INTRODUCTION

As microfinance markets become more competitive, institutions feel increasing pressure to achieve and sustain growth. A crucial driver of success and sustainability, growth allows microfinance institutions (MFIs) to expand their portfolio by providing financial services to a larger number of clients while at the same time fulfilling an MFI’s social mission.

Organizations can use a variety of organizational structures to facilitate expansion, including:
• Growing existing operations
• Legal restructuring
• Franchising
• Strategic alliances
• Mergers
• Acquisitions

Recent trends indicate that various strategies and structures are being deployed in the microfinance industry.

"As microfinance matures and donor funding dries up, MFIs are beginning to look at market forces, such as customer demand and competition. This forces an MFI to consider various expansion strategies beyond growth through existing business."\(^1\) Such is the observation by a microfinance practitioner.

What options are most appropriate for MFIs operating in different contexts? What are frameworks to evaluate various expansion strategies?

This focus note explores options other than growing through an organization’s existing business. Each strategy is defined in a context of a definition and framework and is illustrated by a case study.

This document is based on recent WWB research on growth strategies used in the private sector and those used in microfinance. This analysis is the first of a multi-part series on expansion strategies.

BUSINESS CASE FOR EXPANSION STRATEGIES BEYOND GROWTH THROUGH EXISTING BUSINESS

A new and significant challenge facing many microfinance institutions is increased competition, which forces an MFI to focus on differentiation while maintaining low-cost products and services. Clients are also beginning to demand a greater variety of products and services, especially as markets mature. MFIs, however, may not have the capability or core competency to meet this customer demand. Additionally, regulatory barriers preclude NGOs from meeting client demand for additional services such as savings, insurance, or leasing products. Change in legal structure may be possible, but requires a great deal of resources. Increased competition makes donor funding harder to secure, and MFIs face the challenge of funding constraints. These constraints force many MFIs to be more focused on cutting costs and increasing efficiency, especially given the desire to reach scale and achieve financial sustainability.

Various strategies, structures and alliances are available to MFIs to help them expand outreach and provide offerings in an increasingly competitive landscape.

It is essential to understand which type of expansion strategy is best for a given situation and marketplace. There is not a "one-size-fits-all" model for successful expansion.

When should an MFI begin considering strategies beyond internal growth? There are two frameworks to help answer this question: (1) customer-centric approach and (2) firm-centric approach.

In the customer-centric approach, the microfinance organization first seeks to understand customer needs and demands. This includes not only current needs, but also future trends in the marketplace. Once the MFI determines the types of products and services customers are demanding, the MFI must consider whether it can meet these needs given its internal capabilities and resources. The MFI must also consider how offering these products and services fits...
into its overall strategy. If the MFI determines that its internal capabilities cannot meet these customer needs, yet offering these particular products and services fits into its overall strategy, it should begin considering various expansion strategies. Furthermore, the MFI should consider whether other organizations offer the products and services the customer is demanding, and if so, who these organizations are. The MFI can then consider opportunities to partner or potentially acquire. This framework is shown in the figure below.

In the firm-centric approach, an organization evaluates its internal capabilities (core competencies, current product offering, legal structure, and available resources). If these internal capabilities cannot meet external market factors (such as increased competition, increased commoditization, increased customer demand, etc.), the organization should consider various expansion strategies. The figure below outlines this framework:

The two approaches can be complementary, with the starting point being the analysis of the market and clients.
RANGE OF EXPANSION STRATEGIES

This paper focuses on four types of expansion strategies:
• Legal restructuring
• Franchising
• Strategic alliances and
• Mergers and acquisitions

Each strategy calls for a different amount of time and resources. The figure below highlights the steps, degrees of difficulty and key characteristics of the four types of expansion strategies.

Contrary to existing hypotheses that expansion strategies correspond to a microfinance market’s stage of development, our research indicated that all forms of expansion strategies exist in all industry phases. The reason for choosing a particular expansion option lies in the strategic rationale of an organization.

For example, in India – a market in an expansion stage – we see growth of NGOs through transformation into Non-Bank Finance Companies (NBFC), franchising by SKS and Bandhan, and strategic alliances between CARE and Hindustan Lever.

