

## MELA: New Product Development

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## LIST OF ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
AKF	Aga Khan Foundation
AKFC	Aga Khan Foundation Canada
AO	Area Office
ASA	Association for Social Advancement (a Bangladeshi NGO and MFI)
BDP	BRAC Development Programme
BRAC	Bangladesh Rural Advancement Committee (Formerly)
BUP	BRAC Urban Programme
CIDA	Canadian International Development Agency
FIMM	Fellowship in International Micro-finance and Micro-enterprise
IGVD	Income Generation for Vulnerable Group Development
IRRI	International Rice Research Institute
MELA	Micro-Enterprise Lending and Assistance
MF	Micro-Finance
MFI	Micro-Finance Institutions
NFFI	Non-Formal Financial Institutions
NGO	Non-Governmental Organisation
RCTP	Rural Credit and Training Programme
RDP	Rural Development Program
SME	Small and Medium Enterprises
TARC	Training and Resource Centre
VO	Village Organisation
WFP	World Food Programme
WWB	Women's World Banking

*"A sustainable programme is far from static. Keeping up with client needs is a constant challenge"*  
- Edgcomb and Crawley, 1994

## I. EXECUTIVE SUMMARY

The MELA programme was borne out of recognition that the scope of MFIs (Micro-Finance Institutions) was limited. That is, BRAC recognised that not all people were endowed with the inherent ability to be entrepreneurs, and that what those people needed was access to wage employment. At the same time, it was noted that there was a segment of the poor, the moderate poor, which did not belong to the target group of the MFIs and did not have ready access to formal financial institutions. What differentiated these people from the traditional micro-finance target groups, was that they required larger loans than offered under the traditional micro-credit schemes. It was the intention of the MELA programme to extend small-medium capital loans to individual entrepreneurs who would use the money to expand their businesses and create employment for BRAC's target group.

Historically, micro-finance has succeeded because it has been able to bypass the need for credit histories and employment experience through innovation of the group solidarity model and through reliance on character assessments to mitigate the risks of loan delinquencies.<sup>1</sup> These qualitative methods are unlikely to work under the individual lending model and thus MELA must employ additional methods to mitigate such risk including quantitative methods (such as credit scoring) as well as "cutting edge" product developments.

In the last five years, sufficient data has been collected with which to determine the lending, borrowing, and payment habits of the MELA participants. The results have been clear; with the growth in the outstanding portfolio there has been an increase in the percentage of loan delinquencies. This increase in delinquencies provides an instant trigger that there exist some reformations that need to be made to the current MELA lending technology.

The current MELA loan product offering is a clone of the standardised and bureaucratic VO loan programme (which was designed to serve a much less competitive and complex market). The MELA product line needs to be significantly more varied and market-driven if MELA is to be successful.<sup>2</sup>

This paper was initiated to address the likelihood of grafting new products into the current MELA lending technology. It has been developed because there is belief in the imperative need to develop new strategies in combating the rising delinquency rates among BRAC's MELA programme participants and at the same time maintain a competitive advantage in the small-medium capital lending market. One such strategy that will accomplish both these goals is the creation of new products.

<sup>1</sup> Churchill, C. 1999. *Client Focused Lending: the Art of Individual Lending*. Calmoudow, Toronto.

<sup>2</sup> Kelley, B. & Pikhola, L. 2000. *Micro-enterprise Lending and Assistance Programme (MELA): Review, Analysis, and Recommendations*. Shorebank Advisory Services, Dhaka. [hereinafter "Shorebank"].

A product, broadly defined is anything that satisfies a customer's need or want.<sup>2</sup> This definition is inconsistent with the current operations of many non-formal financial institutions (NFI). The institutional mentality of most NFIs has been product driven rather than market driven, in which the loans issued are highly standardised with little variation or field officer discretion. Mono-products are simple to administer and the costs of fraud are easy to control. Indeed, for the non-formal financial institution monopoly, organisational effectiveness was more important than choice when it faced no competition.<sup>3</sup>

Bangladesh has become a breeding ground for micro-finance organisations and acts as host to over one hundred such organisations, both large and small. The non-formal financial industry has become a lucrative industry in Bangladesh and thus the competitive race to establish such institutions has been fierce. Fortunately, BRAC retains an attitude and mentality that is very forward thinking, innovative and creative. For this reason, BRAC has remained a leader in the non-formal financial industry. In order to secure its position as a leader, it needs to continuously hone and advance its products and services.

This paper will discuss the opportunity that exists at BRAC to increase both its depth and breadth through the creation of innovative products that will be congruent with both MELA's objective as well as the needs of the client. It will outline the areas in which the market allows for further penetration as well as the challenges that exist with the creation of such products. In addition, the conceptual framework of product development will be discussed briefly as injected by practical case examples of areas in the world where new products have assisted and allowed for deeper and broader penetration of the industry.

The concept behind MELA is a relatively new one for the micro-finance industry at large and indeed for Bangladesh. The lending technology needed for this market is fundamentally different from the conventional micro-finance methodologies and there could be a need for other non-financial assistance such as business development services for greater impact. Not much expertise or prior knowledge exists in Bangladesh in serving this market<sup>4</sup>. However, BRAC can benefit from the experience of other financial institutions in other areas of the world. Although, each case is not one that can be replicated in Bangladesh, there are several important lessons to be learned.

