

# Looking Before You Leap

## Key Questions That Should Precede Starting New Product Development

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*Abstract:* Successful microfinance institutions (MFIs) ultimately will be those that are "market-driven." A key element of being market-driven is the development of client-responsive products. This paper outlines some of the basic questions and issues that MFIs should address prior to embarking on the product development process. Effectively conducted, systematic product development will result in products that are popular with clients and more cost-effective operations for MFIs. It will also contribute systematically to the long-term sustainability of MFIs.

### Introduction

The microfinance industry is one of the few remaining industries in the world that are primarily product- rather than market-driven. With the rising recognition of the costs associated with high levels of dropouts and their implications for achieving sustainability, there is a growing appreciation of the need to deliver client-responsive products. Increasing levels of competition in many markets have also highlighted the importance of

a market-driven approach to microfinance. There is little reason to doubt that the microfinance industry will follow the trend of the commercial world toward a market-driven approach and that microfinance institutions (MFIs) that do not respond to the needs of their clients will eventually fail.

Many MFIs are looking at new product development as a way to respond to their clients' needs. However, they often do not understand the complexity and cost of product development. This note suggests a few essential questions to ask prior to initiating new product development:

- Motivation: "Are we starting product development to make our MFI more client driven?"
- Commitment: "Are we setting about product development as a systematic process based on defined objectives?"
- Capacity: "Can our MFI handle the strains and stresses of introducing a new product?"

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- Cost Effectiveness and Profitability: "Do we fully understand the cost structure of our products?"
- Simplicity: "Can we refine, repackage and relaunch existing product(s) before we develop a new one?"
- Minimize Confusion, Complexity, and Cannibalisation:<sup>1</sup> "Are we falling into the product proliferation trap?"

Are we starting product development to make our MFI more market driven?

MFIs profess many motivations to undertake product development, and it is essential that the board, management, and staff involved in the process of product development clarify their motivations. With increasing levels of competition within the industry, many MFIs set about product development only to find new clients or retain existing clients whose needs or expectations have changed. Other MFIs initiate product-development activities in response to high levels of dropout among their clients. Still others develop new products to help leverage existing infrastructure, improve efficiency and profitability, or accommodate other institutional considerations. These are all good, indeed compelling, reasons for considering starting the process of product development.

Other less convincing reasons for initiating product development include getting access to the growing plethora of "innovation funds" available from donors and responding to the microfinance industry's current interest in product development. Effective product development is driven by an MFI's desire to become client responsive and rarely by external factors.<sup>2</sup> MFIs that develop products for reasons other than a commitment to responding to the market and becoming demand driven may well discover that they have entered into a more complex and time/resource-consuming process than expected.

On the other hand, MFIs have to live with the products they deliver, and the investment in developing client-responsive services may well be the most important and cost-effective one they ever make.

Are we setting about product development as a process?

As in the formal sector banking industry several decades ago, the microfinance industry is largely characterized by top-down or "bath-tub" product development. This model of product development typically consists of a senior manager having what appears to be a good idea in the bath and then instructing all branches to offer the resulting new product as of a specified date. Under this model, there is little or no market research, inadequate costing/pricing of the new product, no attempt to describe the product in clear, concise client-language, no pilot-testing, and no attempt at a planned roll-out of the new product. The introduction of the new product is simply dictated from above.

A top-down or bath-tub approach to product development can have expensive consequences—as many MFIs that have introduced products without following a systematic process have discovered. From Latin America to Asia, from Africa to Eastern Europe, MFIs have experienced significant and costly problems as a result of rushing new products into the market place without following a methodical set of procedures. These problems have arisen in such diverse areas as

- Limited demand for the new product (in some extreme cases, additional client drop-outs).
- Cannibalisation of existing products by the new one.
- Ineffective/inappropriate marketing of the new product.
- Set-up costs far in excess of those anticipated.
- Poor profitability of (or more specifically losses generated by) the new product.
- Management information systems unable to monitor or report on the new product.
- Poor product supervision by mid-level managers.
- Serious client problems when product alterations are made to address lack of profitability.
- Staff inadequately trained to market and deliver the new product.
- Distortion of staff incentives and thus their activities in the field.

