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Accelerating Financial Inclusion through Innovative Channels

10 Obstacles for MFIs Launching Alternative Channels— and What Can Be Done About Them

Rarely a day goes by without someone mentioning how financial inclusion can be boosted by new delivery channels, such as ATMs, banking agents, and mobile phones. Yet for all the talk about reaching the "unbanked" and other low-income groups, it is banks, mobile operators, and retailers that have been experimenting with new delivery systems to reach the poor. As the group that is closest to the niche segment, microfinance institutions (MFIs) seem conspicuously absent from the discussion.

Or are they? Based on ACCION's experience in working with over a dozen microfinance partners on delivery channels in Latin America, Asia, and Africa, as well as observations of other MFIs (see interview list in the acknowledgements), it appears that while some experimentation is indeed occurring, significant obstacles remain.

This paper outlines ten challenges that are holding MFIs back from deploying alternative channels and provides a roadmap for MFIs—and broader stakeholders—who seek to overcome these hurdles. This roadmap is relevant not only for MFIs and MFI networks but also for those who provide the enabling environment for financial inclusion, including social investors, banking regulators, grant-making institutions, and prospective partners, such as commercial banks, mobile operators, and technology vendors. The paper concludes with a description of competitive advantages that MFIs have in this space to make them more effective in reaching low-income groups using innovative channels.

Introduction to Alternative Channels

Defining Alternative Channels

For much of its 30-year history, microfinance has been limited to the standard branch-and-loan-officer model of delivering credit. Currently, microfinance institutions are considering non-traditional, or alternative, ways of distributing credit and other financial services to the poor. This function is typically referred to as Alternative Channels.[1]

[1] The term "branchless banking" has been used to describe this, but we prefer using "alternative channels," which is the terminology employed in the banking sector. The term "branchless banking" implies that there is no need for a branch, but branches are still central to MFI operations—especially for operating a savings product and crucially for building customer trust with the institution.

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Banking channels fall into two main categories: direct and indirect. Direct channels are those that the bank "owns" or has main control over. There are two kinds of direct channels: *location-based* direct channels are those that occupy a physical (though not necessarily fixed) presence, whereas *remotely-based* are not. Thus channels—such as branches, kiosks, roaming vans, and business units—are examples of the first; Internet, call centers, and IVR (Interactive Voice Response) are examples of the second. It should noted that remote channels lack face-to-face contact between the institution and the customer, an important consideration when addressing low-income segments and gaining their trust.

Indirect channels are those that the financial institution does not wholly control. Usually this means that the bank needs to engage in some sort of partnership with a third party. Examples include issuing a Mastercard prepaid card, working with a mobile operator to facilitate mobile banking, joining a national switch and deploying ATMs, or leveraging a pharmacy chain as part of a banking agent program. An important focus of indirect channels is thus on working with and through third parties to reach customers and, consequently, outsourcing a significant part of the customer experience to those parties.[2]

The table below provides the key features of the types of channels and the main variables to keep in mind.

Table 1: Types of Alternative Channels and Main Features

Channel Type	Key Features	Operational/ Real Estate Intensity	Technological Intensity	Regulatory Boldness	3rd Party Management†	Long-Term Implementation‡
DIRECT *Location*	• Real-estate heavy • Face-to-face customer interaction	High	Low	Low	Low (typically)	Low (3-6 months)
DIRECT *Remote*	• Technology-Based • High Investment	Low	Medium-High	Low-Medium	Low-Medium (mainly technical consultants)	Medium (6-12 months)
INDIRECT	• 3rd Party Engagement • Regulatory Ambiguity	Medium	High (synchroni-zation)	High (vague, changing)	High (agents, suppliers, alliances)	High (6-24 months)

† Includes consulting firms, agents, suppliers, and strategic alliances.
‡ Approximate average durations. Figures are for comparative reasons; actual durations may vary significantly.

[2] It should be noted that not all channels can be neatly compartmentalized in the above categories. For example, if an MFI were to own, manage, and deploy its own ATMs, it can be reasonably considered a direct channel. The purpose of elaborating the different types is not to tie specific channels with specific categories, but rather to illustrate that the broad categories have different implications in terms of implementation.

Motivation of Alternative Channels

The excitement on new delivery channels is due to their apparent promise to bring about two breakthroughs of major importance for microfinance. The first is that certain delivery channels offer the possibility of **massive outreach** to people in locations that remain underserved, especially those in hard-to-reach rural areas. Some channels, including retail agents such as supermarkets or drug stores that act as banking agents, may bring the industry closer to significantly serving more of the poor.

The second breakthrough involves **dramatic cost reduction**. With an operating model chiefly based on personal, one-on-one relationships, microfinance is remarkably human-resource intensive, with labor costs sometimes accounting for almost half of operating expenses. As competition increases, MFIs hope that different channels may reduce—though not eliminate—their dependence on branch staff and offer a balance between the classic personalized service and an emerging "transactional" service, such as cell-phone banking.

Alternative channels can dramatically reduce costs and greatly expand outreach of financial services to the poor.

There are several more specific motivations for diversifying an MFI's channels beyond the branch:

- **Customer acquisition and retention**: penetrating new markets or servicing hard-to-reach areas.
- **Product diversification Customer acquisition and retention**: offering valuable products, such as micro-savings and remittances, profitably and efficiently.
- **Operational efficiency:** reducing branch congestion and maximizing efficiency of branch tellers and loan officers.
- **Cash reduction:** reducing cash in the financial system to save money, provide more transparency, be less vulnerable to fraud risk, and be safer for the client.

With few established models even in the retail-banking industry, many of these alternative channels are new to microfinance, and thus a high degree of experimentation is currently underway. It remains to be seen which channels will have the transformational impact described above.

