NGO Transformation
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by

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NGO TRANSFORMATION

With the creation of BancoSol in 1992, the microfinance industry witnessed the birth of a new trend in institutional development: the transformation of non-governmental organizations (NGOs) into regulated financial institutions. While not embraced by all, institutional transformation has become the strategic end-objective of a large number of microlending NGOs. The concept was born over a decade ago out of the twin goals of exponentially increasing the number of clients with access to microfinance and reducing donor dependence. These two goals have driven the industry toward greater integration with the formal financial sector, leading a large number of NGOs to consider transformation into privately owned, regulated entities.

The term “transformation” is used generically in this chapter to reflect the institutional process of change that occurs when microfinance NGOs create or spin off regulated microfinance institutions (MFIs). While other forms of institutional transformation are feasible, such as transformation from a public entity to a privately owned MFI, this chapter solely addresses the issues specific to an NGO’s transformation into a regulated commercial MFI, the most prevalent form in the microfinance arena today.

This chapter summarizes the findings and preliminary lessons learned from microfinance NGOs that have created privately owned, regulated MFIs. It begins by looking at the institutional characteristics of these pioneering NGOs, and outlines the reasons why a non-profit NGO would consider transforming into a for-profit, regulated financial institution. Through a close examination of the transformation process among organizations from Asia, Africa and Latin America, the chapter highlights the key issues associated with transformation.

THE TRANSFORMATION LANDSCAPE—WHO IS TRANSFORMING?

Of the 7,000 NGOs providing microfinance services to poor entrepreneurs throughout the world, only a minute percentage has initiated transformation into privately owned, regulated MFIs. Table 1 captures basic information on seven transformed MFIs. As evident from the table, NGO transformation is not limited to a certain type of lending methodology, or determined by a certain outreach level or portfolio size. It is, however, initiated only by those institutions that have achieved cost recovery in their operations and have made a commitment to expand outreach.

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1 This chapter summarizes key findings from the MicroFinance Network’s Occasional Paper #4, Institutional Metamorphosis.
Table 1: Statistics for MFIs at the Time of Transformation

<table>
<thead>
<tr>
<th>NGO name</th>
<th>PRODEM</th>
<th>AMPES</th>
<th>PRO-CREDITO</th>
<th>CARD</th>
<th>ADEMI</th>
<th>ACP</th>
<th>K-Rep</th>
</tr>
</thead>
<tbody>
<tr>
<td>New financial institution</td>
<td>BancoSol</td>
<td>Financiera Calpiá</td>
<td>Caja Los Andes</td>
<td>CARD Rural Bank</td>
<td>BancoADEMI</td>
<td>Mibanco</td>
<td>K-Rep Bank</td>
</tr>
<tr>
<td>Date of transformation</td>
<td>Feb '92</td>
<td>Jul '95</td>
<td>Jul '95</td>
<td>Sept '97</td>
<td>Jan '98</td>
<td>May '98</td>
<td>Sept '99</td>
</tr>
<tr>
<td>Country</td>
<td>Bolivia</td>
<td>El Salvador</td>
<td>Bolivia</td>
<td>Philippines</td>
<td>Dominican Republic</td>
<td>Peru</td>
<td>Kenya</td>
</tr>
<tr>
<td>Transformed institutional structure</td>
<td>Commercial bank</td>
<td>Financiera⁴ (Finance Company)</td>
<td>PFF⁵ (Finance Company)</td>
<td>Rural bank</td>
<td>Development bank</td>
<td>Commercial bank</td>
<td>Commercial bank</td>
</tr>
<tr>
<td>Lending methodology</td>
<td>Solidarity groups</td>
<td>Individual loans</td>
<td>Individual loans</td>
<td>Grameen Bank replica</td>
<td>Individual loans</td>
<td>Individual loans &amp; solidarity groups</td>
<td>Solidarity groups</td>
</tr>
<tr>
<td>No. of active borrowers of NGO at transformation</td>
<td>22,743 (12/31/91)</td>
<td>7,769</td>
<td>12,662</td>
<td>10,868</td>
<td>18,000</td>
<td>32,000</td>
<td>13,201 (12/31/98)</td>
</tr>
<tr>
<td>Value of outstanding loan book at transformation</td>
<td>$4.5 million (12/31/91)</td>
<td>$4.4 million</td>
<td>$4.2 million</td>
<td>$1.7 million</td>
<td>$30.3 million</td>
<td>$14 million</td>
<td>$3.3 million (12/31/98)</td>
</tr>
</tbody>
</table>


¹ The Colombian NGO Corposol transformed into a regulated finance company, known as Finansol, in 1995. The major crisis experienced by the institution in 1995-1996 and the subsequent restructuring into FINAMERICA, S.A., however, make its numbers incomparable to those of the other MFIs included here. For further information on the Finansol crisis, see Chapter 4.

³ Refers to date of official opening/operation as a formal financial institution.

⁴ A financiera is a type of commercial finance company prevalent in Latin America.

⁵ The Private Financial Fund (PFF) category, a type of commercial finance company, was established in Bolivia by Executive Decree in April 1995. PFFs are allowed to provide money transfers, to offer foreign exchange services, to receive savings and time deposits, and to contract obligations with second-tier institutions. They are restricted from offering checking accounts, foreign trade operations, equity investments, and security placements.
Other recent NGO transformations include the following:

**PRODEM (Bolivia)**—PRODEM, the founding NGO of BancoSol in Bolivia, underwent a second transformation in 1999 when it established a Private Financial Fund (PFF) to absorb all its lending activities. The remaining NGO is focusing on business development services.

**ACLEDA (Cambodia)**—The Association of Cambodian Local Economic Development Agencies (ACLEDA) was established in 1993 as a national NGO, funded primarily by the ILO and UNDP. With assistance from UNDP, USAID, and MPDF/IFC, a three year program for transformation commenced in 1988, culminating with the granting of a commercial bank license in October 2000.

**Compartamos (Mexico)**—Compartamos began operations as an NGO in 1990 in the rural areas of Mexico using a village banking methodology. In 2001, Compartamos transformed into a *Sofol, Sociedad Financiera de Objeto Limitado*, a limited liability finance company, with the remaining NGO, Compartamos AC, retaining 36% in the new commercial entity. At year end 2000, Compartamos had over 64,000 active clients located in the rural areas of 10 Mexican states, as well as Mexico City.