Experience has repeatedly shown that investing small amounts up front in a systematic process of product development can save large amounts or generate larger amounts of business in the future. One step of the product development process leads to and informs the next and provides a reality check that insulates the MFI from subsequent problems. A proper process also provides the MFI an opportunity to correct problems or respond to issues while they are limited by the confines of each step.

What is the Process?

The product development process is a systematic, step-by-step approach to developing new or refining existing products:

1. Evaluation and Preparation
  - 1.1 Analyze the institutional capacity and "readiness" to undertake product development.
  - 1.2 Assemble the multidisciplinary product-development team, including "product champion."
2. Market Research
  - 2.1 Define the research objective or issue.
  - 2.2 Extract and analyze secondary market data.
  - 2.3 Analyze institution-based information, financial information/client results from consultative groups, feedback from frontline staff, competition analysis, etc.
  - 2.4 Plan and undertake primary market research.
3. Concept/Prototype Design
  - 3.1 Define initial product concept.
  - 3.2 Map out operational logistics and processes (including MIS and personnel functions).
  - 3.3 Undertake cost analysis and revenue projections to complete initial financial analysis of product.
  - 3.4 Verify legal and regulatory compliance.
  - 3.5 On the basis of the above, plus client feedback sessions, refine the product concept into a product prototype in clear, concise, client language.

3.6 Finalize the prototype for final quantitative prototype testing or pilot testing according to the risk/cost nature of the product.

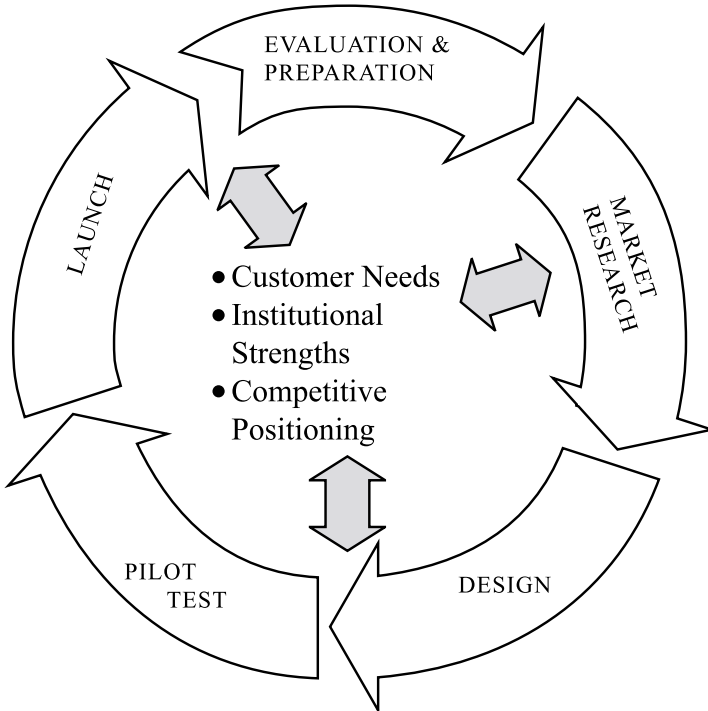
4. Pilot Testing

4.1 Define objectives to be measured and monitored during the pilot test, primarily based on financial projections.

4.2 Establish parameters of the pilot test through the pilot-test protocol, including sample size, location, duration, periodic evaluation dates, etc.

4.3 Prepare for pilot test, install and test systems, draft procedures manuals, develop marketing materials, train staff, etc.