In the microfinance industry, common expansion strategies include those that require fewer resources and are therefore easier to implement. Growth through customer loyalty programs, legal restructuring and strategic alliances is increasingly being observed. For the same reasons, franchising and mergers and acquisitions are less common.

The following is a detailed analysis of each strategy.

1. LEGAL RESTRUCTURING

Legal restructuring is a form of expansion strategy whereby a microfinance organization reorganizes its operations into a different legal entity. Unlike other types of expansion strategies that require due diligence of other organizations, such as strategic partnerships or mergers and acquisitions, legal restructuring is an internal form of expansion.

A common example of legal restructuring in microfinance is a credit-only NGO transforming into a regulated financial institution in order to provide other financial services to its clients. This transformation allows the MFI to offer a greater basket of products and services. However, transformation is lengthy and requires a great deal of resources.
Another example of legal restructuring in microfinance is the service company model, where a bank forms a non-financial legal entity to serve microfinance clients.

A third form of legal restructuring is transformation into a holding company model.

BRAC in Bangladesh, is organized similar to a holding company structure, with numerous related companies such as BRAC Industries, BRAC BD Mail Network, BRAC Services, BRAC University, and BRAC Bank, among others. This structure allows BRAC to offer a wide range of products, target different customer segments, and leverage the BRAC brand across industries.

Benefits

All forms of legal restructuring offer MFIs the opportunity to enter into new customer segments, products and geographies.

- Legal restructuring allows an organization to target different customer segments (e.g. a bank can now target microfinance clients)
- By offering a variety of products and services, an organization can become a "one-stop shop" for customer needs

Through a holding company model, an organization can leverage its brand name across several subsidiaries.

Challenges

Costs for transformation are high and a large amount of resources are required to change an organization’s legal structure.

Within the holding company model, there is a risk of "broken brand promise" if brand expectations are not reached across subsidiaries.

2. FRANCHISING

Franchising is a continuing relationship, in which the franchisor provides a license to the franchisee to do business. It also offers assistance in organizing, training, merchandising, marketing, and managing in return for a franchising fee. The organization is "cloned" by licensing the brand name and providing ongoing business support to the franchisee, which owns and operates the business outlet. An organization typically engages in franchising in order to grow quickly and leverage its brand and business model. Franchising offers a means to expand without much up-front financing and tends to occur in industries with standardized products.

The framework below highlights benefits to both the franchisor (in the center) and the franchisee (around the circle).

Benefits

Organization can grow with relatively low financing up-front. Additional revenue through franchise fees and added growth. Brandization of processes allows for quality control. Brand equity leveraged across geographies. Franchisee may be able to reach populations in remote areas which has important implications for microfinance. Franchising offers a means to be entrepreneurial while minimizing risk. Franchisee receives benefits such as training, advertising and site selection.
Challenges

Strict standardization of business processes makes it harder for an organization to innovate and respond to local market needs. A successful business does not automatically translate into a successful franchise.

While franchising frequently occurs in the private sector (McDonalds, Coca-Cola), there is little franchising in microfinance. Franchising as it occurs in the private sector, with the same brand, strict checks on quality control and standardization, does not currently occur in microfinance. Even in the financial services industry within the private sector, franchising is less common because it seems to work better with a standardized product than it does with a service. Additionally, franchising is rare in this industry because of the high skill and capital needed. For instance, there is an inherent risk for someone with little financial experience to open up a bank franchise branch, no matter how straightforward or standardized the franchise package is.

A form of franchising does exist in microfinance, through replication of business processes and a credit franchise package. Examples of replication include the establishment of Bandhan, which was based on the ASA model. The Grameen methodology has also been replicated by numerous MFIs. These forms of franchising tend to be more of a mentor-mentee relationship, in which advice is offered but not imposed. Brand equity is not emphasized, as replicated organizations have different names and are different legal entities.