**FINSOL (Honduras)**—In June 1999, a group of private investors established FINSOL as a *sociedad financiera*, becoming Honduras’ first private microfinance institution. The microlending portfolio of FUNADEH, a Honduran nonprofit established in 1983, was transferred to the newly created FINSOL via loan renewal, making FUNADEH the principal owners of the new institution. FINSOL provides individual and solidarity group loans.

Transformation is a relatively new phenomenon. Of the seven presented in Table 1, four have received their bank license only in the last four years. As such, some of these recently transformed MFIs are still transitioning between NGO and formal financial institution at an operational level, and in some cases, at organizational and financial levels as well. In CARD’s case, for example, the NGO branches are being transferred to the new bank structure over a period of a few years. While it is too early to evaluate the overall financial health of most of the above institutions, Table 2 highlights key indicators of three MFIs that have at least six years of experience behind them.
Table 2: Current Statistics of Transformed MFIs

<table>
<thead>
<tr>
<th></th>
<th>BancoSol</th>
<th>Caja Los Andes</th>
<th>Financiera Calpiá</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Bolivia</td>
<td>Bolivia</td>
<td>El Salvador</td>
</tr>
<tr>
<td>No. of active clients</td>
<td>Dec ’95</td>
<td>Dec ’99</td>
<td>Dec ’95</td>
</tr>
<tr>
<td></td>
<td>63,038</td>
<td>73,073</td>
<td>16,000</td>
</tr>
<tr>
<td>Gross loan book (in US$ million)</td>
<td>$37</td>
<td>$82.3</td>
<td>$6</td>
</tr>
<tr>
<td>Value of savings (in US$ million)</td>
<td>$30</td>
<td>$54.9</td>
<td>N/A</td>
</tr>
<tr>
<td>Av. outstanding loan balance</td>
<td>$588</td>
<td>$1,126</td>
<td>$375</td>
</tr>
<tr>
<td>ROA (Net income / Average assets)</td>
<td>1.35%</td>
<td>1.38%</td>
<td>N/A</td>
</tr>
<tr>
<td>ROE (Net income / Average equity)</td>
<td>9.02%</td>
<td>9.44%</td>
<td>7%</td>
</tr>
</tbody>
</table>


**Objectives in Transformation—Why Transform?**

Common objectives of NGOs that have created privately owned MFIs to date include: access to commercial capital, the ability to mobilize local savings, expanded outreach, and improved customer service. In general, the institutions have thus far shown success in meeting their principal objectives, although not to the extent previously expected.

**The Institutional Perspective**

For MFIs that adhere to the financial systems approach to microenterprise development, transformation into a formal financial institution is a natural progression, as it is viewed as the only means to attain self-sustainability and profitability. For MFIs that began more as international development projects, transformation may be a way to expand outreach and increase development impact. Regardless of the origins of the microfinance institution, given an amenable regulatory environment, transformation into a formal financial institution can offer many benefits not available to unregulated non-governmental organizations.

**Access to Commercial Capital**

While most microfinance NGOs offer loans at or above market rates and are approaching profitability, few are able to access capital markets as needed for loan portfolio expansion at a reasonable cost. Benefits of this access include the ability to source capital more rapidly and increased leverage.
**Reduction in capital shortage risk:** Transformation may be the only viable alternative for an MFI to continue its rate of growth. While donor funds may be sufficient for initial start-up capitalization needs, MFIs tend to grow quickly and require greater and more rapid access to sources of loan capital. An MFI’s ability to quickly access capital from diversified funding sources, including the discount window at the central bank can reduce the risk of a liquidity shortfall, which can lead to an institutional crisis.

**Leverage:** As unregulated microfinance institutions, NGOs in general have not been successful at leveraging their equity base. Even those NGOs that have accessed commercial funds are rarely able to leverage more than $1.00 or $1.50 for each dollar of equity, a serious impediment to MFIs experiencing rapid growth. Without some form of guaranty facility, commercial banks are reluctant to lend amounts much greater than the net worth of the unregulated MFI. As a regulated financial institution, however, the MFI is subject to ongoing supervision by a regulatory authority, providing depositors, commercial investors and other banks a greater sense of security. As such, the MFI has the potential to leverage its equity up to 11 times, the limit prescribed by the Basle Convention, the international capital adequacy standard for regulated financial institutions. For every dollar of equity, the regulated MFI can fund $12 of assets. However, most regulated MFIs have not obtained such high leverage, due to the higher risks typically associated with a microloan portfolio. BancoSol, which obtained its banking license in 1992, has maintained a relatively constant leverage ratio since 1994, fluctuating between 5 and 6.

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7 The Basle Convention requires an institution’s equity be no less than 8% of its risk-weighted assets.
8 The 1:12 ratio of capital to assets does not represent an absolute ceiling, due to the range in risk weightings among different categories of assets, e.g., loans to government (0%), retail mortgages (50%), as prescribed by the Basle Convention. As such, the ceiling that is consistent with maintaining the 8% capital adequacy ratio will ultimately depend on the institution’s mix of assets.
Ability to Attract Savers

Regulatory policies in most countries prevent non-profit, unregulated organizations from collecting local savings, as there is no way to insure deposits placed at an unregulated institution. In such cases, only by becoming registered as a formal financial institution can an MFI gain access to this most stable capital base, voluntary local savings deposits.\(^9\)

The ability to mobilize local savings is a significant advantage to microfinance institutions for several reasons. Savings mobilization can increase the number of clients served, improve customer satisfaction, improve loan repayment, stabilize sources of funds, and improve governance of the MFI.

*More clients served:* MFIs can reach more clients by offering savings services. Experience has demonstrated that low-income people can and do save, and that they will entrust their savings to formal financial institutions if they are provided security, convenience, liquidity, and positive rates of return.\(^10\) Transforming MFIs have the benefit of a base of loan clients from which to begin marketing savings services. Furthermore, many people dislike or fear becoming indebted and prefer self-financing, which can be facilitated by access to savings services.

*Customer satisfaction:* MFIs can better serve clients by offering savings products, specifically designed to suit their needs. Potential benefits to clients include: i) liquidity; ii) savings for investment and interest earnings; iii) savings for consumption purposes not usually eligible for loans by MFIs, since they do not generate an income stream; iv) lower transaction costs by increasing geographical access and convenience to savings products; v)

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\(^9\) A number of unregulated microfinance programs require compulsory savings from clients as part of their methodology. These savings are used by the program as a loan insurance fund, as a way to mitigate default risk. Clients typically do not have access to these savings until they leave the program. As such, compulsory savings represent a component of the loan guarantee and are distinct from voluntary savings.