10 Obstacles—and Solutions—for MFIs in Implementing Alternative Channels

Despite a substantial amount of awareness and interest in alternative channels, few MFIs have run pilots, and only a handful have successfully rolled out new models. By "success" we mean not only that the channel is functioning from an operational and a technological standpoint, but that customer uptake and usage is significant, and the solution is financially viable. This is based not only on ACCION's own experience consulting to its MFI partners but also on the comprehensive interviews it conducted with the largest MFI networks (which collectively support roughly 120 MFIs around the world) and with individual MFIs in nearly a dozen countries. Why, then, does there appear to be few notable examples of MFIs participating in these potentially beneficial

channels? While some challenges, such as regulation, technology, customer adoption – are frequently mentioned, others are less obvious and possibility pose greater roadblocks to MFIs. Following are ten main challenges facing MFIs and what are needed to overcome the hurdles.

1. Alternative channels is still an emerging field

Unlike other functions, such as risk management, branch operations, or marketing, alternative channels is a relatively new field, even in the banking sector. There are few reference points, especially in the microfinance sector, and even fewer success stories—and almost none are widely communicated across borders or regions. This means that senior executives at MFIs often have an incomplete understanding of alternative channels and how they might fit in their businesses and unclear ideas of what benefits they may bring.

Lack of successful MFI examples of alternative channels is leading to uncertainty and hesitation.

This "Catch-22"—few successful reference points discourage experimentation, leading to few pilots that could result in success stories—is present in all sectors, not just microfinance, and is often broken by a single, highly-publicized "big win." The most telling example is Safaricom's hugely successful M-Pesa product in Kenya, which has catalyzed experimentation among hitherto reluctant mobile operators.

What's Needed

Detailed case studies of MFIs using alternative channels would help spur exploration and experimentation among the many MFIs that are curious about their potential but unsure of their advantages. Few of the current studies to-date on channels has been from the perspective of MFIs, which in turn makes the available insights more difficult for MFIs to apply in their context. Specific tools, such as institutional diagnostics or the use of benchmarks for typical customer usage of certain channels, would help MFIs establish the viability of implementing certain channels. Preparing more comprehensive aids, such as channel-specific manuals (as has been done for product lines like savings, housing, and insurance), are time-consuming but would be enormously useful as a step-by-step guide for MFIs.

Greater dissemination of MFI case studies, combined with channel innovation grants, would spur experimentation.

Much of the burden to gather and disseminate information to the microfinance community falls on those groups that conduct and publish research and, in particular, on those that take an industry view. For example, Microsave has published several helpful briefs on mobile banking that cover topics such as roll-out strategies, technology, and customer adoption. MFIs and MFI networks can also be pro-active by writing blogs, publishing material on websites, and contacting research houses to help disseminate findings.

Grant-making organizations also have a valuable role to play. They could provide funds for researchers to undertake the analytical and dissemination work so crucially needed. In more sophisticated cases, they could set up challenge funds to catalyze innovation and break the Catch-22. For example, the genesis of Vodafone's M-Pesa was a Financial Deepening Challenge Fund set up by the United Kingdom's DFID (Department for International Development) in 2003, which encouraged the private sector to cost-share development projects. The roughly £1 million

funding that DFID provided was matched by Vodafone and created the momentum inside the multinational to pilot a project around mobile phones and microfinance loan repayments.

2. Regulatory frameworks for alternative channels are ambiguous or restrictive

Regulation is often ambiguous or restrictive on new delivery channels. As country regulators grapple with the pace and hype of channels, their first moves have often been to place unclear or conservative guidelines, which in turn slow or stifle innovation. For example, until recently the Reserve Bank of India (RBI) did not permit regulated microfinance entities—such as SKS, BASIX, and Spandana—to be banking correspondents of big banks or to leverage their own network of banking agents. The RBI even adjusted its draft guidelines on prepaid instruments that limited these microfinance institutions to issuing cards that could only be used for purchases of goods at participating merchants, rather than allowing cash withdrawal at a branch or ATM, greatly restricting the usefulness of the channel to the poor. In Mexico, regulators approved banking agent guidelines only in 2008; in the past, some financial institutions (e.g., Banamex since 2001) had taken compliance risks to pilot the channel in absence of supportive regulatory frameworks. Meanwhile, the Bank of Ghana has insisted that all interbank transactions be cleared through its new payment switch and that all banks and savings and loan companies issue—free-of-charge and without any government subsidies—prepaid smart cards to any consumers that request them. In all these cases, lack of supportive regulation has meant missed opportunities for MFIs to spread innovation.

Some regulators around the world, though, have been making advances. South Africa successfully initiated a three-tiered "Know Your Customer" (KYC) norm for account opening, primarily to spur electronic banking. Brazil's banking superintendency instituted banking agent policies in 2001, which led to banks to create over 100,000 new distribution points covering every municipality; a "wave" of supportive banking agent legislation has rippled out to neighboring countries, including Peru, Colombia, Chile, and Bolivia, as regulators seek to replicate Brazil's success.

A country's regulation, or lack thereof, of alternative channels greatly affects the ability for MFIs to consider them.

In short, a country's regulation, or lack thereof, greatly affects the ability for MFIs to consider an alternative channel, let alone implement one. Depending on their tolerance to regulatory risk, which is usually low, many MFIs prudently opt not to experiment unless guidelines are both clear and supportive of their aims.

What's Needed

The onus naturally falls on banking regulators and superintendencies to establish clear and supportive policies. For alternative channels, these usually encompass guidelines on anti-money laundering and combating the financing of terrorism (AML-CFT), KYC norms, and electronic money (e.g., definition of electronic money, types of issuers) and banking agents (e.g., types of agents, insurance policies, maximum amounts). Moreover, regulators should work closely with the relevant stakeholders—including not only banks and MFIs but also mobile network operators ,

retail chains, and payment providers—to design and test regulations. A risk-based, rather than rule-based, approach is often helpful. For example, rather than insisting that a low-income customer provide standard KYC documents to open an electronic account, regulators could reduce KYC requirements for low-value accounts, which hold little risk of money laundering and terrorism financing.