3. STRATEGIC ALLIANCES

Alliance is an umbrella term for a vast array of "organizational partnerships" where each party's core business model remains separate and intact. It is an agreement between two or more separate companies in which there is shared risk, returns, and control, as well as some operational integration and mutual dependence.

An MFI can seek to achieve market leadership through a strategy of differentiation by building upon its core competencies. Examples of such competencies include customer insight, brand reputation, decentralized

Case Study: XacBank’s Credit Franchise Model

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<tr>
<th>Overview</th>
<th>Key Characteristics</th>
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<tr>
<td>2000 merger between:</td>
<td>Initial implementation involved 2 CEO’s; current organization has one CEO</td>
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<tr>
<td>XAC: first registered microfinance company in Mongolia, licensed by Central Bank in 1999</td>
<td>Legal transaction involved swapping shares of XAC for GE assets; GE became holding company</td>
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<tr>
<td>Govlin Edhlel (GE): SME lending operator with 5 branches in Gobi province</td>
<td>Resulting organization upgraded with commercial banking license</td>
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<tr>
<td>Both institutions had non-bank financial institution license</td>
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<tr>
<td>Resulting organization called XacBank</td>
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<tr>
<th>Strategic Rationale</th>
<th>Lessons Learned and Key Success Factors</th>
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<tr>
<td>Expand geographically: both organizations operated in different, non-overlapping areas; merger allowed them to cover all provinces in Mongolia</td>
<td>Cultural difficulties of merger</td>
</tr>
<tr>
<td>Offer full package of financial services: micro and SME loans</td>
<td>“Staff morale is something that requires extra effort since the merger process tends to create lots of tension at all levels” (Ganhuyag Chuluun, co-CEO of XacBank)</td>
</tr>
<tr>
<td>Ability to become market leader in environment of mounting competition</td>
<td>“Marriage of equals” practically non-existent</td>
</tr>
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<td></td>
<td>“There’s always tension in a merger of equals: who has the final say when the organizations are both equal?” (MF practitioner)</td>
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Source: Interviews with MF practitioners; Mergers in Microfinance: Twelve Case Studies, Elsie McCarter, Catholic Relief Services, 2002
operations, illustrated in the diagram above. Often however, it is challenging to achieve organizational goals in more competitive and mature markets. In a strategic alliance, a partner could complement an organization’s capabilities in achieving its goals by:

- broadening brand awareness and deepening the image of trust by association with a reputable institution
- providing new ways for staff to service and interact with clients
- supporting growth by providing a more attractive product offering
- deepening client insight by understanding their needs better

Alliances in the microfinance field include negotiating bulk rate deals, outsourcing, product alliances, channel alliances and full service alliances.

Spandana, an MFI in India, has entered into an agreement with a local gas company to provide gas stoves to Spandana’s clients at a specially negotiated bulk rate which make it cheaper for the client to purchase the product. This service allows clients more time in their business and homes as they no longer have to collect and carry firewood. It has allowed Spandana to expand its client outreach and to achieve its social mission of strengthening the socio-economic status of poor women in rural and urban areas.

Outsourcing is when MFIs subcontract a particular function to a third party vendor. Examples of functions that can be outsourced include MIS operations or cash transactions. Mi-Bospo in Bosnia has no cash activity in its branches as it has forged relationships with several banks through which clients access and repay loans.

Product alliances take place when an MFI is looking to offer additional products to its clients using the partner’s existing products as in the case of Equity Building Society (EBS) in Kenya and Western Union.

A channel alliance occurs when MFIs use the channels of the partner to sell their own products as in the case of Fincomun and PanBimbo in Mexico (see case study).

Finally, an example of a full service alliance is when an MFI runs outsourced operations on behalf of a third party. The partnership agreement between ICICI and multiple MFIs in India is typical of this kind of alliance.

Benefits

Alliances give organizations the ability to differentiate without reinventing the wheel; institutions can move forward relatively quickly and can be more flexible and easier to implement in comparison to mergers and acquisitions.

Shared control mitigates risk: A partner can exit a strategic alliance and fewer resources are needed including less cash
Learning opportunity: Institutions have the opportunity to learn more about key processes/new industries/new geographies.

