Microfinance Myopia

Lessons from the Mainstream

by Kim Wilson

Abstract: This essay attempts to remove the shades that blind the microfinance sector to the value of its customers and what its customers truly value. It proposes that the social agenda and financial health of microfinance institutions would be far more sound if we understood who our customers are, why they leave, what they really want, and the real business we are all in.

Introduction

Harvard Business Review published an article in 1960 that would forever change the way executives think about their businesses. The article, "Marketing Myopia," is a classic (Leavitt, 1960). Business school professors around the world still use it to pose a single question: "What business are you in?" This simple query is as applicable today in the world of dot.coms and virtual companies as it was when first published. It also applies to microfinance.

"Marketing Myopia" looked closely at a variety of businesses and industries that faded or nearly faded because they were oriented only to product and process. These were companies that failed to see how their customers actually used their products and services. For example, railway company executives claimed that they were in the railroad business, insisting

that their competitors were other railroad companies. They failed to see that they were in the transportation business. Soon enough, with the development of other transportation methods, customers found better value elsewhere: passengers defected to buses, freight customers to trucking companies. The railway industry was dying.

Industries guilty of marketing myopia have defined their businesses too narrowly, never seeing their product or service through the eyes of customers. Hollywood claimed it was in the movie business. When studios began to lose ground to television, executives were forced to see that they were in the entertainment business. These insights were both painful and slow to come.

Marketing myopia takes place for one reason: companies fail to see the solution that their products offer to users. Customers do not buy products; they buy solutions to problems. If a competitor offers a better solution, even with a completely different product, customers will defect to the better solution. The key, then, to avoiding marketing myopia is to see products or services through the eyes of customers—to see beyond the product to the solution that customers are seeking.

How does a business know if it is myopic? One sure way to tell, the article said, is to scan industry literature. If the information is primarily technical, the industry may be suffering from marketing myopia. For example, a 1960 publication of the petroleum industry (cited by Leavitt, 1960) might have predicted its near collapse. Telltale articles focused solely on production and the use of electronics in various processes. Not one article was devoted to marketing, sales, or customers. (The petroleum industry eventually realized that it was in the energy business, not the oil business.)

Is microfinance a victim of marketing myopia? One can easily check by reviewing current publications in microfinance.

Kim Wilson is Senior Advisor for Microfinance at Catholic Relief Services. Prior to working in the microfinance sector, Kim was a partner in a venture capital firm based in Boston.

Most focus on the "back room" aspects of microfinance: finance, accounting, forecasting, collections, and MIS. Some focus on social impact and training. None focus on marketing strategies or on face-to-face selling.

Just how damaging is our myopia? How does our focus on the back room instead of the front lines jeopardize sustainability and place our social agenda in peril? We need to declare war on attrition and recognize both the value of our customers and what our customers value. In so doing we will offer customers the financial services they desire and deserve; in other words, we will offer the solutions that solve our customers' problems.

The Main Event

Let us clear any vestiges of marketing myopia with a fresh look at our customers. We might begin with something we already know: our impoverished customers often use cash, our core product, to meet basic demands for food, shelter, and health, even though we often insist they use it only for business investment. They also use cash to meet the demands of

- Predictable, recurring events: managing the peaks and dips of income during the agricultural seasons; and replacing the income spent on school fees, marriage, or burying a family member.
- Crises: coping with the sudden death of a major income provider in the family, a flood, loss of home, famine, disease, or medical emergency.
- Asset creation: seizing opportunities to buy land, build shelter, purchase gold, or buy important equipment, such as a granary.
- Business opportunities: starting or expanding a microenterprise.

In conversations with poor people, Stuart Rutherford learned some very interesting things (2000):

- The poor need to convert small amounts of money into larger, more useful lump sums. This conversion occurs through savings and loans.

- The poor would like to save and borrow to help them solve a household problem or to support an income-generating activity.

Looking at these findings, we get a glimpse into how a customer perceives the problem that microfinance solves. Microfinance performs the service of time-shifting: borrowing money today to solve a problem today and paying the money back in the future, or saving money today for an event in the future. But the key is this: money is a solution. It is not the main event.

When attending a village bank or Grameen bank meeting, one might spend hours observing routines, rituals, and transactions. The credit officer is well versed in each of the details of the meeting. For the credit officer, the main event of the meeting is the cash transaction. But the main event for the customer is how the money he borrows solves his problem. He uses the money to buy oranges for his fruit stand, pay school fees, pay for a proper burial, or buy a small plot of land. His main events are the problems the money solves.

The Bottom Line

Understanding what the customer sees as the main event will shed light on just what business we are in; the main event occurs when money becomes the solution for a client's problem.