Two success stories are worth noting primarily for the *approach* the central banks took to regulation of alternative channels. In the Philippines, the Central Bank collaborated closely with Globe and SMART, the country's two mobile operators, to develop a framework for mobile banking that incorporated consumer protection into the mobile-operator business model. The Central Bank issued guidelines in 2005, shortly after the launch of Globe's G-Cash product, and it continues to engage with a variety of stakeholders today, including most recently the equity stake that Globe took in one of the country's savings banks.

Meanwhile, the Reserve Bank of Pakistan has taken a pro-active approach and established transparent and detailed guidelines for banking agents and mobile banking well-ahead of any large-scale implementation. It recently joined forces with the country's telecommunication authority and set up a joint regulatory committee to propose modifications to the mobile banking regulatory framework. The bank also created a cross-industry, multi-sector "Stakeholders Group" to address product, operational, and technical issues for mobile banking. If regulators in other countries can follow a similarly collaborative, pro-active, and risk-based approach to craft supportive guidelines, it would remove one of the major obstacles for MFIs to develop transformational delivery channels.

Regulators who follow a collaborative, pro-active, and risk-based approach in crafting guidelines would remove one of the major obstacles for MFIs to develop trans-formational delivery channels.

Other stakeholders also have roles to play. MFIs and networks should actively engage regulators, rather than avoiding them or hoping to find loopholes in regulation. Regulators are willing—and in some cases eager—to work with practitioners to explore innovations that can improve financial access. Sa-Dhan, an association that represents microfinance interests in India, made a compelling case to the Reserve Bank of India, to rethink its guidelines on banking correspondents. When the regulators revised the guidelines several weeks later, they incorporated several of Sa-Dhan's recommendations.

3. Poor customers are initially reluctant to adopt technologically enabled channels

MFIs face a particular challenge with alterative channels because their customer bases are generally lower-income, less educated, and have lower familiarity with financial services and technology than mainstream banking customers. Especially for indirect channels for banking or payments, MFI customers may not understand the benefits of a prepaid card, feel comfortable using a cell phone for sending money, or trust a gas-station attendant to deposit money in their savings account. This applies both for the trial of the channel as well as on-going usage.

Many poor customers initially do not trust financial services delivered through technologically-enabled channels.

In customer market research that ACCION has conducted in Peru, Guatemala, Ghana, China, and India, "lack of trust" in alternative channels has been a familiar refrain for certain, though not all, segments of the low-income population. This is especially the case if the interaction involves

technology, a non-cash transaction, or little human interface. Mobile banking, which has all three characteristics, may thus be the most difficult channel to gain momentum among the base of the pyramid. However, when mobile banking does overcome the initial inertia, its benefits of safety, speed, and cost are readily apparent, and the service can gain traction very rapidly among certain low-income segments, as examples in Kenya and the Philippines have demonstrated.

What's Needed

MFIs should base decisions more on properly designed qualitative and quantitative market research to understand their customers. Too often managers in MFIs rely on anecdotes or their instinct in offering products to their customer base; this is not only insufficient, it might also be misleading, and too often it glosses over the nuances of customer behavior. Properly designed customer research allows the MFI to segment its market and carefully design the channel to meet the segment's needs. For example, for a project involving prepaid cards for remittance payments with one of Guatemala's largest banks, ACCION identified and evaluated three main target customer segments from comprehensive quantitative research it conducted. Along with socio-demographic variances, the segments had different needs and wants; ACCION thus designed different product and marketing strategies to respond to each segment's individual needs.

Two other tactics to increase adoption are also starting to emerge. The first is simplicity of the customer value proposition: while it is tempting to offer an array of services through multiple channels, a best practice is to offer a single, compelling benefit to the customer (e.g., "send money home" was the key benefit articulated to Safaricom's M-Pesa's target market; "we're everywhere Brazilians are" for Lemon Bank's network of retail agents). The second is that many customers need to "experience" the alternative channel—as in, convince themselves that it truly functions as the marketing messages promise—a number of times before employing it regularly on their own. In practical marketing terms, this means that MFIs may want to reward customers for minimum usage (e.g., make at least 3 transactions this month and receive a gift) or assist low-income customers in using ATMs when they are first deployed.

Proper market segmentation, product simplicity, and strategies to increase initial usage can greatly overcome the initial mistrust customers have with alternative channels.

There has been much discussion about the need for client education and financial literacy at the base of the pyramid, both for microfinance in general and for alternative channels in particular. In-person training and written materials are indeed important and crucial for any successful deployment of alternative channels. That said, client education is not a panacea; alone it cannot fundamentally change behavior from reluctance and fear into eager adoption of a channel. Based on research conducted by ACCION, while certain customer segments can be coaxed to try alternative channels using a mix of marketing promotion and client education programs, others will reject them altogether.

4. Technological infrastructure remains weak

Technology, both inside the MFI and in the external infrastructure, is another barrier for alternative channels. The first reason is the actual stability and resilience of the core banking system—not all MFIs have banking grade systems capable of handling large volumes of

transactions (e.g., as in the case for mobile banking) and reconciliation errors may occur. Indirect channels such as ATMs, agents, or mobile phones necessarily mean that transactions are initiated remotely, and thus the system must be resilient as well, with little or no down-time and a back-up system in place, as customers who are using such channels are likely away from nearby MFI branches (or making the transaction outside of business hours) and would not be able to visit a branch in case the indirect channel malfunctions.

Indirect channels especially require robust core banking platforms and communication systems.

Indirect channels also require integration and data synchronization between third-party platforms and those of the MFI. For example, an MFI's banking application must "talk" to the partner's IT system using the same communication protocol. For mobile banking, an MFI needs to connect to a mobile operator's platform either directly or, more likely, through the black box of a mobile-technology vendor that provides application development and switching capability. Experience has shown that, though manageable, this is one of the biggest hurdles to overcome. The security in relaying a customer's personal and financial data to the MFI is another concern, and, depending on the risk threshold set by the Central Bank and the MFI's own risk unit, MFIs must ensure that an adequate level of encryption and safe storage employed so that data cannot be intercepted or otherwise compromised.