\(^10\) Robinson, 1994a.
replacement or supplement to credit; vi) increased access to credit through use of savings as security or down payment on a loan; and vii) confidence that their savings are secure.

*Improved loan repayment:* Clients can use their accumulated savings to make loan payments as necessary to cover periods of low income. In addition, clients can use their deposits to secure loans, allowing them to leverage their assets and increasing their level of commitment to repayment. Both of these measures can improve loan repayment.

*Stabilize sources of funds:* Over the long term, mobilizing savings can build a more dependable source of capital funds for MFIs, reducing the need for external funds and offering stability in times of crisis. In fact, low-income earners tend to increase savings in sound financial institutions in times of crisis to guard against potential future income shortages. During the recent financial crisis in Asia, BRI’s rural unit desa clients continued to save. Between 1996 and 1999, the number of accounts increased by 50% from 16.1 million to 24.1 million. In rupiah, the savings more than doubled during the crisis, although the real value of clients’ savings decreased substantially from US$3 billion to US$2 billion.11

*Improved governance:* Savings mobilization can improve the governance of a microfinance institution since it heightens the board and management’s client orientation and requires a higher level of supervision and oversight. This can build local ownership and commitment to the success of the institution, as clients gain confidence in and establish a closer relationship with the MFI.

Unfortunately, few transformed MFIs have taken full advantage of their ability to mobilize savings. One reason for this is the dominating influence of the NGO’s original lending culture, and any cultural shift requires MFI managers and staff to become more familiar with local markets and to shift from the social service perspective typical of an NGO to a customer service orientation appropriate for a financial intermediary.

In addition, transforming MFIs must weigh the benefits of savings mobilization against the costs. The development of savings products is expensive and complex, requiring high levels of liquidity and risk management skills, as well as an understanding of the local economy. The addition of savings products is often more difficult than the addition of loan products. It requires the development of new policies and procedures, additional regulation and security, staff training and evaluation, management information system changes, promotional materials and marketing. It is often more efficient for microfinance institutions to mobilize savings only after achieving a scale sufficient to offer savings products cost-effectively.

The impact of savings mobilization on an MFI cannot be overstated. The addition of savings products usually leads to an increase in loan sizes, as borrowers leverage their savings to access larger loans. While there are relatively few MFIs that mobilize savings currently, those that do often serve far more clients through their savings products than their loan

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products. The most impressive example is BRI’s MicroBanking Division, which serves almost ten times as many clients with its savings services as with its lending operations.12

Improved Customer Service

The benefits of transformation do not rest only with the microfinance institution. For NGOs founded on the vision of providing quality service to significant numbers of low-income entrepreneurs, one of the most convincing reasons for transformation is improved customer service. As markets become more competitive, such as in Bolivia and Bangladesh, microfinance institutions must pay more attention to their customers’ needs and desires to retain their market share. Otherwise, MFIs risk losing customers to the competition. MFIs can encourage customer loyalty by offering competitive interest rates and by providing quality products and services. Transformation allows MFIs to offer the widest array of products and services to meet customer needs at one convenient location. Over the long term, keeping existing customers satisfied is by far less expensive to the MFI than the cost of identifying new customers to replace them.13

Expanded Outreach

All of the benefits of transformation described above tie in to the bottom-line benefit of allowing an MFI to expand its outreach and grow its loan portfolio. Guided by a social mission of providing financial services to large numbers of low-income clients, many MFIs consider transformation as a way to expand outreach to the target market. By providing increased access to cheaper sources of funds, transformation enables the MFI to increase market penetration, open new branches, and increase its loan portfolio. Additionally, by offering new products, such as savings services, the transformed MFI can expand its client base and more fully serve its existing clientele. Caja Los Andes expanded outreach from 12,662 to 36,815 clients and increased its outstanding loan portfolio from $4.2 million to $35.8 million from the time of its transformation on July 10, 1995 to end of December 1999. Calpia began taking deposits in late 1996. In 1997, it had 5,183 accounts, which grew to 18,979 in 1998. By December 2000, Calpia had savings accounts totaling $14.8 million. Likewise, between 1992 and 1999, BancoSol increased its number of active borrowers from 26,200 to 73,073 and expanded its outstanding loan book from $8.8 million to $82.3 million.

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12 BRI reported 24.2 million savings clients and 2.5 million loan clients as of December 31, 1999.
Leading microfinance visionaries, practitioners, donors, technical assistance providers and researchers have espoused beliefs that transformation would lead to increased commercialization and integration of MFIs into the formal financial sector. This vision implies not only increased access to capital markets, but also the transfer of ownership to private investors with strong vested interests.

Private Sector Ownership

The involvement of private investors, with their own capital at risk, can enhance the internal control and governance of the MFI. Unfortunately, transformation has only attracted a small amount of private sector ownership to date. While all of the transformed NGOs in this study involve some form of private sector investment, this has typically represented only a small part of the overall ownership structure of the transformed institutions. Private sector ownership of these MFIs is comprised of individual and corporate investors, and employee stock ownership plans. However, despite the addition of private sector investors in transformed MFIs, public development agencies and non-profit organizations remain the largest investors in most transformed MFIs.

Specialized equity funds, such as ProFund, the ACCION Gateway Fund, and Internationale Micro Investitionen AG (IMI)\(^{14}\), are not pure private investors, yet they play an important role in the transition toward increased commercial investment in microfinance. While primarily capitalized by the public sector, these funds are managed and treated as private commercial money. If successful, these funds will demonstrate that investing in MFIs is viable and will divest their holdings to pure private investors.

Improved Governance and Accountability

With the involvement of new owners/investors, transformation usually requires a revision of the governance structure. This revision allows the MFI to renew the board’s commitment to the institutional mission and to reinforce its long-term strategic plans. The NGO board often chooses the owner mix with the desired board member characteristics in mind, while balancing the commercial and social objectives. Regulatory requirements can also influence the strength of the governance and internal control structures.

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\(^{14}\) ProFund is an investment fund created in 1995 to support the growth of regulated, efficient financial intermediaries which serve the Small and Micro enterprise market in Latin America and the Caribbean. ACCION International Gateway was created in 1997 to support MFIs through debt or equity investments in new regulated MFIs; nonprofits in the process of transformation to a regulated financial status; and already established, regulated MFIs. Internationale Micro Investitionen AG (IMI) was initiated with 51% ownership by the German private consulting firm, IPC. In 1999, however, IPC owned less than 20% of IMI, following subsequent investments by other public sector entities.
The specialized equity funds mentioned previously do help compensate for the lack of private sector representation on MFI boards, as they tend to have a strong interest in overseeing both the commercial and social objectives. Despite holding minority ownership position, these funds make an important contribution to the governance of microfinance institutions by linking technical advice and ownership. This unique link ensures that the providers of influential advice have a financial stake in the MFIs they are advising.

