CASE: GS-83
DATE: 2/20/2014

EXPERIAN MICROANALYTICS: ACCELERATING THE DEVELOPMENT OF MOBILE FINANCIAL SERVICES IN DEVELOPING MARKETS

People were poor not because they were stupid or lazy. They worked all day long, doing complex physical tasks. They were poor because the financial institution in the country did not help them widen their economic base.

—Muhammad Yunus, Founder of Grameen Bank

Microfinance and the Poor

As the world population exceeded 7 billion by the end of 2011, there had been some progress and yet many challenges in alleviating poverty. First, according to the data provided by the World Bank, the percentage of people earning less than US$2 per day had decreased significantly in China (from 67.4 percent in late 1980s to 50.1 percent in late 1990s)[1] and moderately in India (from 83.2 percent to 78.8 percent)[2]. However, this percentage had remained unchanged in Africa (76.1 percent)[3] over the same period. As of 2008, the World Bank estimated that over 1.3 billion people (22 percent of the world population) lived on less than US$1.25 per day.[4] As developing economies such as China and India sustained their economic growth over the last decade, the Gini indices of these two countries have continued to

1 Insert Source: The World Bank Annual Report 2008 (http://go.worldbank.org/JP57KOICX0) .
2 Insert source. Ibid.
3 Insert source. Ibid.
4 R. Alexander, "The Rise of the $1-a-Day Statistics," *BBC News Magazine*, March 9, 2012.

Professor Hau Lee and Professor Christopher S. Tang, University of California, Los Angeles prepared this case as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. The authors are indebted to Mr. Elio Vitucci (Managing Director of Experian MicroAnalytics) for providing information.

rise at the same time.[5] The underlying causes for income disparity have included political stability, government policy, corruption, economic development, job creation, development of financial markets, development of roads, communications and electricity infrastructure, and development of health care and education systems.[6]

As governments, non-governmental organizations (NGOs), social entrepreneurs, and for-profit companies launched various programs intended to alleviate poverty, there was a general agreement that pure charity was not a sustainable solution. While venture capital firms and angel investors could provide capital to start or grow a business, their role in supporting wealth creation in developing economies had been limited for two major reasons. First, the structure for venture financing was not established in developing markets.[7] Second, many small businesses were family-run ventures and their owners preferred to preserve ownership for their children. As such, these small business owners were reluctant to give up equity for capital, i.e., they would prefer taking a business loan to giving up control of the business.[8]

In the absence of venture capital and angel investors in developing markets, Microfinance (MF) was one of the most promising tools in the fight against poverty. In many developing countries, micro-entrepreneurs were not easily qualified to borrow money from traditional banks for several reasons. First, most micro-entrepreneurs found it difficult to establish the creditworthiness of their business due to the lack of reliable financial information and external data sources such as credit bureaus. Second, most micro-entrepreneurs did not have sufficient collateral to secure loan repayments. Consequently, it was difficult for the poor to break the vicious cycle. Adam Smith once said: "Money, says the proverb, makes money. When you have got a little, it is often easy to get more. The difficulty is to get that little."[9] In 1983, the 2006 Nobel Laureate Muhammad Yunus founded the Grameen Bank in Bangladesh because he believed that the poor were eager to learn and willing to work hard, and that the poor could be more trustworthy.[10] Others have followed in his footsteps by establishing different microfinance institutions (MFIs) based on different business models. Even though microfinance covers a wider range of financial services including microcredit, microloans, micro-savings, micro-insurance, and remittance transfers, most MFIs tend to focus on micro-lending, partly because most micro-entrepreneurs need access to credits and loans and MFIs can earn interest on the loans they offer. Also, most

[5] Developing economies included countries such as Brazil, China, Guatemala, India, Kenya, Pakistan, Philippines, Turkey, Vietnam, etc., according to International Monetary Fund's 2012 *World Economic Outlook Report* (http://www.imf.org/external/pubs/ft/weo/2012/02/).