What Business Are We In?

When asking practitioners "What business are we in?" we may hear "the financial services," "the financial intermediation business," "the business of linking capital markets to the poor," "the lending business," or even the broad "improving the lives of the poor business." The truth is, we are in a sector broader than providing financial services but narrower than improving the lives of the poor.

Let us look at our business from the point of view of what our customers really value. They need loans; they need savings. But these products are a solution to a set of problems or an

avenue to opportunity. How well our customers manage their money has great bearing on how well they will manage those problems and opportunities.

We might locate ourselves in the family financial resources business. Our customers value the ways in which cash, appropriately time-shifted, can help manage household problems and household opportunities. Note that this is a serious departure from seeing our business as solely supporting microenterprise activities.

As a sector, microfinance has been competent at the product part of business. We offer loans and savings—even if through highly local methods—and more recently we have investigated insurance products. What we must now consider is the service part of our business. How can we effectively offer services that help customers plan which products work best to optimize cash flow?

If we conclude that our service is not loans (loans are a product) or savings, but family financial resources, we can benefit from what Stuart Rutherford observes. He concludes that only some of the financial resources used by the poor are dedicated to business opportunities. Other resources are applied to household needs, ranging from emergency needs to long-term asset acquisition, such as better housing (2000).

With this new self-definition, we might change our product slightly. Our marketing and outreach strategy might change. Our services might change and become less generic. Even our customers might change—from individual women to families. If microfinance tracks with business, we would see a reduction in attrition and a concomitant increase in both sales and profits, results rooted in a better understanding of the business that we are really in.

The Bottom Line

We must take the time to understand our value to customers and understand the business we are in—the business of family financial resources. The time we spend on assessing what our

customers value is time well spent and will effectively inform product, process, and marketing decisions.

Getting on Track

Recall the railway executives who thought they were in the railway business and failed to see that they were in the transportation business? They were off the track. If we assume we are in the family financial resources business and not in the savings and loan business, or the microenterprise support business, we might see that our current modus operandi is also off track.

The railway companies alienated customers by operating on strict schedules that suited rail workers and station managers, but not the customers, the passengers. The schedules offered set departure times and times to buy tickets, all established for the convenience of the company, not for the convenience of the customer. Bus companies started more closely meeting passenger needs. Customers switched. Train travel started to die out. While passengers fled to bus lines, commercial freight customers fled to trucking companies. The railroads lost again.

In microfinance, most of our programs offer loans according to our schedule. Customer payments must be made according to our schedule. Even internal accounts (village bank savings) are not always accessible to a customer's schedule for withdrawing savings.

It is possible that most of our former customers are not leaving for competitors; rather they are just leaving. This points to an even greater failure by microfinance to satisfy customer needs. At least the railway business could point to the bus companies luring customers. But to whom can we point? Are our products so rigid that customers leave regardless of whether there is competition or not?

The Bottom Line

If we continue to deliver our products on our schedule, and not on the schedule of our customers, we will miss the train.

What If Meeting Needs Costs More?

A 1990 study, published in the *Harvard Business Review*, showed that when a well-run service business reduces its attrition rate by just 5%, it increases profits 25% to 85%. One credit card company dropped its attrition rate by 5% and then saw an increase in profits of 125% (p. 107). The study, written by Frederick F. Reichheld and W. Earl Sasser, Jr., noted that in the credit card business, a "10% reduction in unit costs is financially equivalent to a 2% decrease in defection rate"(p. 108). Think about that: reducing attrition by 2% has the same cost impact on a credit company as reducing unit costs by 10%.

Meeting customer needs effectively and completely may cost more money in the short term. Products must be tested, systems put into place and evaluated, and so on. What happens to sustainability? If we do not carefully manage the reengineering of a product or service, our program can collapse. One good way to guard against disaster is to monitor costs. But we must keep in mind the powerful impact of boosting revenues. Increasing revenues does not necessarily mean increasing revenue per customer—though this is a powerful thing—but increasing overall revenues, and subsequently profits, through retaining all customers.

Again, if we want to sustain our success rate in retaining our customer base, we must return to our vision of our business. If we see our business as providing loans or fostering savings, we have defined our business generically. Price starts to matter. If we see our business as providing a solution and strive to improve the solution, then price matters less. Retaining customers relates to price sensitivity, or price elasticity.