Ability to leverage brand name: Organizations can focus on their strengths (e.g. Starbucks-Barnes and Noble partnership).

**Challenges**

Agreeing to a mutually beneficial and fair deal structure is often a challenge. The lack of trust between organizations may explain the low overall success rate of alliances, around 50%.

Challenge of understanding each partner’s role, which is especially critical in decision-making.

Lower risk implies lower potential reward relative to other expansion strategies such as acquisitions.

Maintaining distinct market segments is necessary to avoid overlapping of clients.

### 4. MERGERS AND ACQUISITIONS

Organizations can also expand through a merger or acquisition. Some organizations use strategic alliances as a stepping stone for an M&A. A merger is the combining of two or more entities into one, whereas an acquisition occurs when an organization obtains control of another organization by purchasing its assets or shares. M&A is the most intensive expansion strategy, in terms of time and resources required, difficulty in implementation, and level of risk. There are also delicate cultural issues that require careful change management and regulatory issues that vary by country. There have been a number of mergers and acquisitions in the microfinance field, including the merger of XAC and GE to form XacBank and acquisitions undertaken by ProCredit.

While mergers and acquisitions differ in definition, they are often lumped together when discussing expansion strategies. Why is this the case? In interviews with private sector experts, whether to call a deal a "merger" or an "acquisition" is usually based on practical implications. According to one academic: "The decision over whether to

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**Case Study - Fincomun-BIMBO Alliance**

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<tr>
<th>Overview</th>
<th>Key Characteristics</th>
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<tr>
<td><strong>FinComun and Bimbo Partnership in Mexico</strong></td>
<td><strong>1st stage</strong>: Marketing/awareness; Bimbo promotes pre-qualified clients and FinComun agent rides in Bimbo busses to promote loan while bread delivered; potential client goes to FinComun branch for loan</td>
</tr>
<tr>
<td><strong>FinComun (MF) entered into alliance with Bimbo (bread company) two years ago</strong></td>
<td><strong>2nd stage</strong>: Bimbo handheld identifies which Bimbo clients are also FinComun clients, client can pay Bimbo agent or go to FinComun branch</td>
</tr>
<tr>
<td>Alliance comprised of 3 stages:</td>
<td><strong>3rd stage</strong>: Debit card to disburse money; FinComun agent on motorcycle gives client debit card</td>
</tr>
<tr>
<td>- Promote FinComun through Bimbo's network (successful 18-22% of pre-qualified Bimbo clients take out loan from FinComun)</td>
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<td>- Bimbo recovering FinComun's payments (currently in pilot phase; 25% clients use this option)</td>
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<td>- &quot;Bank without branches&quot;</td>
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<th>Strategic Rationale</th>
<th>Lessons Learned and Key Success Factors</th>
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<tbody>
<tr>
<td><strong>FinComun leverages Bimbo’s customer base</strong>: Bimbo has 800,000 selling points</td>
<td>Thinking outside box, allying with bread company</td>
</tr>
<tr>
<td>- FinComun able to develop expertise in mom &amp; pop segment, leverages Bimbo database</td>
<td>Close relationship and aligned incentives important</td>
</tr>
<tr>
<td>- Gain efficiency by effectively outsourcing credit checks and having Bimbo collect repayments</td>
<td>Bimbo owns 10% of FinComun shares (began from personal relationships)</td>
</tr>
<tr>
<td>Bimbo advances goal to be #1 supplier by offering financial services and financial education, in addition to bread products, grow customer loyalty</td>
<td>Major challenge of collecting money (e.g. Bimbo drivers collecting for FinComun); potential initiative involves Bimbo clients being repayment collectors for the community</td>
</tr>
</tbody>
</table>

Source: Interviews with MF practitioners
do a merger versus an acquisition is much less strategic and much more pragmatic. It often has little to do with strategy and much more to do with financial concerns, tax implications, stock deals, etc.” According to another academic: "In the real world, there is rarely a true marriage of equals. Even if it’s called a merger, usually one firm is dominant over another, so it’s really an acquisition but called a merger for more practical reasons, like stock price." A private sector consultant puts it more bluntly: "There’s really no such thing as a merger; they’re all acquisitions, where the dominant company’s culture takes over.”