### Systematic Product Development Process



- 4.4 Monitor and evaluate pilot-test results.
- 4.5 Complete recommendation letter that documents the results of the pilot test, do comparison with projections, identify lessons learned, finalize systems/procedures manual, and the initial plans for the roll out.
5. Product Launch and Roll Out
  - 5.1 Manage transfer of product prototype into mainstream operations.
  - 5.2 Define objectives to be measured and monitored during roll-out based on financial projections.
  - 5.3 Establish parameters of the roll out through the roll-out protocol, including schedule, location, tracking, budget, process.
  - 5.4 Prepare for the roll out, install and test systems, finalize procedures manual, develop marketing materials, train staff, etc.
  - 5.5 Monitor and evaluate roll-out process and results.

Can our MFI handle the strains and stresses of introducing a new product?

The process of product development consumes time and money. It often highlights opportunities or needs to change central elements of an MFI's systems. MFIs should therefore carefully consider before jumping into product development the questions "Are we really ready?" "Do we have the resources?" and "Are we really committed to this?" As a first step to answering these questions, the MFI should conduct a thorough institutional analysis.

#### Institutional Strategy

The institutional analysis should start with a review of the MFI's institutional strategy and the business plan to achieve it. The MFI should have a business plan that both includes, and specifically allocates funds for, product development. This requirement will necessitate the preparation and integration of the product development process into the cash-flow budget prepared with a business plan to document clearly the resources allocated to product development and the expected

returns. These business plan components set out the institutional priority placed on product development as a controlled and integrated part of the MFI's overall strategy.

#### Financial Viability

The MFI should also analyze its current and projected financial viability, including capacity for managing liquidity, insurance of full product costing of current products, and attainment of self-sufficiency. A new product can seriously affect financial viability and proper financial management, and an MFI should manage and track these key performance areas prior to embarking on any product development.

#### Organizational Structure and Philosophy

For effective product development, an MFI needs an organizational structure and philosophy that encompasses and encourages both a customer service orientation and a culture of innovation. This structure will require effective and efficient internal communications at all levels. Good communication allows the MFI to enforce conformity to standard procedures in branches (through the development and use of procedures manuals) with clear authority levels and successful delegation by management. In addition, the MFI will need a management culture of, and systems for, listening to its front-line staff with a view to optimizing client service. Finally, the MFI's board must have the commitment to customer service and the will to follow the product development process in a systematic and structured manner.

#### Human Resources

The MFI will also need the human resources to conduct product development in terms of the availability and experience of appropriate staff. Product development requires training of existing staff and therefore a strong training department or other training options. Low staff turnover will make the product development process easier and the process of testing new or refined products more valuable and informative. Finally, the MFI will need to dedicate high-quality management



resources to the product-development team to oversee and implement the process.

#### Marketing

An MFI serious about client-responsive product development will need to focus on marketing—to track progress of existing products, formally assess competition on a regular basis, and understand the MFI's strengths and weaknesses relative to that competition. The MFI should also regularly track the results of marketing efforts to assess their effectiveness.

Prior to initiating product development, the MFI should ensure that it has some marketing capacity available. The MFI should already possess skills in assessing client needs and satisfaction (including the institutional ability to perform qualitative research), tracking results of marketing and products, and evaluating its position within the market. This capacity can be in-house or (more rarely) can be contracted out to market research companies.

#### Systems

The MFI should complete a thorough review of its existing systems with a view to optimizing them in response to client needs and organizational efficiency goals prior to entering into product development. Current systems form the basis of new product systems, and so they should be capable, user-friendly, accurate, timely, and comprehensive in reporting and tracking. These features pertain to both electronic and manual systems. A process review of the systems assesses staff satisfaction with current systems, and analyzes the ability of the systems to deliver accurate, timely, comprehensive data to users. The system should encompass procedures for monitoring and auditing financial controls, including external audits as well as a manual or electronic system able to track financial and nonfinancial data by product and branch.