Finally, the infrastructure in the country or region that is needed to support certain alternative channels is not always reliable. This includes sporadic power supply, a weak wireless telecom infrastructure, and the limited availability of a national switch to process electronic transactions across multiple payment platforms. Almost all well-developed ATM networks, for example, rely on these three characteristics to allow customers real-time access to their funds in nearby locations.

What's Needed

MFIs must ensure their IT platform is adequate to support channels, and ideally bring on board a reputable vendor to support them in design and deployment.

If they do not have one already, MFIs should carefully consider upgrading their IT platform to either a customized or off-the-shelf core banking solution that is banking grade and can safely support multiple payment modules as well as significantly greater transaction volume. Furthermore, it is highly recommended that the MFI engage a reputable technology vendor that can offer a turn-key solution (systems integration, application development, front-end support, switching capabilities, data processing, etc.), as these functions are beyond the core competency of all but a handful of MFIs.

Improving the country's energy and communications infrastructure is imperative for certain remote channels to flourish, though naturally financial inclusion is but one of many infrastructure-dependent activities which government decision-makers must consider, and infrastructure typically takes years to improve to a satisfactory level. In the meantime, MFIs may have to consider alternatives—such as back-up power generators, fixed-line communications, and multiple interfaces with banks (en lieu of a broad switch)—that allows them to offer a robust and reliable banking channel to their customers.

5. Dedicated and specialized human expertise for channel projects are lacking

The cross-functional nature of alternative channels typically involves many aspects of an MFI's operations, bringing the technology, commercial, and marketing departments into a close working relationship for both strategy and implementation. Not all institutions have the resource capacity available to do so in-house. In addition to dedicating staff, MFIs must have or develop capabilities, such as cross-functional collaboration, solid project management to supervise a lengthy implementation process, management of an extended team, and senior-level commitment to bring the project to fruition.

Few MFIs have in-house capacity and expertise to successfully implement alternative channels.

Moreover, alternative channels require specific knowledge, skills, and experience. Because of its relative infancy in the microfinance sector (and for certain channels, in all sectors), it is understandably not always common to find personnel with direct experience within the MFI.

What's Needed

Many MFIs have ambitions to explore different innovations but fall short on actual execution. Small or start-up MFIs in particular are often understaffed for all the initiatives being pursued, and managers lack the bandwidth necessary to manage the milestones, budget, and scope. Projects requiring longer timeframes for implementation should be led by a project manager—either an existing staff member or a new hire—in order to drive execution.[3] For example, FINCA Mexico brought on board a project manager to manage its project on prepaid cards for loan disbursement; FINCA staff credit this move as a key reason the project has successfully moved into a pilot phase. Larger institutions that are committed to developing multiple channels can learn from the capacity-building approach of Equity Bank in Kenya: its Alternative Channels unit is comprised over a hundred cross-functional staff that regularly interface with the bank's other functional units.

To obtain channels expertise in the short-term, MFIs can hire external consultants. These consultants should not be from technology vendors (although many offer this as a service), as they will neither have a neutral view of what channels should be implemented nor be able to objectively suggest an appropriate technology provider. (The exception is if the MFI has *already* made an informed, unbiased decision on the type of channel and vendor, and the vendor consultant is assisting with specific design to implement its solution.) Channel consultants should ideally have a broad understanding of multiple delivery channels and their implementation so that they can recommend appropriate channel solutions for the institution and support the MFI to bring them to fruition. For example, Triple Jump, a niche consulting firm, has largely been the driving

In the long-run, training and capacity building for MFI staff will be necessary for multi-channel strategies to become the norm for MFIs

[3] ACCION's experience suggests that a cross-functional team should be set up and that the channels project be owned and led by the operations, marketing or commercial units, not by technology. This is not to dismiss the significant of the IT department — in fact, its contribution is paramount for many of the channels. Yet the MFI's marketing or commercial units are closer to the customer and contain the processes that will be most affected by the introduction of new channels. They are therefore the ones who stand to benefit (from a cost-reduction or revenue-generating perspective) from these channels. Ideally, one of these units would be chiefly responsible for conducting due diligence, allocating resources and budget, and making requests to related units and parties.

force behind the design of mobile banking programs in SMEP and Tujijenge, MFIs in Kenya and Tanzania, respectively.

In the long-run, training and capacity building for MFI staff will be necessary for multi-channel strategies to become the norm for MFIs. Some conferences, such as the Mobile Money Transfer series organized by Clarion Events, now include comprehensive workshops on everything from customer adoption to technology-vendor selection for mobile banking. Other centers that already offer training, such as the Boulder Institute for Microfinance, could expand their offerings or provide separate training on channel development and implementation. Grant-making organizations could support the development of the curriculum and subsidize participant fees.

6. MFIs are unsure about how to engage third parties

MFIs are not accustomed to identifying, negotiating, and working with vendors and service providers.

In many ways, indirect channels are a double-edged sword for MFIs; working with and through third parties such as banks, mobile network operators, and payment networks can greatly reduce operational costs and expand outreach, yet it also requires a significant amount of third-party management. Getting a relationship right requires tactical items, such as selection criteria, legal review, and contract negotiations, as well as strategic and "cultural" alignment. For example, the fundamentally different cultures of banks and mobile operators are often a challenging factor for collaboration banks are hierarchical, more risk-averse, and take more defensive approaches; telcos are younger, innovative, and aggressive in the marketplace.

Moreover, as most MFIs are relatively small—both in client numbers and in budget—it is sometimes difficult to get the attention of larger third parties unless these companies have made an explicit commitment to work with MFIs and/or reach the base of the pyramid (e.g., Roshan, a mobile operator in Afghanistan, launched mobile banking with two microfinance banks; Visa has a strategic alliance with ACCION International). There is also a perceived, and in some cases justifiable, concern that there is often a distinct power imbalance when individual MFIs partner with large companies. This is further complicated by the fact that many countries have only a handful of service providers like large retail-chain outlets, ATM vendors, and payment switches. This often makes it difficult for MFIs to negotiate arrangements that work for them and benefit their clients.