The resulting products were the result of discussions with many layers of the lending cycle including district managers, area office managers, MELA programme officers, MELA loanees, as well as those who have recently submitted application for MELA loans. In total over fifty members were engaged in discussion spanning five area offices: Gazipur, Sreepur, Faridpur, Madhukali, and Rajbari. Further, several articles

<sup>2</sup> Kotler, Philip. 1997. *Marketing Management: Analysis, Planning, Implementation, and Control*, ninth edition. Upper Saddle River, NJ: Prentice Hall Inc. [hereinafter "Kotler"].

<sup>3</sup> Brand, Monica. 1998. *New Product Development for Micro-finance. Evaluation and Preparation Technical Note Number 1*. Micro-enterprise Best Practice, Bethesda, MD. [hereinafter "Brand 1"].

<sup>4</sup> BRAC. 2000. *Innovating on Solid Ground: RDP Phase IV, 1996-2000*. Dhaka: BRAC. [hereinafter "Phase IV"]

on the topic were consulted. In summary the four products further discussed and recommended in this paper are:

1. *Inventory-Supply Loan:* This loan product has been developed as an incentive to retail clients to accelerate their payments and reduce the total interest outlay. It also reacts in response to the concerns of loanees regarding the above average effective interest rate paid by them to BRAC. It reduces the loan term from 24, 18, or 12 months to a six or three month term, which reduces the entrepreneurs' cash-interest outlay without adjusting the standard 15% interest rate.
2. *Agricultural Loan:* This agricultural loan product is designed for small farm owners who live in rural areas of the country. The terms of this loan are specifically tailored to the seasonal needs of its target market, including interest only grace periods and balloon end-payments tied to the harvest cycle. This loan should only be available in certain areas where agriculture has a comparative advantage.
3. *Manufacturing Loan:* This loan product includes organising industry members into co-operative groups, allowing for physical collateral guarantees of loans, and sharing of technical assistance and ideas to fellow group members.
4. *Parallel Loan:* A parallel loan is an imitation line of credit facility whereby a borrower in good standing can take on additional, short-term credit during peak season or during rapid expansion phases, but within a term loan structure.



## II. INTRODUCTION: BRAC, BANGLADESH, AND MICRO-FINANCE

BRAC (formerly the Bangladesh Rural Advancement Committee) is at the forefront among NGO's working in Bangladesh. It was founded by Mr. Fazle Hasan Abed in 1972 as a simple relief organisation for refugees returning from India after the Bangladesh Liberation War. Since then BRAC has evolved into a comprehensive multifaceted development organisation providing primary and adult education, training and enterprise skills, economic support, and health and family planning services, with a particular emphasis on the most disadvantaged: women. At its core, BRAC's main objective is the alleviation of poverty through empowerment of the poor. Today BRAC is noted as being the world's largest indigenous organisation and has been heralded by many as a "model" in its multi-faceted and holistic approach to development.

The view that poverty is reproduced in a major way through capital market imperfections was recognised by BRAC in its early days.<sup>6</sup> Lack of access to reliable financial services was deemed to be a significant constraint of the poor in their efforts to lift themselves out of poverty.<sup>7</sup> Intervening in this market with a view to democratising access to capital and other financial services was recognised as an important step towards removing a block that hinders the poor's effort to actively improve their own socio-economic condition.<sup>8</sup>

This recognition led BRAC to first experiment with credit in 1974. By disbursing loans to small groups of people and providing the technical assistance to involve themselves in different income generating activities, BRAC observed that there existed significant poverty alleviating opportunities through micro-credit. Following that first experience as a credit giver, BRAC tested various approaches to micro-loans, and appraised the credit inputs in the lives of the poor. Since then, BRAC's micro-finance programme has grown to include over 4.25 million people as targeted through various segments of the population including the extreme poor, moderate poor, and non-poor.

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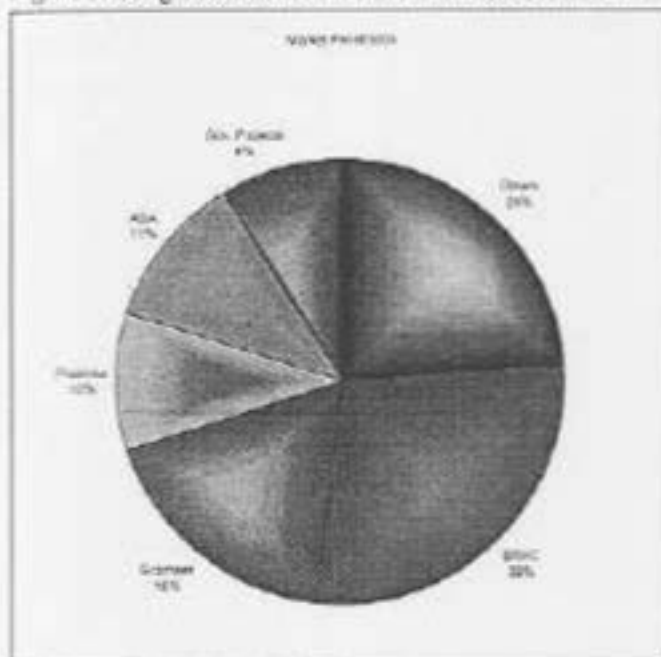
<sup>6</sup> Phase IV, *supra*, note 5 at 7.

