreement. With IFC's advisory support, the project and grant targets can then be amended as necessary, based on the initial results of the project to ensure realistic but sufficiently aggressive objectives.

To avoid placing undue risk on the client during the early stages of the project, the grant agreement is also structured with a significant upfront payment and with the first performance-based tranche linked to output-based targets (for example, number of agents) that the client has more control over; later tranches are more closely tied to the outcomes and impact of the project. Even mature microfinance institutions are unlikely to push ahead without some reassurance that early stumbles will not result in the withdrawal or curtailing of IFC's financial and advisory support.

The Africa microfinance team's partnerships also go beyond the individual-project level. For example, based on positive initial outcomes from the partnership in the Democratic Republic of Congo and the strength of this relationship, FINCA has asked for IFC's assistance in rolling out its alternative delivery channel strategy worldwide—with additional support from IFC as a provider of advisory assistance and as a shareholder.

CONCLUSION

Although it is still early days, IFC's initial experience in supporting ADC projects with African microfinance partners has been largely positive. Nonetheless, our initial engagements in this space serve to highlight the reality that branchless channel development is new territory for both IFC and our clients—even those that are more mature and relatively sophisticated. This means IFC cannot expect our microfinance clients to hand us a fully baked project, signed, sealed, and delivered. We are all figuring this out as we go along, and success in ADC implementation will require a true partnership to reach the mutual goal of expanding access to finance for those who are least served.