What's Needed

Third-party engagement with channel providers may well be one of the more challenging obstacles for MFIs to overcome. Part of what is needed is an appreciation from MFIs of the level of effort needed to properly manage third parties and dedicating a certain portion of an executive's time to do so. For example, contracts with providers are sometime signed chiefly based on the basis of the MFI's personal relationship or opportunistic encounter with the vendor, rather than through a formal process of issuing a request for proposal, applying selection criteria to assess vendors, and crafting a service-level agreement to ensure the ongoing health of the relationship. This due diligence takes time and effort. For their part, third-party providers need to appreciate that many MFIs may not have the same operational processes, technological platform, and

in-house expertise they are accustomed to when dealing with larger clients such as commercial banks.

When engaging large corporations, MFIs may also want to consider partnering with other MFIs before approaching the company. This not only helps with negotiating product terms and pricing, but may also affect the overall economics of the partnership (see the following *Channel Economics* section for an example). The advantages and disadvantages of "coopetition"—a relationship that involves both cooperating and competing with similar entities—do apply: for example, an MFI may lose competitive differentiation, but gains on price reduction. Yet in many cases, MFIs that work alone either risk a challenging relationship with a substantially more powerful stakeholder or may not be able to strike a mutually beneficial accord in the first place.

When engaging large corporations, MFIs may also want to consider partnering with other MFIs before approaching the corporation

7. Alternative channel pilots are rarely "quick and dirty"

Another reality of alternative channels is that it is rarely possible to run a quick pilot to obtain learnings from the market and inform product development. Compared to innovations like a new credit-scoring methodology or marketing promotion, many alternative channels are lengthy and costly to design and implement. This is particularly true if the channel requires significant IT development time or engagement with third parties. For example, an MFI cannot launch a banking agent program with a pharmacy chain in a matter of weeks; senior management must recognize from the start that a robust channel solution will require time and money to put-in-market and even then may or may not be successful. The stakes are thus high with channel projects. Even Vodafone, a large, resourceful company, spent nearly three years to understand the consumer and to design and launch the pilot, before rolling-out M-Pesa in March 2007.

A related point is that many alternative channels require "proof-of-concept" testing, where the overall innovation itself has not yet been verified (unlike "parameter" testing, where incremental changes are made to an existing product). This means that much of the functionality and customer value proposition need to be in place before going to market. It also means that it is difficult to isolate the variables that are creating success or failure in terms of adoption and usage. For example, if an MFI were to pilot a mobile banking service allowing clients to repay loans through existing savings accounts and found that resulting usage was low, it would be challenging to determine whether low usage resulted from lack of product awareness, insufficient training, poor product design, entrenched competition, or some other factor. An otherwise promising mobile-banking service thus might be abandoned, even though perhaps all that was missing was a personalized marketing campaign to increase adoption.

Alternative channels are still in "proof-of-concept" stage in the industry.

What's Needed

That alternative channels take time to implement is a reality. But MFIs can ensure that the pilot process is effectively run and is providing the right insights to guide the roll-out strategy. Senior management must have a long-term commitment to see the channels project through. Equity Bank's CEO, Dr. James Mwangi, is credited with driving a multi-channel strategy: the bank now

has 3 million customers, over half of the market share, and in just four years since the deployment of non-branch channels, nearly 75-80% of all transactions are through alternative channels.

At the same time, MFIs need to include frequent points in the process that allow them to assess the project and stop or hold it if necessary—say, if certain milestones have not been achieved—to save the MFI additional expenses and opportunity costs. Classic stage-gate new product development is one plausible way to proceed. It breaks down the entire process into six specific stages—discovery, scoping, business case, development, testing and validation, launch—with decision-gates after each one when senior management explicitly agrees to "go, hold, or kill" the project.

Rigorous experimental design helps maximize pilot learnings.

Adequate test design is another feature usually lacking in MFI pilots. MFIs often run pilots with only a vague idea of what outcome would constitute success, and they typically use a simple trial-and-error approach rather than experimental design. MFIs need to first determine the various hypotheses being tested (e.g., issuing prepaid cards for remittance payments will reduce branch congestion), specific success metrics to allow the MFI to quantitatively validate or disprove it (e.g., 10% reduction in average branch teller wait time), and reporting requirements to ensure that information is being captured (e.g., tools to measure average wait time).[4] Depending on the nature of the pilot, the MFI would ideally try to maximize learning by testing the channel with multiple "levers." In the previous example, the MFI might decide to test various combinations of card designs, price points, and marketing material, with the winning combination being the one that maximizes the pre-determined success metric(s).

These recommendations apply for all pilots, but are especially relevant for alternative channels, because they demand higher cost and time than other projects, are inherently proof-of-concept in nature, and call for major investment decisions, should the MFI decide to roll-out. For these reasons, MFIs should strive for greater rigor in the pilot process and product development.

8. Non-bank MFIs have inherent limitations on what channels they can deploy

Though a number of leading microfinance institutions are full-fledged banks (e.g., Compartamos in Mexico, Bank Rakyat in Indonesia, Equity Bank in Kenya) and many more are finance companies, the majority of MFIs are still unregulated, non-governmental organizations (NGOs). Organizational form other than banks encounter three main limitations in terms of launching alternative channels.

Being an NGO (and sometimes being a finance company) limits the types of financial services the institution can offer and thus curtails its ability to launch transactional payment channels. Because NGOs cannot legally offer savings accounts, they cannot offer useful services, such as account-to-account transfers, utility payments, or cash-in or cash-out transactions through retail-agent channels. Depending on country-specific legislation, NGOs may not be able to pay out

[4] If the MFI seeks additional rigor, it can validate the hypotheses using statistically significant sample sizes or randomized trials to measure the success metrics.

international remittances or collect insurance premiums. A narrow product line not only limits the client convenience offered through alternative channels but also makes economic viability more challenging for the MFI as there are fewer sources of top-line revenue and cost-savings that can be derived (see next section).