<sup>7</sup> Phase IV, *supra*, note 5 at 7.

<sup>8</sup> Phase IV, *supra*, note 5 at 7.

With a population of 131 million (July 2001 estimate)<sup>9</sup> of which 36% (1996 estimate) are below the poverty line<sup>10</sup> there exists a large market and need for micro-finance activities. In fact, it is estimated that Bangladesh holds a target market of 18 million, with an actual outreach of 15.5 million<sup>11</sup>. As the population continues to increase,

Figure 1: Bangladesh's Micro-Finance Market Penetration



there exists a larger scope for MFIs. In Bangladesh the MF market has been penetrated by several MFI's both large and small. At the head of this is BRAC which has captured 28% of the MF market share.

Simply defined, micro-finance is the provision of financial services to the poor at a micro level. It has been deemed an effective and critical development tool as it benefits poor households by providing financial choices using credit and savings facilities, insurance and leasing services, and advice on life management skills. Experience of micro-finance

institutions all over the world has clearly demonstrated that the poor are committed, they are bankable and that they make valuable clients of specially designed financial services.

The goal of BRAC's micro-finance programme is to provide specifically tailored banking and other services to the poor.<sup>12</sup> Ultimately, the objective of BRAC is to promote the economic development of the country by increasing the income level of the rural poor, particularly women.<sup>13</sup> Initially, however, BRAC was concerned with creating a self-sustaining body whose credit activities generated sufficient income to support other social development programmes.<sup>14</sup> The impact of credit provision has been felt by the 3.48 million women who are increasingly being understood as an important income generator in their household and in their country.

In 1979, BRAC launched two separate programmes: The Outreach Programme, which mobilised the landless to use their own resources and obtain support from the local government to improve their lives; and, the Rural Credit and Training Programme (RCTP) which organised landless groups, and provided them with training, credit and

<sup>9</sup> CIA - *The World Fact Book - Bangladesh*. Central Intelligence Agency, 17 Feb. 2002 <[www.odci.gov/cia/publications/factbook/geos/bg.html](http://www.odci.gov/cia/publications/factbook/geos/bg.html)> [hereinafter "CIA"].

<sup>10</sup> CIA, *supra*, note 9 at 10.

<sup>11</sup> Women's World Banking, 4 to 8 February 2002. Maximising Efficiency Workshop Conference Handouts, Dhaka.

<sup>12</sup> Phase IV, *supra*, note 5 at 7.

<sup>13</sup> Phase IV, *supra*, note 5 at 7.

<sup>14</sup> Phase IV, *supra*, note 5 at 7.

self-employment opportunities. In 1986, Rural Development Programme (RDP) was formed, which, among several other components, included provision of savings.

Additionally, BRAC provides financial services through a number of other programmes which provide tailor made credit to specific target groups. The Income Generation for Vulnerable Group Development (IGVGD) Programme provides credit and other support services including training and essential health care to the extreme poor who receive food aid through the World Food Programme (WFP). The BRAC Urban Programme (BUP) also provides financial services to the urban poor. And lastly, the Micro-enterprise Lending and Assistance Programme (MELA), as the youngest member of the family of financial services, is directed towards serving the financial service needs of the more entrepreneurial advanced among our VO members and also among non-members.

MELA is a relatively new BRAC programme. It was born in 1996, with the objective of generating income and creating new employment through enterprise development in the rural and semi-urban areas of Bangladesh by providing credit facilities and technical assistance to new and existing small businesses. MELA was introduced through 10 branches of RDP in 1996. At the end of February 2002, MELA operated in 194 branches.<sup>15</sup>

The option of self-employment is at times too risky especially for the very poor. Wage employment can create the conditions for many of them to take up self-employment and more rewarding entrepreneurial ventures later. Supporting micro-entrepreneurship by removing the capital bottleneck can be an effective strategy in contributing towards creating a more vibrant local economy. This, in turn, can benefit the poor through employment and consumption linkages. This is the conceptual underpinning behind the MELA Programme, which aims to provide working capital credit to existing micro-entrepreneurs who want to scale up. Both member of the village organisations who show an entrepreneurial drive and micro-enterprises of non-members in MELA's working area are considered as the target market for this programme. The rationale behind including RDP non-members for this programme has been driven by two considerations. One is to ensure that there are enough clients to make the MELA unit's operations viable - the number of RDP clients who would be suitable for this programme might not be enough. The second reason was to further strengthen the consumption and employment linkages to benefit the poor, by supporting a larger and more varied range of enterprises<sup>16</sup>.