Current systems will require the flexibility to accommodate new products. Given that new products will create additional work for existing systems, these should have significant excess capacity available, or the MFI should plan to add this

additional capacity. Finally, it is important to note that in many cases new products will not only require modifications to the information systems but may also necessitate completely different delivery systems.

In summary, an MFI should already do the following before significant funds are expended on the new product development process:

- Practice the level of tracking and management required of a new product.
- Understand the capacity issues in all relevant departments,
- Have the will and full commitment of management and the board behind the process.
- Possess or have available staff and systems that can manage, implement, and develop the new product.
- Have the capacity to train all relevant staff.

Do we fully understand the cost structure of our products?

In view of increasing professionalism of MFIs and the competition in the MFI market place, it is essential that MFIs understand exactly how much each part of their operations costs in order to facilitate informed management decisions. Key decisions include how to increase profitability by cutting costs or increasing income; how to assess product-level performance, and if necessary modify the price of existing products; whether to accept and implement new products; and how to price new products.

Product costing on a simple allocation basis is a relatively straightforward exercise that provides the MFI with a wealth of information and activity-based costing, while more complex activity-based costing provides additional information on how and why costs are incurred. This information is of great value to management teams committed to cost-efficient operations and

- Determines the full costs of delivering products.
- Determines the profitability/contribution of the products, including over time.

- Assists making informed decisions about selection of products, including cost/benefit analysis.
- Promotes a high quality MIS.
- Facilitates development of cost/profit centres.
- Reveals hidden-costs.
- Instils cost-consciousness among product/service department managers—enhances productivity.
- Facilitates the pricing of current/future products.
- Provides a basis for business planning and investment decisions (such as which product to market etc.).
- Can be used as a basis for variance analysis (budget v. actual comparisons, and so forth).
- Provides important insights that help identify inefficient procedures.
- Facilitates reengineering processes and procedures used to deliver the MFI's products.

Can we refine, repackage, and relaunch existing product(s) before we develop a new one?

Product refinement fine-tunes or adjusts existing products, often with limited effect on the existing systems—for example, by changing the interest rate or marketing strategies of an existing product.

New product development is the process of developing a brand-new product—for example, a housing loan or a contractual savings product. Prior to starting the process of new-product development, MFIs should give careful consideration to options for refining, repackaging, or relaunching their existing products. Product refinement is considerably less expensive, time-consuming, and disruptive than new-product development. Market research often shows that MFIs simply need to change the way their staff talk about or describe an existing product to bring in new clients or retain those who might otherwise leave. This slight change is clearly one of the least disruptive forms of product refinement, since it requires only that the MFI invest in retraining staff and developing appropriate marketing materials. Similarly, refining smaller, client-sensitive

details of existing products can often yield significant results at a relatively low cost.

Opportunities for product refinement can arise from both the front- and back-office aspects of the existing product. For example, increasing the efficiency of the back-office staff or systems can have a significant effect on the demand for the product and the retention of clients. For instance, increased efficiency can result in faster loan disbursements in response to loan applications or decreased interest rate or fees as a result of cost reductions. Reengineering back-office systems is as much of an innovation as developing a new product, a fact that should be clearly communicated to those administering donors' innovation funds.

Upon completing the process of refining or repackaging an existing product—whether in the front-office, the back-office, or both—the MFI can relaunch the existing product. The relaunch provides an important marketing opportunity through which the MFI can demonstrate its demand-led approach and its commitment to meeting the needs of its current and future clients.

Are we falling into the product proliferation trap?

Product proliferation is increasingly common among some MFIs that try to tailor products to respond to individual market segments with specific needs. These MFIs can find themselves offering many slightly different loan products. A multitude of products often results in

- Confusion among front-line staff and clients.
- Complex delivery systems.
- Complicated management-information systems.
- Cannibalisation among products.