Second, the regulatory form of a financial institution has direct implications in terms of what channels an MFI can offer. In India, for example, the regulators permit only full-fledged commercial banks to offer mobile banking services and develop banking-agent programs; even regulated non-bank finance companies are not allowed to develop these channels. One of the reasons for mobile operators to partner with banks is "regulatory cover," but non-bank MFIs cannot provide this. Moreover, NGOs cannot be a member of the major payment networks, such as Visa and Mastercard, and can only access these networks through partnerships with member banks.

Non-bank MFIs are restricted in their options to offer various products and alternative channels.

Third, because NGOs and small finance companies have greater difficulty raising funding than full-fledged banks, it is harder for them to assemble the essential ingredients for implementing channel projects. In many cases, NGOs have greater difficulty attracting and retaining expert staff (in part due to lower salary levels), do not have budget to upgrade their IT systems,[5] and lack funds to grow to significant customer scale. Such limitations impact the human capacity, technology, and channel economics respectively, which, as discussed in other sections, are key aspects for successful deployment of alternative channels.

What's Needed

Despite these challenges, MFI NGOs can still offer alternative channels to their customers by creatively leveraging existing infrastructure and platforms.[6] FINCA Mexico has been piloting a Visa-branded prepaid card for loan disbursements through HSBC and allows its customers to withdraw at the bank's ATMs. FINCA Mexico owns the product design and takes advantage of the bank's built-in capabilities—such as card printing, issuance, and management—as well as its membership with Visa.

Even small, young NGOs can innovate with the breakthrough channels: Tujijenge, a small NGO in Tanzania that started in 2006, is piloting a scheme for disbursing and repaying loans under a certain amount through M-Pesa, a mobile money scheme developed by local mobile operator Vodacom (similar to M-Pesa in neighboring Kenya).

Leveraging existing infrastructure and platforms is one way non-bank MFIs can still offer alternative channels to their customers.

In lieu of formal savings accounts that are so crucial for transactional banking, MFIs may be able to design prepaid instruments as a "virtual" account that offer some of the same benefits as a

[5] A recent CGAP microfinance technology survey showed that out of those small MFIs that would like to upgrade their MIS, just under three quarters of respondents cited a lack of funding for doing so.

[6] MFI NGOs could also consider transforming to a regulated entity which would remove some of the restrictions covered in this section, though naturally other factors need to be considered before undertaking the transformation process. For more information, see *Transforming Microfinance Institutions* by Joanna Ledgerwood and Victoria White.

traditional bank account[7] in addition to requiring less documentation to open. For example, a prepaid card can be instantly issued at a retailer or branch and easily "loaded" with a certain value by the MFI (e.g., to disburse a loan), and it requires no statement processing and sending—all of which makes a prepaid card cheaper for the MFI issuer than traditional debit cards. The regulations concerning prepaid instruments and which entities can offer them are still evolving in most countries, and MFIs should analyze these to see if this is a possible channel they can use.

9. *Alternative channels make economic sense with a high volume of transactions*

As noted earlier, the emerging nature of channels means that it is challenging to forecast the economic viability of a given channel. In comparison, it is relatively straightforward to project the business cases for credit, savings, or to deploy additional branches, as cost estimates, average uptake, and benchmarks are readily available.

Capital expenditures for alternative channels are often relatively high.

What is clear is that the economic justification of a new alternative channel usually rests on high volumes of transactions. This is because top-line revenue or cost-savings (in the case of channels that have lower transactional costs than the standard channels) are relatively small per transaction, yet capital expenditures (e.g. software development, point-of-sale devices for retail agents) and variable costs (e.g., monthly fee for an EFT switch or call center services) can, in many cases, be comparatively high.

Most MFIs are at a particular disadvantage in this equation because their customer base is relatively small, and thus their volumes are low. Moreover, as mentioned earlier, they tend to have only one or perhaps two main products (e.g., loans and savings) to deliver through a new channel, and thus there is less additional value to be derived. Comparatively, an MFI would maximize economic benefits by offering a full suite of products through a new banking agent channel: domestic and international transfers, bill payments, basic investment services, and mortgage loan applications in addition to the more traditional services, such as loan repayments, new accounts, and deposits and withdrawals.[8]

What's Needed

Surprisingly, it appears that few MFIs conduct estimated financial projections to determine whether a proposed channel might be viable, or at least to understand under what conditions it will be. MFIs need to conduct simple but comprehensive financial modeling exercises to assess various alternative channels and their estimated return on investment. CGAP and other organizations representing the microfinance industry or those groups with experience designing financial modeling tools for microfinance, such as Microsoft Research India and MicroFin, could develop and disseminate channel-specific financial modeling tools for MFIs. MFIs also need to improve

[7] Some prepaid schemes even offer competitive interest rates and reward schemes, depending on the regulatory framework. Such instruments could be paper, Internet, card, or mobile-based, though in practice they are almost always the latter two for MFIs.

[8] For further discussion on the link between multiple products and economic viability for alternative channels, see Ignacio Mas, "The Economics of Branchless Banking," *MIT Innovations Journal* 4, no. 2 (Spring 2009).

their collection and management of operations data as input to these tools. For example, an MFI should track the fully loaded transaction cost at a branch teller so that it can be compared to an alternative channel.

If an MFI's low transaction volume makes viability more difficult to achieve, one obvious solution is to for the MFI to collaborate and attempt to distribute capital expenditures across multiple actors. Additionally, MFIs can leverage existing infrastructure and pay a per-transaction fee to reduce otherwise costly expenditures. In Tanzania, for example, which does not have a national switch, several MFIs have used both strategies successfully to gain access to a shared ATM network and distribute their own debit cards. Started in 2007, the "Umoja Switch" is a consortium of roughly ten microfinance institutions, managed by the third-party provider BCX, that manage and deploy ATMs around the country. MFIs pay a monthly fee to participate, and the ATM fees charged to the customer are distributed among the customer's bank, the merchant bank, and BCX.