<sup>15</sup> Currently BRAC operates out of 453 Branches (or area offices) and 672 outposts. BRAC realised that the coverage of its catchment area was concentrated within the area around the AO's and that most NGOs working in an area were also clustered around the main town, leaving the peripheries relatively unserved. Remoteness is closely linked to forms of chronic poverty, and thus in an effort to reach out more extensively and serve the peripheries and remote area, BRAC has introduced outposts that are attached to the nearest AO.

<sup>16</sup> Phase IV, *op cit*, note 5 at 7.

### III. CONCEPTUAL FRAMEWORK FOR DEVELOPING NEW PRODUCTS

With the rapid onset to establish micro-finance institutions in Bangladesh, competition has been fierce at attempting to capture a larger share of the micro-finance market. In fact, currently Bangladesh is host to some 100 micro-finance institutions (both large and small). In the last ten years, product development has been seen as a means to differentiate and to increase the breadth of these institutions. In her *Technical Notes 1 and 2, New Product Development for Micro-finance*, Monica Brand<sup>17</sup> discusses the process of new product development. The notes are "intended to serve as a guide for micro-finance institutions looking to expand their reach both in breadth (new markets) and depth (new products)"<sup>18</sup>. Brand's paper identifies the approach to the development of new products that should be taken. The following is a summary of this approach.

#### Traditional Approach to New Product Development

A product is anything that satisfies a customer's need or want.<sup>19</sup> From an institution's point of view, a new product represents an opportunity to create value, and in so doing, offers a strategic competitive advantage.<sup>20</sup> Brand's technical note deals primarily with financial services and thus it takes the broadest definition of product to include its component parts:

**Core product:** The reason *why* the customer pays money — a benefit (e.g., financial return, security) or the need it fulfils (e.g., liquidity, livelihood);

**Actual product:** The specific features that characterise *what* the customer is buying — including how it is designed (terms, interest rates, eligibility requirements) and packaged (length and clarity of the application, colour of the passbook);

**Augmented product:** *How* the customer receives the product — the way in which it is delivered and serviced (application turnaround time, hours of operation, waiting room facilities, and customer service — in terms of friendliness, accessibility before and after the loan is closed; product knowledge of loan officers).

New product development involves refining and expanding these component parts in a methodical and systematic manner. Corporate approaches to new product development have been consistent over the last couple decades, and have followed a sequence similar to that depicted in the figure below.

<sup>17</sup> Monica Brand is Director of Programme Evaluation for ACCION International, a nonprofit organization that finances micro-enterprise development throughout the Americas. Previously, she worked in and around San Francisco, California, for the Development Fund, helping design a \$50 million, statewide, multi-bank lending intermediary to finance small businesses; for an environmental loan fund; and for the Women's Initiative for Self-Employment, providing business training to female micro-entrepreneurs.

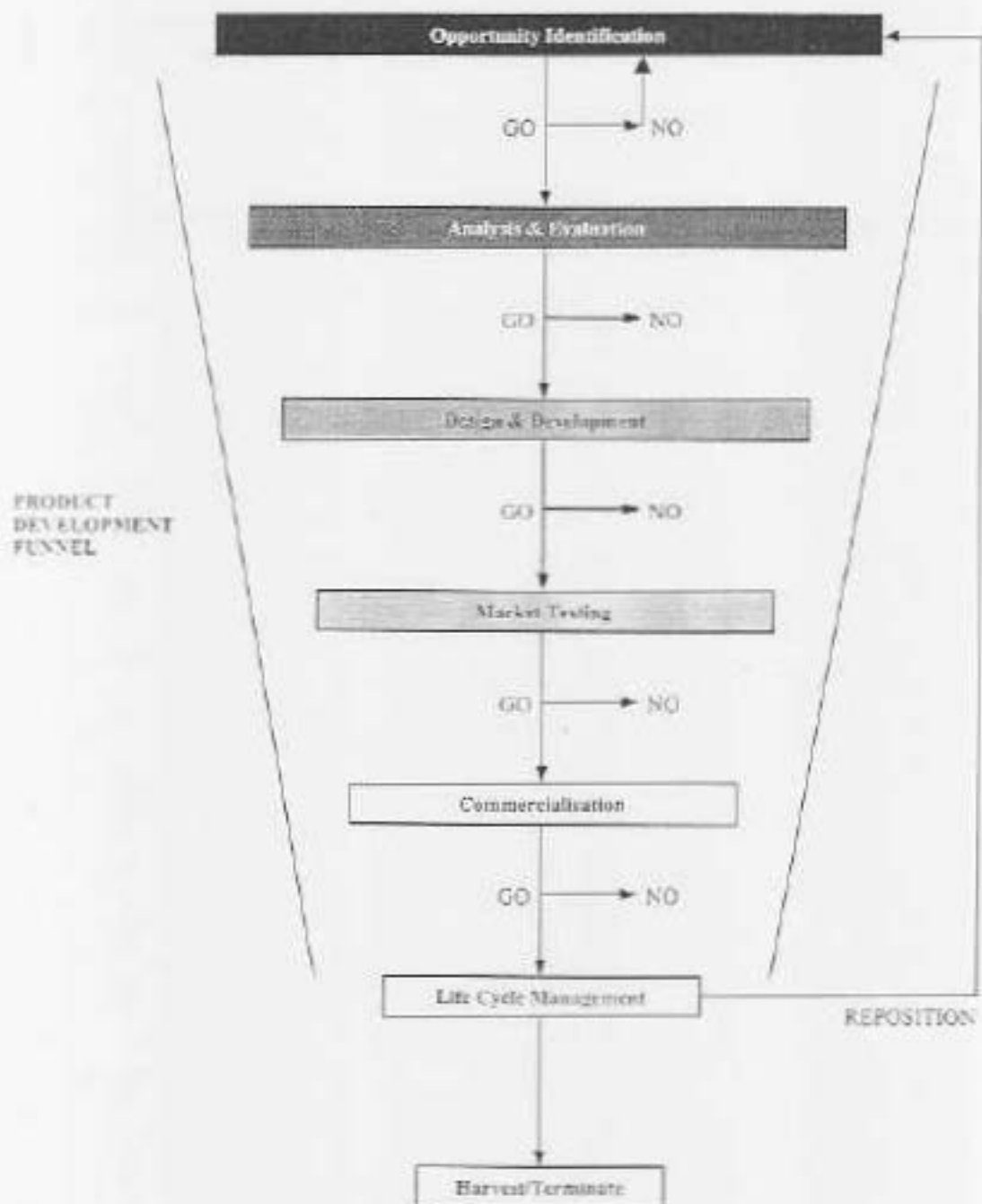
<sup>18</sup> Brand 1, *supra*, note 4 at 7.