**MFIs Cannot Do Everything!**

When evaluating the diverse needs of clients, the MFI should recognize that it cannot design a product to respond to each and every individual specific need. The MFI should group the most common and prevalent needs and develop products in

response to them. The following variables must be considered when evaluating the most common needs among an MFI's clients:

- Time scale/duration/maturity of the product—short, medium or long term.
- Nature of deposits/repayments—small regular, small irregular or single/few lump-sums.
- Liquidity—the ease of access to savings/speed of disbursement of loan.
- Access issues—branch proximity/opening hours and numbers of withdrawals/concurrent loans.

One product can be marketed in many different ways to meet a variety of clients' needs. The MFI can market the same short-term emergency loan as an education loan to meet periodic school fees, a health loan to meet doctor's fees and medication, or a loan to allow clients to take advantage of an unexpected opportunity, to name but a few.

### Conclusion

Product development is an essential activity for market-responsive MFIs. As clients and their needs change, so the market-driven, demand-led MFI must refine its existing products or develop new ones. But product development is a complex, resource-consuming activity that should not be entered into lightly. This paper outlines some of the basic questions and issues that MFIs should address prior to embarking on the product-development process.

Recognizing all of the above, those MFIs committed to being market leaders and to responding to their clients must indeed conduct product development. Effectively conducted, systematic product development will result in products that are popular with clients (even in very competitive environments) and more cost-effective operations for MFIs. More client-responsive products will reduce dropouts, attract increasing numbers of new clients, and contribute substantially to the long-term sustainability of the MFI.

Indeed, in the long run, those MFIs that do not embark on a systematic product development process will suffer the fate of all businesses that do not respond to their clients' needs.

## Annex

### Selected Resources Available

Market research and product development have only recently become "hot topics" in MicroFinance and so there are relatively few resources available. That said, because they are now hot topics, the number of resources is growing. The best of those currently available are listed on the following page.

## Notes

1. Cannibalisation occurs when the introduction of a new product diverts sales from a company's existing products and when revenue is displaced rather than created.

2. However some product development is appropriately spurred by external factors, such as changes in the legal/regulatory environment.

Table 1:

Process Step	Resources Available
<b>Overview of the Product Development Cycle</b>	<ul style="list-style-type: none"> <li>• <b>Brand</b>, Monica, New Product Development for Microfinance: Evaluation and Preparation, <i>Microenterprise Best Practices Project, Technical Note # 1</i>, DAI, Washington, 1998.</li> <li>• <b>Brand</b>, Monica, Product Development Cycle, <i>Microenterprise Best Practices Project, Technical Note # 2</i>, DAI, Washington, D.C., 1998.</li> <li>• <b>Brand</b>, Monica, The MBP Guide to New Product Development, <i>ACCION International</i>, 2000.</li> <li>• <b>CGAP</b> Training Course on Introduction to Product Development, <i>CGAP</i>, Washington, 2000.</li> <li>• <b>Wright</b>, Graham A. N., Beyond Basic Credit and Savings: Designing Flexible Financial Products for the Poor, in <i>Micro-Finance Systems: Designing Quality Financial Services for the Poor University Press Ltd, Dhaka and Zed Books</i>, London and New York, 2000.</li> <li>• <b>Wright</b>, Graham A. N., Market Research and Client Responsive Product Development, <i>MicroSave-Africa</i>, 2001.</li> </ul>
<b>Market Research</b>	<ul style="list-style-type: none"> <li>• <i>MicroSave-Africa</i>, Market Research for MicroFinance (A Training Course), <i>MicroSave-Africa</i>, Nairobi, 2001.</li> <li>• <b>Wright</b> et al., Participatory Rapid Appraisal for MicroFinance, <i>MicroSave-Africa</i>, 1999.</li> <li>• <b>Wright</b>, Graham A. N., Market Research for MicroFinance-Letting Demand Drive Product Development, <i>MicroSave-Africa</i>, 2001.</li> <li>• <b>SEEP Network</b>, Learning from Clients: Assessment Tools for MicroFinance Practitioners, <i>USAID-AIMS</i>, Washington, 2000.</li> <li>• <b>Grant</b>, Bill, Marketing in Microfinance Institutions: The State of the Practice <i>Microenterprise Best Practices Project</i>, DAI, Washington D.C., 1999.</li> <li>• <b>Krueger</b>, Richard, Focus Groups: A Practical Guide for Applied Research, <i>Sage Publications Inc.</i>, California, 1998.</li> <li>• <b>Lee</b>, Nanci, Client-Based Market Research: The Case of PRODEM, <i>Calmeadow</i>, Toronto, 2000.</li> </ul>
<b>Concept Development</b>	<ul style="list-style-type: none"> <li>• <i>MicroSave-Africa</i>, Market Research for MicroFinance (A Training Course), <i>MicroSave-Africa</i>, Nairobi, 2001.</li> <li>• <b>Rutherford</b> Stuart, Raising the Curtain on the Microfinancial Services Era, <i>CGAP Focus Note</i>, Washington, 2000.</li> </ul>
<b>Refine to Prototype</b>	<ul style="list-style-type: none"> <li>• <i>MicroSave-Africa</i> and <b>Research International</b>, Market Research for MicroFinance (A Training Course), <i>MicroSave-Africa</i>, Nairobi, 2001.</li> </ul>
<b>Costing and Pricing</b>	<ul style="list-style-type: none"> <li>• <b>CGAP</b> Costing and Pricing MFIs' Products <i>CGAP Toolkit (draft)</i>, 2001.</li> <li>• <i>MicroSave-Africa</i> and <b>Aclaim</b>, Toolkit for MFIs -Costing and Pricing Financial Services, <i>MicroSave-Africa</i>, Kampala, 2000.</li> <li>• <b>CGAP</b> Setting Interest Rates on MicroFinance Loans <i>CGAP Occasional Paper</i>, Washington, 1997.</li> </ul>
<b>Quantitative Prototype Testing</b>	<ul style="list-style-type: none"> <li>• <i>MicroSave-Africa</i> and <b>Research International</b>, Prototype Testing Using Quantitative Techniques, <i>MicroSave-Africa</i>, Kampala, 1999.</li> </ul>
<b>Pilot-Testing</b>	<ul style="list-style-type: none"> <li>• <b>McCord</b> Michael and <i>MicroSave-Africa</i>, Planning, Conducting and Monitoring Pilot Tests for MFIs: Savings Products, <i>MicroSave-Africa</i>, Nairobi, 2001.</li> <li>• <b>McCord</b> Michael and <i>MicroSave-Africa</i>, Planning, Conducting and Monitoring Pilot Tests for MFIs: Loan Products, <i>MicroSave-Africa</i>, Nairobi, 2001.</li> <li>• <b>McCord</b> Michael and <i>MicroSave-Africa</i>, Planning, Conducting and Monitoring Pilot Tests for MFIs: MicroInsurance Products, <i>MicroSave-Africa</i>, Nairobi, 2001.</li> </ul>
<b>Roll out</b>	<ul style="list-style-type: none"> <li>• <b>McCord</b> Michael and <i>MicroSave-Africa</i>, Planning, Conducting and Monitoring Roll out for MFIs.</li> </ul>
<b>Useful websites</b>	<ul style="list-style-type: none"> <li>• <i>MicroSave-Africa</i>: <a href="http://www.MicroSave-Africa.com">www.MicroSave-Africa.com</a></li> <li>• <b>CGAP</b>: <a href="http://www.cgap.org">www.cgap.org</a></li> <li>• <b>MBP</b>: <a href="http://www.mip.org">www.mip.org</a></li> <li>• <b>AIMS</b>: <a href="http://www.mip/componen/aims.htm">www.mip/componen/aims.htm</a></li> <li>• <b>Bank Akademie</b>: <a href="http://www.international.bankakademie.de">www.international.bankakademie.de</a></li> </ul>