The key value proposition in engaging in a merger or acquisition is to create value by realizing synergies. Cost-savings synergies (reducing duplicating functions and sharing operating activities or facilities) can be realized quickly and are more likely to succeed. Revenue-generating synergies (the ability to expand to new channels and new products post-merger or acquisition) are more difficult to realize, thus resulting in a lower probability of success. This can be seen in the following framework schematic:

While synergies contain the potential for cost-savings and increased revenue generation, organizations must beware of the “synergy trap.” Companies often overestimate the amount of synergies that a merger of acquisition will create. A 2004 Bain & Company survey found that two-thirds of executives admitted to having overestimated the synergies available from combining companies. Moreover, companies often fail to recognize potential negative synergies, such as joint customers curtailing their purchases once two companies combine their accounts, for fear of being overly reliant on a single supplier.

Careful due diligence is required to assess the potential synergies of the resulting merger or acquisition. Organizations need to maintain a balance between achieving synergies and positioning themselves as a leader in the market. Microfinance institutions considering M&A must take these lessons from the private sector into account.

**Benefits**

Potential for MFIs to scale up and reach economies of scale in a timely way.

- Ability to spread organization’s fixed costs over a large client base, providing more services at a lower cost to clients.
- Increase efficiency by decreasing overhead and administrative costs.
- Ability to expand product offering in light of customer demand.
- Achieve portfolio risk diversification through an expanded product offering.
- Increase number of distribution channels, e.g. buying portfolio or client base.
- Gain organizational benefits through increased learning via new organizational competencies (e.g. credit methodology, MIS).

**Challenges**

Careful due diligence is crucial; however, it is difficult to value MFIs, and there are few specialists found in this area in microfinance.

MFIs face resource constraints that make M&A difficult; as a microfinance practitioner stated: "A merger should not be an MFIs first choice if it’s looking for an arrangement that is fast and relatively straight-forward; a merger is very challenging and resource-intensive.”

Risks of spreading management talent too thin.

Cultural issues present in all M&As are especially difficult in microfinance, due to the social aspect of the organization’s mission (being sustainable, yet staying true to the mission).

Many countries have regulatory issues related to M&As.

A large part of M&A involves streamlining operations; therefore, potential risk concerning funders, who prefer covering program costs rather than operational cost.

Despite these challenges, there are numerous examples of mergers and acquisitions in the microfinance field which have
taken place to expand outreach, increase the product offering, and gain synergies. Some of these examples include: North American merger of Grameen Foundation USA’s technology center and Digital Partners, XAC and Goviin Edhiel’s merger to form XacBank in Mongolia (Case Study), and the merger of Save the Children and Catholic Relief Services in Armenia. In Uganda, FSDU (a project of the Department for International Development, or DFID) has established the Consolidation Challenge Fund to facilitate consolidation. This group co-funds activities such as feasibility studies, asset valuations, legal review, and market studies to support consolidation such as mergers and acquisitions.

In the future, it is likely that we will see more M&A activity in more competitive markets.