<sup>19</sup> Kotler, *supra*, note 3 at 7.

<sup>20</sup> Thomas, R. 1993. *New Product Development: Managing and Forecasting for Strategic Success*, New York: John Wiley & Sons, Inc. [hereinafter "Thomas"]

Figure 2: Traditional Approach to New Product Development

The figure depicts that new product development is an ongoing process of refinement based on client feedback and market analysis. Successful new product development is as much about revising and repositioning existing products as they evolve as it is about innovation. It is the process as much as the features of the product itself that will ultimately determine success. (Taken from Monica Brand (1998))



The figure depicts six stages of new product development.

1. **Opportunity identification** in untapped markets is about the signals from within and outside an institution that give rise to new product ideas. An MFI's new market opportunities include increasing its product line's depth (new products and services to existing customers) and breadth (current products to new target markets<sup>21</sup>).

How can an institution conclude that new products are required? Certainly, one of the most basic and efficient methods is to analyse current lending trends. Sharp increases in delinquency or desertion are strong indicators of new product requirements. This instantaneous delinquency trigger, which is part of most strong methodologies, can be a source of new product development if an MFI can incorporate the valuable business information that late payments signal. A business might face repayment difficulties because of a change in cash flow needs (e.g., seasonality, rapid growth), external economic factors (e.g., industry downturn, recession), personal factors (e.g., sick family members) or, simply, because it was a poor credit risk. Understanding these differences is important because there may be mutually beneficial product development opportunities that can meet customer needs while improving the bottom line. In particular, MFIs have addressed repayment problems brought on by a business cycle or a particular stage of growth by refining their products.

#### Box 1: Freedom from Hunger

*Freedom from Hunger* is an international development organisation working in fourteen countries across the globe and is a non-profit, non-governmental, non-sectarian organisation. Established in 1946, *Freedom from Hunger* is recognised for fighting hunger with innovative self-help programmes. In 1961, it developed the world's first integrated micro-credit/health and nutrition education programme. Today, the *Credit with Education* programme is serving over 170,000 families in some of the poorest countries on earth.

In Thailand, the affiliate of *Freedom from Hunger* extended its typical monthly loan cycle from four months to six to accommodate the silk harvest, in which many of its clients were engaged. "We have to be responsive to the borrower's needs. Rice farming has a rapid cycle—four to five months—so short-term loans are easily serviced. With mulberry trees and silk worms, it takes longer. So rather than force our borrowers to sell bananas to meet rapid repayment schedules, we tailored the loan product to meet the need."

Source: Brand, *Monde* (1998).

2. **Analysis and evaluation** deciphers opportunity signals to determine whether developing new products makes strategic sense based on an assessment of client needs, competitive threats, and its own institutional resources.

3. **The design and development** phase delineates how to design and develop a *prototype* (a representation of all or parts of a product) to be pilot tested. This phase requires two major steps:

- a. *Internal set-up*. This process involves mobilising the interdepartmental collaboration necessary to undertake the development of the new product including identifying a product champion (its main proponent), staffing the cross-functional team, and building institutional buy-in, or full acceptance, of extending the product line.

<sup>21</sup> Kotler, *supra*, note 3 at 7.



b. *Market research.* Once the desired product mix has been defined, the MFI undergoes a process of segmenting the market and forecasting demand through different methods of market research. Sources of information and approaches for gathering data can be pulled from both inside the organisation and external sources, including valuable customer feedback.