NGO investors tend to place a heavier emphasis on the fulfillment of the social mission than the commercial objective, in line with their original reason for engaging in microfinance. The Corposol/Finansol crisis, as described in Chapter 4, offers one example of the governance limitations of controlling ownership by the former NGO, particularly when the NGO is a majority shareholder and there remains a strong operational link between the NGO and the new bank. NGOs can fulfill their governance role only if they apply high professional standards and technical expertise to analyze and interpret the MFI’s financial evolution. Board members representing the NGO should be prepared for the increased time commitment required to successfully oversee a regulated MFI.

**KEY ISSUES IN TRANSFORMATION**

The creation of privately owned, regulated MFIs is technically defined by two distinct events: the granting of a license by the central bank and the introduction of ownership through stock issuance. A third, more evolutionary phase of the transformation process is characterized by a multitude of organizational development changes.

**Integration into formal financial system: the licensing process.** The licensing process typically proceeds in one of two ways. MFIs either select an appropriate institutional structure from current banking legislation, or work with the supervisory agency to enact special regulatory legislation for institutions providing microfinance services, such as defining a category for non-bank financial institutions.

**Ownership and governance: implications of stock issuance.** By definition, NGOs have no owners; they are typically capitalized with grants and donations. With transformation, the new MFI’s capital base expands from donated equity and retained earnings to include share capital, creating an ownership base of individuals or entities seeking some form of return. In addition to the founding NGO, new owners typically include some combination of international development funds, employee stock ownership programs, and, in some cases, local private investors. A board is usually formed by representatives of the new shareholders, establishing a link between ownership and governance.

**Organizational development.** The granting of a license and the issuance of stock characterize the initial transformation process. The creation of a new institution, however, is a more lengthy process. From the addition of new systems and human resources to changes in organizational culture and funding relations, organizational development evolves over time.
INTEGRATION INTO THE FORMAL FINANCIAL SYSTEM

An MFI’s entrance into the formal financial system must begin with a review of the country’s political and economic environment, as well as an in-depth understanding of the regulatory framework.

Political and Economic Environment

Contextual considerations of the country’s political and economic environment play a determinant role in the implementation and timing of the transformation process. When weighing the pros and cons, microfinance institutions must first determine whether the anticipated benefits associated with transformation can in fact be achieved in the current political and economic environment. In addition, a transforming MFI should be aware of the long-term implications of integration into the formal financial system. Because the transformation process can take a number of years, institutions must attempt to evaluate these contextual considerations over a multi-year time horizon.

Key Contextual Considerations

Key political and economic issues MFIs need to consider as they assess the options and timing of their transformation include:

# Stability of the political climate: A country’s overall political stability can significantly influence a transforming MFI’s ability to attract and maintain access to investment capital. Political instability can lead to arbitrary changes in monetary policy, such as statutory reserve requirements, foreign exchange holding policies, or directed lending mandates. Unstable political environments may also magnify competing political agendas among government officials, including bank regulators, creating significant delays in license processing.

# Macroeconomic trends: MFIs looking to transform into regulated financial institutions must take into consideration general macroeconomic trends in both their country and their region. Such trends would include the level of inflation, currency stability, unemployment and the general health of the financial sector and the economy.

# Characteristics of the financial system: Transforming MFIs need to be aware of the full range of players in their country’s financial system. As a regulated financial institution, an MFI enters into a new competitive environment. While microfinance NGOs remain competitors for market niche on the lending side, the transformed institution’s entrance into deposit mobilization may bring it into competition with other regulated financial institutions. In addition, the banking laws and regulatory environment play a key role in attracting investors, particularly as they affect the rights of shareholders.
# Current policy environment for microfinance: The government’s support for and understanding of microfinance, as demonstrated by the country’s general policy environment for microfinance, plays a significant role in determining the timing of transformation. For example, the Philippine government’s shift away from directed credit initiatives encouraged CARD to pursue integration in the formal financial system. However, in a country where interest rates are limited by usury laws or where government-directed credit programs are prevalent, an MFI’s ability to charge adequate interest rates to cover costs and provide a return for investors may be limited. The extent to which legal contracts are enforceable and sanctions for default, fraud or theft are applied also influences a microfinance institution’s ability to manage its loan portfolio quality.

# Political nature of superintendent: In many countries, the superintendent of banks is either a political appointee, or reports to the President. While the independence of bank regulators is often cited as a critical ingredient of a stable financial system, the political nature of the superintendent’s position can limit the level of independence. In countries where the government specifically targets the microenterprise sector in its plans to promote economic growth, the bank superintendent often acts as the link between the government’s political agenda and the regulators’ work. This was the case in Peru with Mibanco, where the approval and transformation process was relatively short, as the bank superintendent was aware of the president’s interest in the establishment of a Peruvian microfinance bank.\(^{15}\)

Implications of Integration into the Formal Financial System

Transformation of an NGO into a formal bank exposes the MFI to many factors and influences of the local political economy. As NGOs, microfinance organizations are isolated or at least partially protected from the shocks and regulatory decrees that often characterize the formal banking system. While some countries have begun to include provisions for microfinance NGOs in their regulatory frameworks (Uganda, Ghana, South Africa, Ethiopia), most NGOs have evolved outside of any regulatory restrictions, allowing them to operate with relatively few constraints in terms of geographic location, methodology, cost structure, and growth rate. By choosing to transform into regulated financial institutions, however, microfinance institutions could lose this independence, as their operations become closely linked to the overall stability of the banking system.

Regulatory Framework

The decision to transform into a regulated financial institution is heavily influenced by the country’s regulatory environment. Transforming MFIs need to examine carefully the pros and cons of each regulatory category before selecting the institutional type best suited to their operations. This process represents the beginning of a long-term relationship that must be

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\(^{15}\) See Chapter 5 for more detail on the Mibanco transformation.
Exchanging Options

Before deciding on their institutional structure, transforming MFIs must first research the alternatives available in their respective environments. While many transforming NGOs seek to establish a regulated financial intermediary within the country’s existing regulatory framework, some lobby regulators to create a new financial institution category.