Price elastic services are those services where price is important to customers. The prices stretch according to the customers' perceived value of the service. If customers believe the price is too high, they will switch to a competitor's services for a better price or will forgo the service altogether. Price inelastic services are services resistant to switching based on price. For example, our root canal surgeon may be providing a

price inelastic service. We are not likely to switch even if the brand-new dentist across the hall offers services for a little less money. On the other hand, telephone service is often price elastic; if my long distance phone service costs more than that of other carriers, I might indeed switch companies.

We hear program managers groan when government loan programs, hugely subsidized, enter the scene. They offer generic loans. "We can't compete," practitioners say. That is true, if we are in the loan business—we cannot compete. But if we are in the family financial resources business, maybe we can compete. If we are in the business of solving household financial problems, maybe we can compete. In other words, if we can distinguish our service as a better solution, we can compete.

The key to combating price elasticity is to transform generic services and products into unique services or products. Products and services become unique through patents, trademarks, brands and product features. But the best way to make a service unique is to commit to meeting and exceeding customer preferences. The more effectively needs are met, the more loyalty a customer has, and the more chances the service has to become price inelastic.

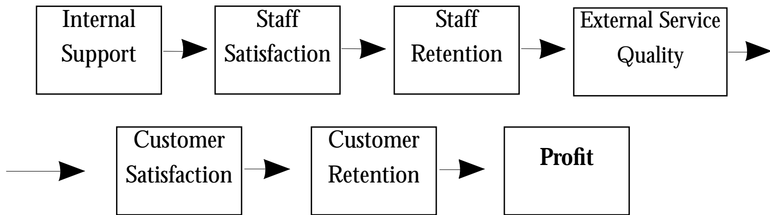
The Bottom Line

To retain customers, microfinance programs must transform from generic services into unique services, valued by customers.

Staff Satisfaction and Customer Retention

The service-profit chain (see fig. 1), a model conceived by Leonard Schlesinger and James Heskett of the Harvard Business School and published in the *Harvard Business Review* in 1991, has a central premise: employee satisfaction drives customer satisfaction and therefore profits ("Debate").

Figure 1. The Service-Profit Chain (modified for this essay)



Note that customer retention is a key to profit. Customer retention results from customer satisfaction, something driven by the perceived value of services. In a service company, staff are the main creators of value. Staff must be satisfied to create value.

Service company employees have ranked what they value most: (1) good training, (2) compensation based in part on performance, and (3) latitude to solve customer problems.

Service companies have found that if their frontline salespeople, technical staff, and managers have the authority to respond to customer problems, two things occur: (1) Staff feel empowered, they are more satisfied, and they stay with the business, which keeps staff turnover costs down. (2) The span of control (the ratio of staff to managers) increases from seven to twenty and sometimes to forty. In industrial companies—as opposed to high-performing service companies—the average span of control is about seven staff to one manager. By giving staff the training they need and allowing them to solve customer problems, service businesses have found that their spans of control can increase three to six fold. This increase far outweighs any extra costs that staff may have incurred to solve customer problems.

Also important to the service-profit chain is staff retention. Merck & Company found that staff turnover costs a company 1.5 times the average annual salary for the turned-over position

(Schlesinger & Heskett, 1991). This figure does not include the cost and effect of staff turnover on customer relationships.

The concept of the service-profit chain may apply to microfinance services. The following checklist may help to determine whether a program might be able to put these concepts into practice.

- ❑ What do our staff value? Empowerment? Autonomy?
- ❑ What is our program's span of control? Can we increase this ratio?
- ❑ Do staff have the latitude to solve customer problems?
- ❑ Do they have the training, ground rules, and guidance they need to respond to customer issues?

The Bottom Line

The service-profit chain demonstrates that staff satisfaction leads to customer satisfaction. To increase profitability, we should pay special attention to staff satisfaction.

What Customers Value

We have proven in microfinance that customers will pay for services that are new to cultures unfamiliar with long-term financing. No one in mainstream business ever believed poor, rural villagers would pay back loans or even be able to save. Yet clever, hardworking microfinance practitioners have demonstrated a true market where no conventional businessperson would have ever suspected one to exist.

Now what does this market really value? By "value" we mean, which benefits will this market pay for? Do customers value meetings? Do they value rules? Do they value quick access to cash? Do they value knowing how to optimize loans or savings? What about flexible loans? Accessible savings? Do they value a friendly promoter? Or doing the books? Or monitoring fellow villagers?

At the heart of the mainstream approach to service is this imperative: Examine the preferences of customers as customers, independent of operating systems or constraints.

Many microfinance program managers first look at how they do business now, and then they see how their programs might fit customer needs. When interviewing customers to understand preferences, managers are seeking a fit between what their programs offer and what the customers want. They look at MIS, accounting, credit methodology, constraints in promotion techniques, and so on. Rarely do they really look at what the customer values.