[6] Statistics are provided by the World Bank, World Development Report 2006 and United Nations Development Programme 2008. Some underlying causes are articulated in recent research articles by A. Karnani, "The Mirage of Marketing to the Bottom of the Pyramid: How the private sector can help alleviate poverty," *California Management Review*, 49/4, Summer 2007, pp. 90-111; S. Vachani, and N.C. Smith, "Socially Responsible Distribution: Strategies for reaching the bottom of the pyramid," *California Management Review*, 50/2, Winter 2008, pp. 52-84.

[7] A. Patricof, "In Developing Economies, Equity Beats Microfinance," *CNN Money*, April 20, 2011.

[8] P. Sangani, "What Sets Entrepreneurs in Emerging Asian Markets Apart?" *The Economic Times*, Dec 2, 2011.

[9] A. Hollis and A. Sweetman, "Micro-Credit: What can we learn from the poor?" *World Development*, pp. 1875-1891, October, 1998.

[10] According to the data provided by the World Bank in 2008, Bangladesh had the highest population density among all countries in Southeast Asian. Also, over 41 percent of its 150 million population earned less than US$1 per day and the adult literacy rate was 47.5 percent.

people think of microfinance narrowly as micro-lending services to low-income clients (i.e., micro-entrepreneurs), partly due to the publicity created by Grameen Bank in Bangladesh, SKS in India, and Kiva in the U.S., which are based on different business models.

Challenges Faced by Microfinance Institutions

In 2009, it was estimated that there were over 2 billion adults who needed financial services (credits, loans, savings, etc.) to start or sustain their business, but they lacked collaterals, credit history and experience in managing money.[11] Traditional banks had not been available to provide financial services to poor customers with small balances conducting small transactions. This created a need for MFIs to fill this huge gap. By the end of 2010, there were over 160 MFIs in Africa alone, lending over US$4.7 billion to over 5 million borrowers.[12] For a complete listing of MFIs around the world, see: www.mixmarket.org. While MFIs have served an important role in alleviating poverty, MFIs themselves were facing many challenges even if their funds were sufficient to lend money to the poor. Two major challenges stood out:

1. ***High operating costs***. MFIs faced high operating costs because transactions were often very labor-intensive, especially since many small loans were taken by micro-entrepreneurs who were physically dispersed in remote areas. High operating costs had two undesirable consequences. First, MFIs needed to charge higher interest rates to cover their high operating costs.[13] Consequently, micro-entrepreneurs were likely to become poorer.[14] Second, most MFIs were unable to become self-sufficient (or profitable) themselves, and the majority relied on donations and subsidies to stay afloat (e.g., Kiva).[15]
2. ***Low productivity.*** Besides the fact that micro-entrepreneurs were sprawled over large areas, their capabilities and their needs were diverse in terms of language, cultural background, types of enterprises, etc. As such, it took special training for the MFI officers to understand the needs of the micro-entrepreneurs, to evaluate the borrower's credit risk, and to explain different services being offered without intimidating or under-serving potential clients. Because of these additional requirements and the need to spend a lot of time traveling long distances to remote villages to visit poor micro-entrepreneurs, productivity was relatively low, making it a big challenge for MFIs to expand their operations quickly (e.g., Kiva's field partners).[16] Consequently, most MFIs were unable to scale up their operations rapidly and economically. To enable both micro-

[11] Chaia et al., "Half the World Is Unbanked," *Financial Access Initiative*, 2009.

[12] Data source: http://www.mixmarket.org/mfi/region/Africa

[13] In 2006, the average worldwide microfinance lending rate was 24.8 percent, but interest rates above 50 percent were not uncommon. See: Guntz, S., "Sustainability and Profitability of Microfinance Institutions," Research Paper 4/2011, *Center for Applied International Finance and Development*, University of Applied Sciences Nuremberg, Germany, 2011.

[14] A. Karnani, "Microfinance Misses Its Mark," *Stanford Social Innovation Review*, summer, 2007.

[15] According to a UN report, only 10 percent of MFIs are profitable. See: http://www.uniteforsight.org/pitfalls-in-development/pitfalls-in-microfinance.

[16] There were reports claiming that many of Kiva's field partners were spending most of the time travelling to remote villages and no time to counsel the borrowers on their businesses. See: http://www.socialedge.org/blogs/beyond-good-intentions/archive/2009/05/25/micro-lending.