Exchanges with Regulators

For the first NGO transformations in a country, the MFI usually has to assume responsibility for orienting the local banking superintendency about the particular characteristics of microfinance and its role in the larger financial sector. This orientation ranges from extensive one-on-one dialogues, to the hosting of local policy workshops, to organizing and accompanying regulators to examine field operations of successful MFIs both nationally and internationally. While both CARD and Mibanco experienced a relatively short time delay (approximately six months) between the submission of their banking license application and its approval, both organizations dedicated many years to regulatory dialogue and education prior to submitting the application.

In many cases, the standard regulatory framework for financial institutions is not appropriate for the supervision of microfinance institutions. A superintendent’s principal goal is to protect the financial system from unsound practices by deposit-taking institutions. From a traditional bank examiner’s perspective, many of the characteristics of microfinance - unsecured loans, limited financial statement analysis, transactions occurring outside formal bank premises - are considered unsound. The transforming MFI is tasked with convincing the regulators of the soundness of their practices or making the necessary changes to comply with regulatory requirements. For example, the security of the proposed bank’s location was just one of the many issues raised by the CBK that K-Rep had to overcome to secure its bank license. K-Rep successfully convinced the regulators of the importance of conducting operations in low-income areas due to the proximity to its clients. However, K-Rep Bank did have to comply with the CBK’s physical security standards, which were much higher than those of the NGO.

Ownership and Governance

Once the MFI decides to transform into a privately owned institution, it must determine the desired composition of its new board, which usually comprises its owner-investors. In most cases, the NGO board will develop the proposed institution’s mission and use it as a guide in seeking potential owners and board members. Potential owners review the capitalization and
asset-liability transfer strategies before reaching their investment decision. Therefore, the roles of ownership and governance, as well as capitalization and asset-liability strategies, are simultaneous related considerations.

Institutional Mission

Boards of transforming NGOs are often concerned with ensuring that the new microfinance institution retains the social mission. Transforming NGOs attempt to strike the desired balance between commercial and social objectives in the development of the new board and by selecting owners. A well-defined mission statement can help guide the board through the selection process. Boards can also add clauses to the new institution’s bylaws that ensure a commitment to the target sector, for example, by requiring that the MFI’s borrowers represent the microenterprise sector. This can be measured by loan size, or by the clients’ profits or accumulated assets.

Board Formation

A transforming NGO should not assume that its current board has the necessary skills and financial backing to guide it through the transformation process, or to lead it as a regulated financial institution. While there is no formula for board formation, ideally the board consists of members with a diverse set of skills, including private business, financial sector and legal or regulatory expertise.

*Board member selection:* The link between ownership and board representation is a key difference between governance structures of NGOs and those of many privately owned financial institutions. Board members of NGOs are usually selected for their community connections or respected technical expertise. While these attributes are certainly relevant for a regulated financial institution, a bank board also typically includes representatives of the institution’s key investors - individuals who have a financial stake in the future of the organization. Additionally, the banking superintendency will often require that a certain number of board members have formal financial management experience.

*NGO board member overlap:* The prevalence of former NGO board members in transformed MFIs typically reflects the percent of NGO ownership of the new MFI. For example, in the case of CARD Rural Bank, three of its seven board members are from the former NGO board, which corresponds with the NGO’s 44 percent ownership.

*Client representation:* Clients are rarely represented on the boards of regulated MFI. As board members, clients’ ability to balance their own interests as net borrowers against the institution’s larger interests of outreach and sustainability is inevitably tested. One way in which a central bank might limit this potential conflict of interest is through restrictions on loans to directors, officers, shareholders and related interests, as in the case of the Central Bank of the Philippines and CARD Rural Bank.
**Employee representation**: In many cases, the new board includes the managing director/president as a member. However, due to concerns regarding the sensitivity of information discussed at board meetings, rarely are other employees allowed to participate in board meetings. This also helps ensure that the three organs of the bank, the board, management and staff, function semi-independently of each other.

**Ownership Options**

**Table 3** identifies the breakdown in shareholders for seven transformed MFIs. To facilitate comparison, the table distinguishes between seven different types of ownership: founding NGO, other NGOs, public development agency/donor, specialized equity fund, foreign private investor, local private investor, and employee stock ownership plan (ESOP). None of the institutions has any direct government ownership.

**NGO Ownership**

The dominance of NGO ownership and control raises questions about the nature of transformation. Since NGOs and private development agencies by definition have no owners, their ownership in the transformed financial institution does not represent personal equity. As discussed below, the NGO’s portion of paid-up capital typically comes from grants and accumulated capital. Regulators, however, typically want to see a group of individuals or firms (not donors) who have put funds at risk. A dominance of NGO ownership can reduce the intended benefits from private ownership of increased accountability and access to additional sources of capital.

All the cases of transformation included here involved the creation of a new privately owned, regulated financial institution by a non-profit NGO. In each case, the NGO, through various mechanisms, capitalized a sizable portion of the new financial institution. In each of these transformations, NGO ownership was considered vital to maintaining the founding vision of the regulated financial institution.

Among these newly regulated financial institutions, the initial level of NGO ownership ranged from 27 percent at CARD to 60 percent at Mibanco, highlighting a significant range in levels of NGO ownership. It is important to note that in CARD’s case, although the Bank initiated operations with a high ownership percentage held by “local private investors” (73 percent), those investors were mainly individuals closely affiliated to the NGO, primarily selected by senior management. By the end of 1999, the NGO itself had increased its ownership to approximately 44 percent of CARD Rural Bank, while the local private investors had decreased ownership to 33.1 percent.

In K-Rep’s case, while K-Rep had sufficient capital to meet the CBK’s minimum capital requirements to create the new bank, Kenyan law limits the amount that any person or institution, except banks and public companies, can own of a bank. Therefore, K-Rep was forced to seek outside investors and reach an acceptable shareholder agreement.
## Table 3: Ownership of Transformed MFIs, at transformation (left column) and in 1999 (right column)