To illustrate the importance of what customers truly value, let us take an example from mainstream business. For years, fast-food restaurants assumed that customers valued wide menu selection, healthy food, many special promotions, and fancy equipment. One fast-food leader took the time to do a little research and found that customers valued three things, and three things only: (1) food quality, (2) service quality, and (3) physical appearance. That's all. Other features were nice but did not create value. In other words, customers did not want to pay for these other features.

The company then invested large sums to strengthen each of these three areas. Three things happened. First, the company became more efficient. Because it only had to focus on three things, it could eliminate the cost of all other features. Second, sales increased by 60%. Third, a decrease in costs plus an increase in revenues generated additional profits of 25%.

There are many ways to ask our customers what they value. The best way is to seek out our customers and listen. Whatever method we choose, we must not limit questioning to what we already offer or how we currently offer our services.

The Bottom Line

We must find out what customers value and engineer operations around these "domains" of value. This would help us eliminate unnecessary activities and reduce costs.

Why Customers Leave

In an interview, Michael Selbst, a marketing vice president for BankBoston, noted that businesses built on repeat business, such as credit card companies and banks, lose about 10–12% of their customers a year (August, 2000). These businesses are not subsidized, nor are they monopolies. Quite the opposite; they operate in fiercely competitive environments. At CRS our microfinance programs also experience 12–30% customer erosion per year. By contrast, we are subsidized, at least initially, and we often operate in the absence of competition. So how do we justify a similar attrition rate?

Do we know why our customers leave? Generally, we know that some move out of town, some die, some switch to competitors, some are asked to leave because of their poor performance, and some go back to meeting their needs the same way they did before using our services. They go back to tucking rice into bamboo and coins into piggy banks, and they go back to borrowing from relatives and moneylenders. It is quite possible, then, that our biggest competitor is "going-back-to-the-way-things were." But sadly, most microfinance programs do not routinely perform interviews to find out just why customers leave.

Mainstream commerce on the other hand, invests staff and money in studying why repeat business goes elsewhere. This kind of research has a very specific objective: to find out why customers leave and how their needs are being met now. For example, Staples, the office superstore, as profiled in a 1990 Harvard Business Review article, "constantly tracks defections, so when customers stop doing business there or don't buy certain products, the store notices it immediately and calls to get feedback." The article goes on to say "defection analysis can also help companies decide what service-quality investments will be profitable" (Reichheld & Sasser, p.109).

Savvy businesses use "defection" information to make important investment decisions. For example, if long lines at a bank cause customers to look elsewhere, the bank may invest

in more ATMs or more teller windows. If customers defect from a favored office supply store because prices are too high, the company may choose to cut prices or find better value alternatives. If customers move to a new airline because the wait for making telephone reservations is too long, managers may invest in a better phone system and more reservation representatives. Investments are made to improve processes that directly affect the customers' experience.

The Bottom Line

Like their mainstream counterparts, microfinance programs must study what motivates customers to leave. This information will help us to make wise investments to improve performance and increase profits.

The Value of Customers as Income Streams

As a sector, our proposition to donors is that financial services are essential services. Some go so far as to say that credit is a human right. However, when looking at attrition rates of 12–30% per annum, as cited in a recent survey completed by the Catholic Relief Services,[1] we face a dilemma. Either we are wrong about the importance of financial services in the lives of our customers, or we are not providing a service valuable enough to keep these customers.

Beyond our proposition to donors, attrition is alarming. Attrition holds us back from our mission of service to the poor. Moreover, it is expensive and can negatively affect sustainability.

Serious levels of attrition tell us that something is wrong. In the formal, industrialized financial sector, customers do not withdraw completely from financial services. Imagine we decide to stop using local banking services entirely, we decide to resume borrowing from friends and stashing cash under our mattress. This is hard to imagine. Because once we have access to financial services, we will probably want them for a lifetime. Yet much of our programming at CRS shows that customers are voting with their feet.[2] They are leaving our

programs even though in many instances no obvious alternative exists. We need to value customers more.

The "lifetime value of a customer" is a concept that cautions businesses to stop seeing customers as transactions. For example, a man walks into a used-Mercedes lot and is seen as a $20,000 sale by Ed, the owner. Ed markets his cars based on transactional thinking—using a slick, quick-sale approach. The customer buys the car but thinks Ed is pushy, vowing next time to shop elsewhere.