**Case Study - Xac and Goviin Edhiel Merger**

<table>
<thead>
<tr>
<th>Overview</th>
<th>XacBank: Credit Franchise Model</th>
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<tbody>
<tr>
<td>XacBank provides credit franchise package at low cost to rural co-ops in Mongolia</td>
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<tr>
<td>Began franchising in 2001; currently 24 credit unions, approximately 1000 members</td>
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<tr>
<td>Franchise package (&quot;Development Guide&quot;); handbook manual with 5 modules: lending (3 loan products), training, legal &amp; regulatory; accounting; governance (currently establishing MIS system)</td>
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<table>
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<tr>
<th>Key Characteristics</th>
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<tr>
<td>Rural co-ops (franchisees) do not keep Xac name</td>
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<tr>
<td>XacBank provides franchise package, initial training, and initial funding for executive director of co-op</td>
</tr>
<tr>
<td>In return, co-op must meet certain requirements (e.g. amount of assets, members)</td>
</tr>
<tr>
<td>XacBank does not count co-ops’ members as its own, but offers wholesale loans to rural co-ops and charges franchise package fee (upfront fee + quarterly fees)</td>
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<table>
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<th>Strategic Rationale</th>
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<tbody>
<tr>
<td>Increases outreach to remote rural areas; XacBank began with mobile model but franchise model seen as more sustainable</td>
</tr>
<tr>
<td>XacBank collects revenue from franchise fee (not currently profitable, but plans for future profitability; may charge for training and raise fees)</td>
</tr>
<tr>
<td>XacBank provides wholesale loans to co-ops; hopes to build loyalty through initiatives such as co-ops buying bank shares</td>
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<tr>
<th>Lessons Learned and Key Success Factors</th>
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<tr>
<td>While XacBank offers franchise package, success dependent on co-ops taking control and initiative – cannot force co-op to grow (2002 liquidated bank and brought assets to co-op, unsuccessful and forced to write it off)</td>
</tr>
<tr>
<td>Challenge in identifying local people to take initiative and start cooperative</td>
</tr>
<tr>
<td>Operational challenges in implementation and risk management</td>
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</table>

Source: Interviews with microfinance practitioners; XacBank: Panet Rating June 2004

**CONCLUSION**

Expansion strategies offer numerous benefits and challenges. When evaluating options, it is important to take into account their attractiveness and an organization’s ability to execute them.

There are different ways MFIs can expand, create value for clients and be differentiated in the market. To determine which strategy is best for an institution, here are some key questions to consider:

- **Market Attractiveness**: What is the size of the market and how quickly is it growing? How strong is the understanding of customer’s needs and preferences?
- **Competitive Positioning**: What does an analysis of the industry and competitors indicate? Are there barriers to entry? How fierce is the competition?

- **Fit**: Does the expansion strategy fit with the mission of the organization? Are there synergies given the existing business model?
- **Executability**: Does the organization have the capacity to make a substantial change? Does the skill set reside within the institution? What is the risk tolerance of the institution? Can the risks be managed?

An organization cannot be all things to all people. Knowing when and how to expand, and what choices to make, are key strategic decisions that will impact the long term success of an institution.
APPENDIX 1

Stages in Industry Evolution

Source: Women’s World Banking, Strategic Positioning Product
REFERENCES
Ernst, David; Bamford, James, "Your Alliances are Too Stable," Harvard Business Review, June 2005
McCarter, Elissa, Mergers in Microfinance: Twelve Case Studies, Catholic Relief Services, 2002
McCarter, Elissa, Tying the Knot: A Guide to Mergers in Microfinance, Catholic Relief Services, 2002
NAMAC Trust, "Best Practice Manual for Franchising"
Women’s World Banking interviews with industry experts in microfinance field, academia, and private sector

ENDNOTES
1 Women’s World Banking Interviews, 2005.
2 Refer to Appendix 1.
3 SKS is a microfinance NBFC based in Andhra Pradesh, India and Bandhan is a microfinance NGO operating out of West Bengal, India.
4 Unilever’s Indian subsidiary.
5 Framework developed by Accenture Development Partnerships (ADP).
6 Spandana is an NBFC in Andhra Pradesh India serving around 600,000 clients.
7 MI-Bospo is a leading regional microfinance provider of credit in Bosnia and Herzegovina and a member of Women’s World Banking.
8 EBS is a member of the Global Network for Banking Innovation (GNBI) of Women’s World Banking. For more information on the alliance, refer to Innovation Brief on Remittances by Women’s World Banking.
9 ICICI is a GNBI member of the Women’s World Banking network.
10 Women’s World Banking Interviews, 2005.
12 Sirower, Mark, The Synergy Trap.
13 Ibid.
14 Ibid.
15 Women’s World Banking Interviews, 2005.
16 Developed by ADP.
This note was prepared by Harsha Thadhani Rodrigues and Tricia Morente. WWB would like to thank Accenture Development Partnerships for its input into WWB’s approach on expansion strategies.

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