<table>
<thead>
<tr>
<th>Country</th>
<th>BancoSol</th>
<th>Financiera Calpiá</th>
<th>Caja Los Andes</th>
<th>CARD</th>
<th>Banco-ADEMI</th>
<th>Mibanco</th>
<th>K-Rep</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Bolivia</td>
<td>El Salvador</td>
<td>Bolivia</td>
<td>Philippines</td>
<td>Dominican Republic</td>
<td>Peru</td>
<td>Kenya</td>
</tr>
<tr>
<td>1992†</td>
<td>29</td>
<td>20</td>
<td>30.0</td>
<td>30.0</td>
<td>37.5</td>
<td>39.1</td>
<td>27</td>
</tr>
<tr>
<td>% founding NGO</td>
<td>29</td>
<td>20</td>
<td>30.0</td>
<td>30.0</td>
<td>37.5</td>
<td>39.1</td>
<td>27</td>
</tr>
<tr>
<td>% other NGOs</td>
<td>19</td>
<td>14</td>
<td>19.8</td>
<td>19.8</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>% public development agency</td>
<td>0</td>
<td>22</td>
<td>50.0</td>
<td>50.0</td>
<td>43.7</td>
<td>39.3</td>
<td>0</td>
</tr>
<tr>
<td>% specialized equity fund</td>
<td>0</td>
<td>34</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>% foreign private investor</td>
<td>27</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>17</td>
</tr>
<tr>
<td>% local private investor</td>
<td>25</td>
<td>10</td>
<td>0.3</td>
<td>0.3</td>
<td>18.7</td>
<td>7.7</td>
<td>73††</td>
</tr>
<tr>
<td>% ESOP</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>22.7</td>
<td>20.0</td>
</tr>
<tr>
<td>Minimum capital requirement at transformation</td>
<td>$3.2 million (Commercial Bank)</td>
<td>$1 million (Financiera)</td>
<td>$1 million (Private Financial Fund, PFF)</td>
<td>$116,279 (Rural Bank)</td>
<td>$2.2 million (Development Bank)</td>
<td>$5.6 million (Commercial Bank)</td>
<td>$6.8 million (Commercial bank)</td>
</tr>
</tbody>
</table>

† At December 31, 1992.
†† Represents selected senior management.
†††† Note: Financiera Calpia is currently considering transforming into a commercial bank.
* K-Rep Holdings Ltd., a newly established holding company, will own 32.5 percent of K-Rep Bank rather than the NGO.
** Represents client ownership.
The NGO’s management of its new ownership stake in a commercial MFI is a critical issue. Many issues are less clear under NGO ownership, such as who will take responsibility for managing the investment and what role it will play. The new bank charter should clearly define the NGO’s intentions for disposing of this investment in the future, preferably with plans for eventual divestment. This issue should be addressed within the framework of the NGO’s future plans for income generation and asset accumulation. If the NGO plans to continue as some form of operating entity, it needs to have a clear funding strategy, independent from the new bank. Some NGOs have been known to view their investment in a commercial MFI as a potential (and possibly important) source of future income to be used to finance operating costs and or/services. Conflicts arise when, for one reason or another, the commercial MFI decides to withhold dividend payments in order to build capital to finance expansion, upgrade facilities or any number of other internal issues. The continuing role of the NGO is treated as a separate discussion below.

Limited Local Private Ownership

The initial amount of local private ownership in these new formal financial institutions is quite limited. K-Rep sought local investors, but the Kenyan banks were not interested initially because they were unfamiliar with microfinance. Only later, as the process advanced and K-Rep received support from reputable international entities such as the World Bank/IFC and positive media attention, did local banks express an interest. Unfortunately, at that point it was too late for their participation. Mibanco’s local private ownership is comprised of two private commercial banks, Banco de Crédito and Banco Wiese, each of which owns 6.6 percent of the bank. There was interest by other banks and insurance companies, but with the NGO taking 60 percent of the shares, the potential for private ownership was minimal. BancoSol is an exception, in that it had 25 percent local private investors at the end of 1992 and its shares are now sold on the Bolivian stock exchange, as described in the textbox below. However, several of the local private owners did not have a long-term commitment to their investment and have since divested, reducing BancoSol’s local private ownership to only 10 percent at the end of 1999.

To date, the microfinance sector has attracted very limited private capital. Private investors have not necessarily been convinced that such an investment makes sense, for a number of reasons. First, except in a few isolated cases, returns within the microfinance industry have not yet been realized. Second, in most cases, there is no liquid market for the shares, limiting the investor to dividend returns and hindering their exit strategy. Third, when the founding NGO maintains majority ownership, private investors are
led to question both their own abilities to shape the long run vision of the organization and the NGO’s commitment to prioritizing profitability.

**ESOPs**

As a vehicle for staff ownership, employee stock ownership programs (ESOPs) provide a mechanism for aligning employees’ goals with the goals of the company. In general, these programs offer employees the ability to benefit from the increase in value of the company, either directly as shareowners or indirectly through incentives tied to profitability.

In three of these seven cases, an employee stock ownership program was designed to reward and acknowledge the contribution of staff and management’s service to the organization, ranging from 10 percent at K-Rep Bank to 22.7 percent at CARD Rural Bank. In both CARD and K-Rep, non-voting shares are made available to staff based on a combination of seniority and professional status. As of June 2001, the ESOP portion at CARD had decreased to 5%, with the increase in CARD member participation. At BancoADEMI, 20 percent of the shareholders’ control was relinquished to ADEMI employees by means of a special bonus based on accumulated severance and pension benefits.

In K-Rep’s case, staff that have been employed by K-Rep for three years or more are eligible to participate in the ESOP. Participation is voluntary, and 90 percent of staff hold stock options. Eligible members must agree to purchase one right for every right awarded as a bonus. To facilitate this process, employees can borrow money to purchase shares at 9 percent p.a. for five years, although in case of payment default, all shares are lost. With initial funding from CGAP, the Kwa Multipurpose Cooperative Society, a credit and savings cooperative for K-Rep staff, purchased and assigned these initial rights to members. Shares can be sold at times and dates specified by Kwa. In case of death or permanent disability, shares can be cashed out. In addition, if an employee leaves K-Rep before completing five years, the employee forfeits rights to the “free” shares. K-Rep has allocated 50,000 shares to staff; the balance is being allocated as annual bonuses under a five-year program.\(^{16}\)

The element of risk in ESOPs can be significant in transforming microfinance institutions. There is usually a great deal of pressure to participate in the program, yet no proven stream of earnings to aid staff in making informed decisions as the ESOP is typically launched in conjunction with the opening of the newly formed bank. Transforming MFIs need to be aware of this element of risk when launching an ESOP and ensure a balance between individual risk and salary stability. CARD and BancoADEMI both awarded shares to staff as a special bonus, essentially eliminating individual risk. Since 1998, BancoADEMI, where employees own 20% of the bank, has paid out $1,286,620 in dividends on employee shares.

**Client Ownership**

CARD Rural Bank is the only institution among those examined to incorporate client ownership into its initial share structure. CARD now offers preferred stock to individual

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\(^{16}\) Presentation by Kimanthi Matua, MFN/Accion Commercialization Conference, June 2001, Washington, DC.
members who meet certain eligibility criteria (such as having completed fourth loan cycle and having maintained a repayment rate of 100% for all loans) and allows clients to use their center fund contributions (composed primarily of clients’ compulsory savings) or cash to purchase the shares. As of June 2001, client member ownership represented 29% of the total CARD capital structure.