MFI collaboration is also important to facilitate the business case for technology vendors and suppliers to customize products and services for niche market segments. Large technology providers rarely tailor specifications to microfinance because the scale requested is relatively low compared to the necessary R&D investment. MFIs, networks, or associations could play a catalytic role in aggregating demand. For example, many MFIs need ATMs that provide basic product functionality (e.g., withdrawals, pin change, account information) yet also need to be technically customized for base of the pyramid conditions (e.g., smaller, more rugged and secure, customizable screen for financial education, or biometric authentication or voice-activation). None of the major ATM manufacturers would design such an ATM for one-off demand from an MFI, but if a network or consortium could assess demand across several MFIs, it may well generate interest to pilot a specialized type of ATM.[9]

MFIs may consider collaborating with other like-minded MFIs to build sufficient customer scale and negotiate with technology providers.

10. Many MFIs do "reactive innovation"

Compared to companies in other sectors, such as telecommunications, pharmaceuticals, and fast-moving consumer goods, financial institutions historically have tended to be slower and more conservative in innovating, and this goes for microfinance institutions as well. In part, this is because MFIs have until very recently operated in uncontested market space in many countries where demand for financial services among their target segment easily outstrips supply. Why would MFIs launch untested, risky, and costly alternative channels if building branches and employing loan officers is a surefire method to acquire and retain customers? Is there truly an aspiration to massively increase outreach and radically decrease operational costs? Even if so, why should an MFI be the guinea pig for channels that may yet be unproven in the country or region?

As in other sectors, MFIs tend to innovate only when forced in order to stay competitive.

The most innovative MFIs, be it with channels or other new product offerings, are typically in the most competitive marketplaces—such as Bolivia, Peru, Uganda, Kenya, Serbia, and Indonesia—where innovation is imperative to stay ahead of competitors.[10] On the other hand, some MFIs,

[9] Core banking systems for MFIs have followed this path, and there are now specialized packages, such as MIFOS and Banker's Realm, expressly designed for the sector.

[10] Mobile operator-led mobile money projects, such as SMART Money in the Philippines and M-Pesa in Kenya, were initially developed as a way to offer a differentiated product to the market, but in these countries, where mobile

particularly those in their early-stages, may decide to prioritize business fundamentals and growth before exploring innovative channels.

For these reasons, MFIs have tended to be reluctant to move forward with innovative channels, even if some of the earlier obstacles have been, or can be, overcome.

What's Needed

Given the challenges involved with implementing alternative channels, it is clear that they should be pursued only if they directly address the strategic objectives of the institution. Some MFIs view deploying other channels as an additional project that may be desirable but that does not relate to its core business goals; it would be essentially innovating for innovation's sake. Yet in fact, in many cases it directly affects the bottom-line. Issuing a prepaid remittances card may be a good way to acquire new customers and drive top-line revenue; providing services through m-banking could reduce branch costs and support customer retention.

Channels innovation can, and should, directly impact the MFIs double bottom-line of financial and social impact.

Even some of the typical problems MFIs face may be addressed using channels. For example, in some congested urban centers, one factor for low savings balances is inconvenient or congested deposit points for the customer. Offering greater options for the client to pay may be one solution; WWB Ghana implemented a channel using savings collectors equipped with biometric, wireless POS devices who visit clients directly at their business; almost half of its savings portfolio is now through this channel. This is obviously not to imply that alternative channels are always tied to the institution's overarching goals, but it does mean that channels can be a strategic option that also happens to be innovative, rather than part of an isolated innovation agenda.

As mentioned earlier, the rate of channel innovation among MFIs appears slow; the less MFIs launch new channels, the less other MFIs feel the need to keep up. As competition increases for providing financial services to the base of the pyramid, MFIs can take a pro-active approach to differentiate themselves by offering channels that are cheaper, safer, faster, and simpler for the customer. At some point, the MFIs that gain first-mover advantages in this space will challenge other MFIs to develop similar strategies to stay competitive.

The table below summarizes the ten obstacles, and what is needed to overcome them.

Table 2: Obstacles and potential solutions to MFI's deployment of alternative channels

Obstacle	What's needed
1. Emerging Field	Development and dissemination of tools, case studies, and benchmarks; funding for the above.
2. Regulatory Frameworks	Regulatory assessment tools; risk-based policy. Closer collaboration/engagement between MFIs and regulators.
3. Customer Market and Adoption	Robust market research; detailed customer segmentation; client education strategy.

banking is more advanced, offering mobile money is now seen as a standard product offering that mobile phone users demand, with Globe in the Philippines, and Zain in Kenya, offering similar products.

4. Technological Infrastructure	Standardized, upgraded back-end. Collective action to create common infrastructure.
5. Human Resources	Dedicated project managers; cross-functional set-up; consultants where needed to fill in expertise gaps. Training and capacity-building for staff.
6. Third-Party Engagement	Guidance on engaging larger players; due diligence when choosing alliances. Partnership with like-minded MFIs to approach larger players.
7. No "Quick and Dirty" Pilots	Long-term commitment from senior management; clear stage-gated process on when to go/kill/hold. Adequate experimental design to maximize learning.
8. Organizational Form Limitations	Piggyback on existing platforms and infrastructure; specific solutions, such as prepaid accounts, to mimic transactional-banking capabilities. In longer-term, seek transformation to regulated financial institution.
9. Alternative Channel Economics	Clear financial model; collection and analysis of transaction data. Collaborate with others to gain client scale and drive tailored solutions to MFIs. Offer wider product range through channels.
10. Reactive Innovation	Clear link between strategic goals and channel options. Differentiate offer in marketplace to remain competitive.