4. **The market test phase** involves the introduction of the *prototype* into the market on a limited scale to provide a reality check on the research and to refine the product. *Pilot testing* helps predict the product's future market acceptance. The process involves:

- Selecting test sites, which includes the size of test group, location of test, and *target market*;
- Setting landmarks during the pilot test to pause for analysis and product refinement;
- Establishing test duration by comparing the benefits of thorough field research with the costs involved, including direct cash outlays and the *opportunity cost* of time and market share; and
- Analysing the results of the pilot test by considering the financial, competitive, methodological, and institutional issues of adopting the new product.

5. **Commercialisation** includes market launch or product rollout and is the result of a successful research phase. Product scale-up, or rolling out the product to the entire market, starts with the four Ps of marketing—product (design), price, promotion, and positioning (including both physical distribution and market positioning vis-à-vis competing products). Implementation of a new product also requires building up the institutional capacity of the organisation in terms of staff training, incentives, and information systems.

6. **Life Cycle Management:** Tracking of the product's life cycle includes a product's initial implementation and subsequent market penetration. Product development is treated as an ongoing process of refinement based on client feedback and market analysis.

Tailoring products to the evolving needs of clients can have real profit opportunities. In addition to reduced delinquency, which inevitably comes when cash flow from operations is better aligned with repayment schedules, is the relationship that is built upon customer service. Loyal borrowers are a source of profits for most MFIs because of borrowers' increased demand for new services, their lower risk of costly delinquency, and their invaluable word-of-mouth publicity. As a customer's enterprise grows, so does its need for tailored financial services, adjusted terms, and new products.

In a later paper, "Commercial Approaches to New Product Development in Micro-finance: Case Studies of Banco Solidario de Ecuador and Cajas Municipales de Arequipa Peru" (August 1999), Brand, identifies some of the key elements that resulted in successful product development initiatives among micro-finance institutions. The elemental features attributed to success of a product according to her have been summarised as follows:

1. **Take a target-market approach to product design.** Micro-entrepreneurs are not homogeneous. Within the micro-enterprise sector, different segments appear with different needs and demands. Likewise, micro-enterprises and households have different financial needs at different times. Using a product development process that is client-centred allows commercially oriented micro-finance institutions to meet both their financial as well as social goals. Products tailored to a client's financing needs have a greater impact in helping them manage the volatility inherent in the sector within which they work. Designing product terms tied to client cash flow also improves their repayment capacity, allowing the institution to sustain operation and take greater risks.
2. **Develop risk management techniques to preserve asset quality.** Risk control measures need to be taken in both the delivery of the products and the actual design. Institutions should try to be creative and flexible in instituting risk controls to maintain the attractiveness of their products to customers while preserving asset quality.
3. **Offer a diversified portfolio of products to penetrate more deeply into the target market.** In serving multiple markets, an institution runs the risk of spreading its resources too thinly and diluting its efforts. An MFI should use their diverse product menu to provide incentives for prompt repayment and to position themselves as the one-stop shop for a micro-enterprise's financing needs.
4. **Establish a culture of innovation to develop new product opportunities.** This point is not limited to the generation of new product ideas. Rather, it is a critical component of the ongoing refinement that is necessary to ensure the product meets the needs of an ever-evolving target market. Institutions should use technology and incentives to foster a culture of innovation that promotes the generation of new product ideas.

**Box 2: Cajas Municipales de Peru**

Cajas Municipales de Peru offers a product, called *perpetual loans*, which provides short-term working capital to seasoned borrowers for periods of high productivity. Cajas Municipales de Peru offers automatic credit to clients with a proven repayment history, which provides instant access to up to three loans within an established limit, and which can be adjusted based on client demand. The financial benefit to the MFI is threefold: increased sales to strong clients, reduced transaction costs because of streamlined credit assessment and delivery, and improved customer satisfaction and loyalty.

Source: Morita Brand, (1999)

The micro-finance industry is evolving quite rapidly around the world. With the rapid spread of best practices in micro-finance, there are an increasing number of institutions providing micro-finance services with an increased emphasis on sustainability and profitability. The markets for micro-finance services are evolving with increased competition, increased sophistication of the clients, and more and varied services being offered. The increased competition is putting greater pressure on the micro-finance institutions to retain their existing clients and to identify new clients or new financial products in order to continue to expand their services. More sophisticated clients are looking for new financial products that meet their needs. The combination of all of these factors is increasing the importance of marketing new products within the MFIs.



#### IV. CURRENT PRODUCTS AND TREND ANALYSIS

From humble beginnings as a pilot project that was directed towards graduated members of the BRAC's Micro-finance programme, MELA gained quick momentum to become a successful and rapidly growing venture. By January 2002, MELA had cumulatively disbursed almost 1.4 billion takas in loans and further had attracted over 16,000 borrowers. After five years it is large enough to have a lending history, significant cash flow, and an emerging management capacity<sup>22</sup>. Before proceeding with a discussion on the loan products that are recommended to further expand the programmes it is important to gain an understanding of the trends that MELA has followed in the past year. This will create an understanding of the areas in which MELA has succeeded and the areas in which there exists areas for improvement. This portion of the paper is dedicated to analysing historical data of MELA and to determine if trends exist that will assist BRAC in determining the next course of action in its on-going development.