Now, imagine Ed does a bit of research and finds that the average used-Mercedes owner purchases a Mercedes every four years and that about 80% of this market does not move out of town. He also knows his first-time customer is 28 years old. Ed does the math. This first-time customer will probably purchase a used Mercedes eleven times during his life, generating commissions of $220,000. Assuming 80% of these customers stay in town, the potential income stream to Ed is $176,000 for each first-time customer.

How does this thinking apply to microfinance? If programs view customers as a source of monthly revenue, then each customer produces gross revenues of perhaps $3. But looking at a customer's lifetime value to the program, would it be fair to say that each is worth not $3, but rather $1,440 (assuming that each adult wants 40 years of financial services)? If a program holds steady at 5,000 customers but has an annual attrition rate of 20%, then in a single year, that program has lost $1.4 million of future income through attrition.

The Bottom Line

Each customer is a lifelong income stream *vital* to a microfinance program.

The Value of Customers as Profit Streams

Income streams are valuable to a business. Of course, so are profit streams. One study analyzed a number of service industries, including the credit card, auto servicing, and industrial

distribution industries. The study found that reducing defections of loyal customers by 5% can boost profits 25% to 85%. New profits came from increased purchases, higher balances, reduced operating costs, and new customer referrals (Reichheld & Sasser, 1990).

In microfinance, a customer's value over time is also of great importance. Imagine we conduct a cost/revenue analysis in one microfinance program. We track the monthly costs and income from a new customer that we have attracted into our program. During the customer's first year, she maintains an average balance of $75, paying about 3% interest monthly.

In that first year, our new customer brings us revenue of $2.25 per month for nine months. It costs us $2.50 to bring her into our program and get her ready for the first loan. She then costs $1.20 per month to maintain. Her annual profit contribution in her first year is $6.95.

If we follow similar logic in this customer's second year, the balance rises to $100. Costs remain steady at $1.20 per month, so she produces a profit contribution of $21.60. In her third year, if her balance rises again to $125, her profit contribution is $30.60.

The Bottom Line

For companies wishing to stay vital and profitable, retaining current customers is essential to reaching those goals. Microfinance programs must track dropouts and focus substantial investment on retaining current customers.

Conclusion

The chief enterprise of microfinance to date has been the delivery of credit to microentrepreneurs. Recently, we have seen growing interest in offering more flexible services, but we have not gone far enough. Too often, changes have been slow, incremental, and straitjacketed by managerial dogma. Rigor mortis has set in. Microfinance institutions lack the drive to operate creatively and the mandate to respond to customers. Orthodoxy rules.

Managers, it seems, prefer to please customers only to the extent that their current systems can handle customer satisfaction. They gear systems to stem the cost of delinquency, but not the cost of attrition—the cost of lost customers. In fact, so little attention is paid to attrition that it is hard to find good data on why customers leave. But our myopia cannot last indefinitely. If systems are not redrawn to support more satisfied customers, our institutions will continue to see the revolving door of customers spin. The cost of lost revenues will advance unchecked. Eventually, we may run out of customers.

We must launch a full-scale attack on attrition. We must radically depart from how we see our business, the business of microfinance, by looking beyond our systems to our customers. In doing so we will benefit from greater revenues and greater profits. We must offer not just a product, but a solution. When we solve a customer's problem, we become an integral part of that customer's life.

Focusing on customers may necessitate reengineering what we do. It may mean developing new systems to give frontline staff more latitude in making decisions. It may mean investing in different MIS to manage loans and savings that support the full complement of a household's financial needs. Whatever it means, if we manage the process well, we will most likely see an increase in growth. Customers will stay with us longer. They will refer new customers to us. We will spread initial marketing costs over more and more people. We will hold on to our more profitable customers, those with higher balances, and will benefit from the revenues they bring. But most important, focusing on our customers places our mission front and center, giving us a greater promise of offering the poor the services they value.

Notes

1. These figures are based on CRS Poverty Lending Status reports and reports from several organizations during the SEEP 2000 annual meeting.

2. CRS Poverty Lending Status reports (1998–2000) indicate attrition levels of at least 12% and usually more. Some organizations report up to 30% but are really "not sure" because attrition is not tracked.

References

Debate: how does service drive the service company? (1991, November/December). *Harvard Business Review*, 146–158.

Leavitt, T. (1960). Marketing myopia. *Harvard Business Review*,

Reichheld, F. F., & Sasser, W. E. Jr. (1990, September/October). Zero defections: quality comes to services. *Harvard Business Review*, 105–111.

Rutherford, S. (April 2000). *The poor and their money.* New Delhi: Oxford University Press. Chapters 1, 2 and 7.

Schlesinger, L. A., & Heskett, J. L. (1991, September/October). The service-driven service company. *Harvard Business Review*, 71–81.