The MFIs' Hidden Advantages in Channel Delivery

Despite the obstacles above, MFIs actually carry some distinct advantages that can and should make them compelling stakeholders and channel partners in innovative delivery systems for the low-income segment.

The first centers on what can broadly be described as **understanding the customer**. The MFI's front-end staff—loan officers, promoters, and tellers—are intimately aware of the needs and realities of the institution's low-income customer base. More than any other group, MFIs have the knowledge to design and market tailored products to increase adoption and usage through alternative channels. No other entity knows the financial needs of the base of the pyramid better than MFIs.

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Because of its high-touch model, MFIs are further able to **connect with customers**. For example, they are well-placed to provide training to poorer customers on using debit cards and ATMs or showing clients how to conduct transactions via mobile phone. As mentioned above, trust in the alternative channel is a key barrier to customer adoption, and, because of the MFIs personalized service, customers at the base of the pyramid tend to have a higher degree of trust in MFI staff than of other service providers that do not explicitly cater to that segment. Whether for sales, education, or customer service, "customer trust" makes for a compelling reason for third-party providers to enter into a partnership with MFIs when delivering their product to the low-income market segment.

MFIs have a close, trusting relationship with their clients – a key factor in adopting alternative channels.

Naturally, an MFI can fully leverage its close relationship with the customer and deploy the channel itself. It is quite plausible that an MFI's mobile-banking service would more likely garner more confidence among the low-income client base than a rival product provided by a large commercial bank or relatively unknown third-party provider (e.g., Txt 'n Pay in Ghana, Obopay in India). Mobile operators, however, are different; in some cases, dominant brands, such as Vodafone, MTN, and Telefonica, have high degree of trust among the masses.

MFIs have a major competitive advantage in developing banking agent networks, as many of these same retail agents are already the MFI's customers.

Knowing and connecting with the customer is especially relevant when it comes to implementing banking agent programs, as in many cases the small retail agents are themselves entrepreneurs and quite possibly the MFI's own clients. The **banking agent channel** presents a massive opportunity for MFIs. They know the entrepreneurs well, carry a long-standing and trustful existing relationship with them, and hold key financial data on the business through existing loan accounts. Information—such as cash-flow, liquidity, seasonality, goods and services offered, and profit margins—provides valuable criteria for banking agent selection and management. Moreover, the entrepreneur agent holds a loan product and possibly a savings account with the MFI, meaning that the underlying operational requirements for cash deposits, advances, or reconciliations as needed for banking agent transactions are already in place in some form.

Banks and non-bank service providers are increasingly viewing licensed MFIs are ideal partners, either through alliances or acquisition.

MFIs that are **licensed financial institutions** are well-positioned to partner with non-financial institution stakeholders, such as telcos, technology providers, payment networks, and retailers. In mobile banking, for example, mobile operators might decide to partner with regulated MFIs that offer savings accounts, handle cash, provide multiple sources of fund transfers through loans (disbursements and repayments), or that offer other financial products, such as remittances, insurance premiums, and government payments. In fact, two mobile operators have recently acquired equity stakes in MFIs precisely to expand their mobile banking product—Telenor Pakistan bought a 51% stake in the country's largest MFI, Tameer Bank, while Globe Telecom in the Philippines made a 40% investment in one of the savings banks of the Bank of the Philippine Islands.

Licensing is becoming increasingly important as more regulators insist that mobile banking initiatives either must be "led" by a bank or regulated financial institution or be done in coordination with one (such as the mobile operator-bank venture that BNP Paribas and Orange formed in order to offer mobile transfers in the Ivory Coast). Naturally, behind-the-scenes entities, such as technology providers (Fundamo) or payment networks (Visa, Mastercard), must partner with a financial institution to offer their products or services.

For the specific but growing case of mobile-operator-led mobile banking, **MFIs can use their branches** to be agents themselves[11] and assist with agent liquidity management. It is important to note that these need not be mutually exclusive to an MFI's existing mobile banking service; in

[11] There has been some discussion that MFIs can themselves act as channels to deliver other products to the base of the pyramid, from consumer goods like mobile phones and water filters to services like health care and adult education. For more information, see Alex Counts, "Reimagining Microfinance," *Stanford Social Innovation Review*, Summer 2008, www.ssireview.org/articles/entry/reimagining_microfinance/.

Kenya, for example, Equity Bank has its own mobile banking service called EAzzy 24/7 but also provides the "cash-in and cash out" service for Safaricom's M-Pesa mobile banking program. Because of the bank's impressive branch network coverage in both urban and rural areas, it also supports nearby M-Pesa agents with liquidity management.

The final hidden advantage is one which few MFIs have exploited: the massive volume of business-to-business (B2B) cash transactions that would be conducted through electronic payments. Almost all MFIs provide business loans to microentrepreneurs and to small and medium enterprises, many of whom are importers, wholesalers, distributors, and retailers that form the bulk of the often lengthy supply chains found in developing countries. As MFIs seek transaction volumes to make the channel economics viable, B2B transactions are a substantial source. One South American MFI estimated that nearly 80% of small-value supply-chain transactions in its country are handled in cash.

B2B transactions , many of which are between the MFI's own customers, represents a significant opportunity for the institution.

Conclusion

MFIs have an active role to play in alternative delivery systems to the poor. While challenges do exist, none of them are insurmountable, even though some may require a combination of time, investment, and innovative problem solving. Moreover, even though it is banks, mobile operators, large retailers, and payment providers that have grabbed headlines in serving the unbanked in innovating ways, MFIs have built-in advantages that make them compelling leaders, or ideal partners, in channel delivery.

Many of the more promising alternative channels will require building relationships, agreements, and alliances—sometimes with parties unfamiliar to MFIs—and thus multi-sector dialogue and collaboration will be a key skill that all stakeholders will need to enhance. Ultimately, MFIs and other stakeholders need to develop mutually beneficial channel solutions that both create business value for the institution and enhance the availability, accessibility, and affordability of financial services to the poor.

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