##### Current Loan Products

MELA currently offers one product: the demand loan. The terms of such a loan are outlined as follows:

###### Box 3: MELA's Current Loan Product

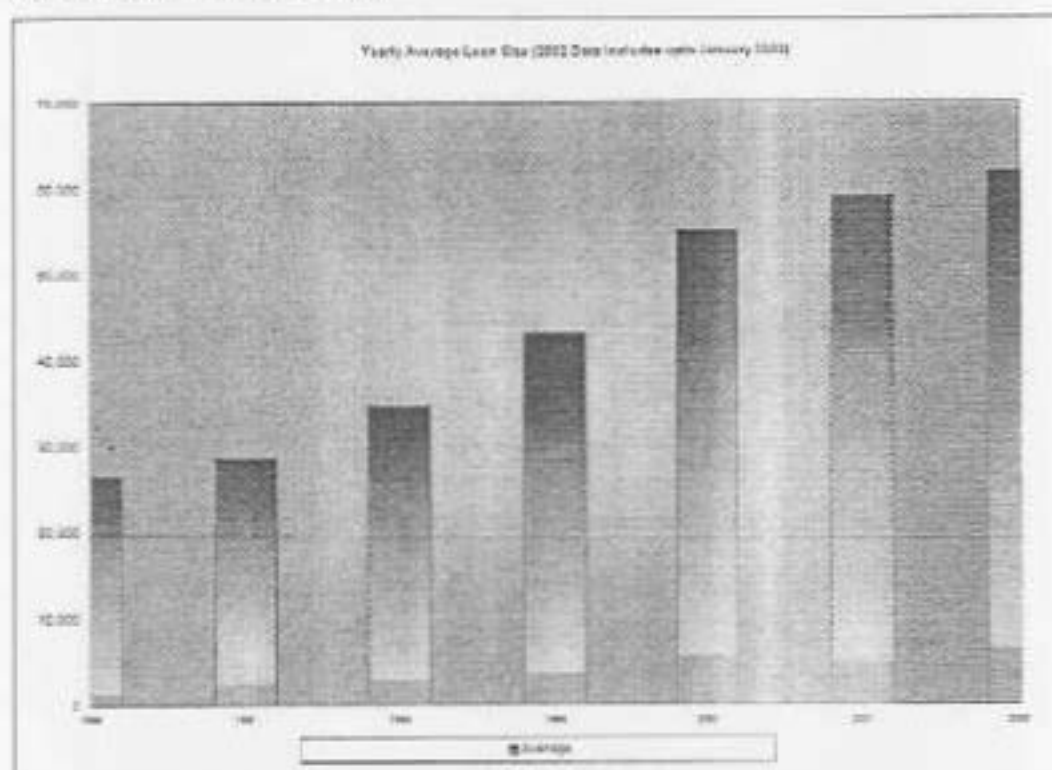
- Loan Range: 20,000tk-200,000tk
- 16% flat interest rate (28% effective rate of interest)
- Monthly equal loan repayment instalments
- Loan terms: 12 months, 18 months, and 24 months
- Twenty different business sectors are supported
- Service charge rebate: 15% of the amount paid in advance

##### Average Loan Size

Over the last five years, the average MELA loan size has increased: from Tk 26,600 in December 1996 to Tk 62,000 in January 2002. This increase of 133% over the past five years is indeed encouraging as it confirms that BRAC loans are penetrating the market more profoundly with respect to depth. This analysis corroborates that there is in fact a gap that exists in serving this increasingly important market segment: that is the moderate poor. Ironically however, based on discussions with programme officers, more often than not, programme officers give less than the amount requested by the businesses; if in fact the amount requested by the borrower was in fact met, the average loan size would likely be much higher. Further, as the pool of repeat borrowers increase, the number of larger loan sizes increase. This is due to the fact that repeat borrowers demand larger loan amounts, and if they have exhibited diligent repayment behaviour, programme officers are likely to authorise the disbursement of a larger loan amount.

<sup>22</sup> Shorcbank, *supra*, note 2 at 6.