Capitalization

The initial capitalization of a regulated financial institution is typically determined by two factors: the regulatory requirements in the country and the institution’s business plan (which includes management’s projections for growth and capital needs). In this review, minimum capital requirements ranged from $161,000 (CARD Rural Bank) to $6.8 million (K-Rep Bank). In addition, diverse growth plans led to different capitalization strategies, as each institution sought to maintain appropriate leverage ratios.

In NGO to bank transformations, the net assets of the NGO are typically transferred to the new regulated financial institution in exchange for some combination of debt and equity in the new institution. The variations among capitalization strategies primarily reflect differences in the transaction method and in the timing of the exchange. The transaction can either happen as a direct swap, as in the case of PRODEM/BancoSol, whereby the assets of the NGO were directly sold to the bank in exchange for shares, or as a cash capitalization, as in the case of ACP/Mibanco and CARD, in which the NGOs provided the paid-up capital in cash. In this second scenario, the NGO either borrows the necessary funds for the paid-up capital requirements, paying off the loan as its own loan book comes due, or uses its own accumulated capital. The choice between initiating a direct swap of assets for shares, as opposed to capitalizing the new institution in cash is often a function of the regulatory requirements in the country. Providing the capital in cash is often viewed as preferable for preserving the integrity of the capital account.

Asset and Liability Transfer Issues

The transfer of assets and liabilities from an NGO to a regulated financial institution raises a number of key issues. These include the following:

# Debt/equity split: The proportion of debt to equity is influenced by five primary factors: i) the minimum capital requirements in the country; ii) the maximum leverage ratio allowed by bank regulators; iii) the value of the NGO’s net assets; iv) regulatory limits to ownership; and v) to a certain degree, the NGO’s ownership ambitions. Each of these variables influences the initial funding structure of the new regulated financial institution.

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17 BancoSol exchanged shares based on the value of PRODEM’s loan book plus a 10 percent premium.
# Valuation exercise: Microfinance institutions that seek private investors need to determine the net value of the new institution. While this can be determined internally, it is typically done through a formal valuation of assets and liabilities by a reputable accounting firm.

# Premiums: In each case, the new financial institution gained instant access to the NGO’s client base. As compensation, some NGO to bank transfer strategies are structured to include a premium payment from the bank to the NGO. For example, Mibanco agreed to administer ACP’s existing loan book at no cost for the first year, and to pass on the interest revenue on all pre-existing loans until they came due. In addition, Mibanco paid ACP a premium of $1 million in cash for access to ACP’s clients. The agreement required capital, temporarily increasing its ownership holding to 49.75 percent. The CBK granted KHL a permanent waiver on the 25 percent ownership limitation, yet KHL offered all shareholders the option to increase their subscription in order to retain their respective original ownership percentage. Almost all shareholders accepted this offer, leaving KHL with 32.5% ownership.

# Lender negotiations: NGOs that have sourced funds from commercial or other lenders need to negotiate carefully either a transfer of this liability to the regulated institution or some other arrangement which will allow the NGO to continue to pay off the debt with resources from the regulated institution.

# Donor negotiations: A portion of an NGO’s capital base typically comes from donor contributions. Funded by taxpayers, development agency resources are typically restricted to non-profit organizations with social objectives. When the NGO creates a for-profit financial institution, the transfer of assets funded by these donations can raise concern among donors. In Bolivia, for example, PRODEM hoped to transfer a significant portion of its loan book, largely funded by USAID, to BancoSol in exchange for shares.
Only after complex negotiations did USAID approve the transfer, based on the notion that USAID funds donated to PRODEM were no longer classified as U.S. government funds since they had been lent once and repaid. Despite donors’ support for commercialization of MFIs, most donor agencies do not yet have written policies and procedures to address the issue.

# Capital transfer to private individuals: In a number of NGO transformations, donor funds have been used to capitalize individual shareholdings. While in some cases, shares in the new financial institution were sold to private individuals, in others the shares were simply transferred to board members, managers or staff of the former NGO. This raises ethical questions as to the fairness of transferring share capital partly accumulated with taxpayer money to a few well-placed individuals. Donors that have supported the subsidized transfer of shares to private individuals argue that funding individual share ownership helps foster enhanced levels of governance and accountability. CGAP, for example, provided funds to facilitate the creation of an ESOP for K-Rep employees. CGAP views this support as an important contribution to moving microfinance forward and hopes that K-Rep’s ESOP will encourage higher levels of staff commitment and productivity, providing a demonstration model to other MFIs in the future.

**Organizational Development**

Identifying investors, establishing a board, and transferring assets and liabilities represent only the beginning of the transformation process. A range of organizational development changes must also be addressed, which is an evolutionary process that requires time and effort. A new mission must be identified for the founding NGO. Furthermore, the leadership of the new regulated financial institution must communicate its vision to employees and clients, generating enthusiasm without creating unrealistic expectations. Systems must be put in place, and new staff hired and trained.

**Continuing Role of Founding NGO**

The extent to which transformation ultimately encourages commercialization will be largely dependent on the new financial institution’s ability to gain complete independence from the NGO. This includes eliminating dependence on the NGO for such core functions as product development and market research. True commercialization of the sector will occur when a financial institution becomes not only independent of donor funding, but also independent of donor-dependent NGOs for key development functions.

**Organizational Culture**

Organizational culture is a system of shared beliefs and values that develops within an organization and guides the behavior of its stakeholders. It is created by the leadership of the organization, often articulated in the organization’s mission statement, and shaped and sustained by the organizational structure, policies and procedures, and the relationships among staff and between staff and management. When a non-profit NGO transforms into a
privately owned, regulated financial institution, each of these influential factors can change, thereby altering the MFI’s organizational culture.

The degree to which transformation affects the organizational culture of an institution is largely influenced by changes in management and communication styles. In Mibanco’s case, the strategic plan called for a blend of NGO and bank managers in the management hierarchy. The institutional structure was revised to accommodate the transformation from an NGO to a bank. The addition of traditional banking professionals with strong personalities in key management positions led to changes in communication patterns among staff (more hierarchical and formal) and in methodology (based more on traditional banking methods). These changes temporarily lowered employee morale and customer satisfaction. The board quickly recognized and corrected the imbalance by shifting management positions so that former NGO staff would hold positions involving close contact with branch staff and clients.

In contrast, CARD has not experienced a significant change in organizational culture. From both an accounting and organizational chart perspective, CARD is composed of two distinct entities, a bank and an NGO. However, when viewed from an operational perspective, CARD is one organization. This distinction is important as it underlies CARD’s ability to implement successfully a phased approach to transformation. Bank and NGO staff do not see themselves as working for two separate organizations. The interconnectedness between the NGO and the bank, from the operations’ level to the board, has helped shape this perception. In addition, CARD did not hire a cadre of traditional bankers when launching CARD Rural Bank, opting instead to train current staff in their new responsibilities.

Effective leadership and management are essential to the transformation process. Because transformation can take a long time, both what is communicated about the change and how it is communicated to staff are critical. By emphasizing the twin goals of better client service and organizational sustainability, management can provide concrete reasons for the transformation. The challenge for a leader is to keep staff informed of anticipated changes and to generate enthusiasm for these changes, without excessively raising expectations or causing fear among staff. This is a delicate balancing act. If change is oversold, unmet staff expectations may lead to low employee morale in the future. On the other hand, if not enough information is communicated to staff, unfounded fears around job stability may mount.

Human Resources

The set of skills required of staff changes as NGOs transform into regulated financial institutions. Whether an organization chooses to hire traditional bankers, to initiate an intensive training program for its own staff, or to apply a combination of the two, MFIs need to be aware of the significant amount of time and money required to prepare staff for the transformation. At PRODEM, for example, the executive director prioritized building staff capacity and invested heavily in preparing the NGO’s employees for the transition, determined that NGO staff would fill as many bank positions as possible. Seminars and training sessions, which focused on the technical aspects of banking as well as on the cultural differences between an NGO and a bank, were held for all staff levels. BancoSol’s early
success is largely attributed to this emphasis on cultural integration and to the effectiveness of these trainings in smoothing the transition. At Mibanco over $180,000 was spent on training in one year, preparing employees for the transformation. This included training on the new computer system, as well as special training for loan officers on a new loan review process, loan sales and collections. Both K-Rep and CARD contracted outside service providers to conduct introductory courses on traditional banking for their staff.

The additional training needed to educate and train staff on bank procedures should not be underestimated. Initial training needs to focus on building employee commitment for the transformation and on how staff should communicate the transformation to clients. This includes reviewing upcoming operational changes and ensuring employees are prepared to articulate the future vision of the new regulated financial institution to clients.

**From Credit Officers to Financial Service Marketers**

With transformation comes a shift in loan officers’ responsibilities and the MFI’s approach to expanding outreach. In a microfinance NGO, most field staff focus only on the provision of loans to clients. For those MFIs that become deposit-taking institutions, the MFI must also sell its clients on its financial strength and build their trust in its ability to manage their savings. Transforming NGOs need to train employees to handle this level of financial service marketing. Employees will need to understand the typical concerns clients have about saving in a formal financial institution and how to overcome them. In addition, as new loan products are introduced, such as individual loans, loan officers may require a different set of tools to analyze the creditworthiness of their borrowers. For example, loan officers may need to be trained in basic cash flow and balance sheet analysis.

**Importance of Grooming Middle Management**

Transformed microfinance institutions tend to expand rapidly, leading to an increase in new branch openings and therefore increased demand for branch managers – many of whom are chosen from the pool of loan officers. One of the key challenges faced by transforming microfinance institutions is to develop a management training or grooming program that will adequately supply a quickly expanding middle management team.

**Increased Responsibilities of Senior Management**

The responsibilities of senior management increase significantly with transformation to a regulated financial institution. Organizations need to establish the right balance between hiring bankers for certain key banking functions and training their own staff to assume these functions. The goal should be to create an institutional culture with the right mix of the two cultures, adequate to provide the security of a formal bank while catering to the microenterprise market. Traditional bankers are appropriate for new positions that require traditional banking expertise, such as Investment or Treasury Officer. Existing staff,
however, are often better suited for positions that require an in-depth understanding of microfinance and directly oversee branch level personnel, such as Operations or Business Manager.

Client Transitioning

Responding to client needs is one of the principal reasons for transformation. Transformation into a regulated financial institution allows an MFI to expand its market, offer its clients a broader range of products and services, and in some cases, even offer its clients a stake in the ownership of the bank. While each of these benefits may be clear to the management and staff of the organization, the clients’ perception of the transformation process will depend on the organization’s ability to effectively market these changes. The word “bank” often has negative connotations for people who have been excluded from the formal financial system due to lack of traditional collateral requirements or insufficient minimum balances. An NGO’s announcement that it plans to create a bank may fuel concerns that the organization will shift target markets or that customer service will deteriorate.

MFIs considering transformation need to involve their clients in the transformation process from the beginning. This involvement may include focus groups to collect input on the transformation process, or workshops to explain the potential impact of transformation. In CARD’s case, for example, clients were informed from their initial membership with CARD about CARD’s intention to become a bank. In addition, training sessions were scheduled to explain to clients the benefits and risks of purchasing share capital in the bank. Mibanco officially communicated the transformation to clients through a written letter mailed to each customer, verbally by employees, and through posters that described Mibanco’s mission statement and commitment to serve microentrepreneurs. In addition, radio and newspaper advertisements announced the transformation publicly.

Finally, clients need to see tangible benefits of the transformation soon after the bank is opened. Depending upon how the transformation is communicated, expectations can be high. Clients often expect greater efficiency, a broader selection of products, and improved customer service. At the same time, the newly formed bank is trying often to launch a new computer system, implement new procedures, and schedule additional training for staff and management. The more well-prepared an institution is for the operational side of transformation, the easier it will be to meet the clients’ expectations.

SUMMARY

Transformation is just one component of a broader movement toward the commercialization and integration of microfinance into the formal financial sector. The transformation phase of the microfinance industry’s evolution has been essential to this movement because it has allowed MFIs to reach critical mass in terms of business operations and outreach, and to demonstrate financial viability and profitability. The transformation phenomenon has already attracted attention from the commercial world and caused donors to change policies in
preparation for a burgeoning microfinance industry based on market principles. Throughout the 1990s, transformation has been closing the gap in the provision of services to microentrepreneurs and opening access to financial services that had long been denied to the poor. Competition from transformed MFIs has caused banks to attempt to reach further down to lower income sectors and microenterprises. If the microfinance NGO transformations continue to demonstrate the levels of success and profitability to which they aspire, access to commercial sources of funds, including equity from private investors, will likely increase.
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