Figure 3: Yearly Average Loan Size

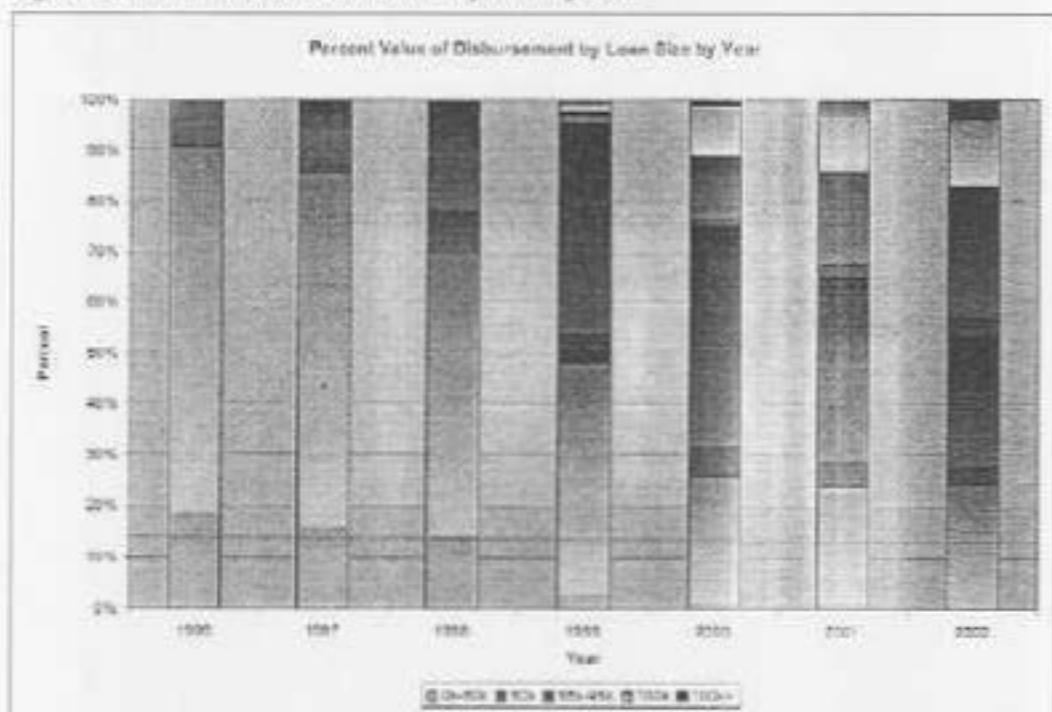


To support this analysis is the graph below which outlines the percent value of disbursement by loan size for the past five years. As the programme matured in the first five years, the bulk of the loan gradually moved upwards from 0tk to 50,000tk to 50,000tk, and in the recent past to between 50,000tk and 100,000tk. Overall, this trend is both positive and necessary: if MELA is to achieve its stated goal of growing existing small businesses, new rural jobs and wage employment, it must consistently increase its average loan size.<sup>23</sup> This dramatic portfolio growth must be accompanied by a parallel development of staff, management and strategic capacity, for it is only through the development of strong management skills focused on implementing a highly focused and strategic MELA plan will this programme achieve its economic development goals.<sup>24</sup>

<sup>23</sup> Shorebank, *supra*, note 2 at 6.

<sup>24</sup> Shorebank, *supra*, note 2 at 6.

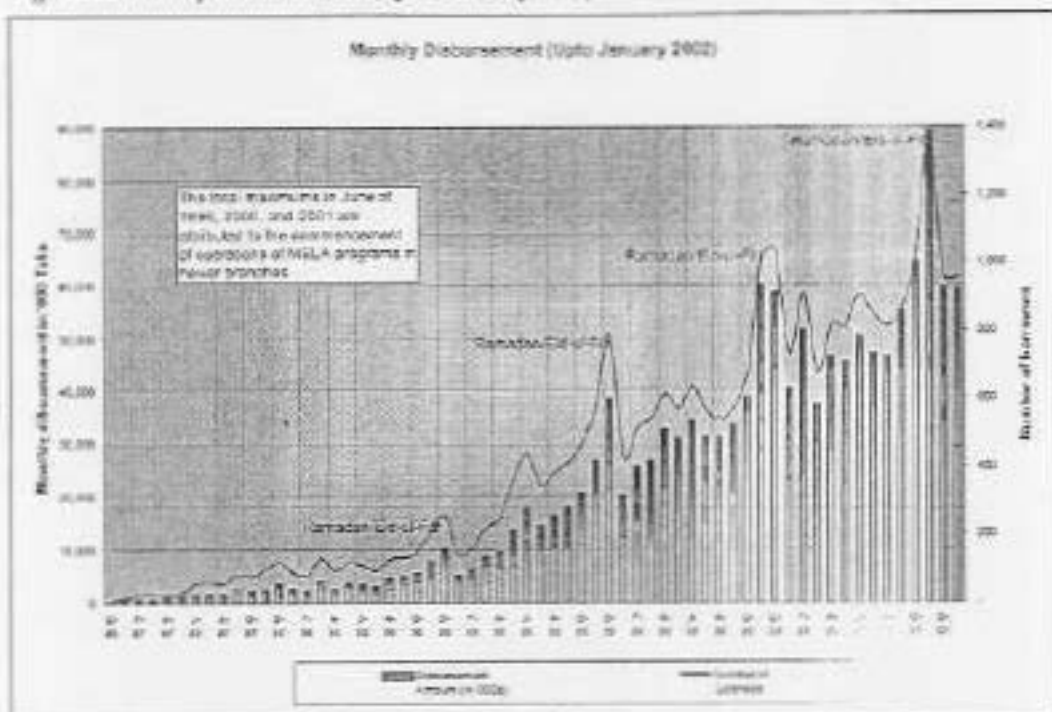
Figure 4: Percent Value of Disbursement by Loan by Year



#### Monthly Disbursement

The graph below depicts the monthly disbursement as well as the number of loans disbursed in the month. The most obvious trend is the fact that since inception, the number of loans disbursed has been increasing significantly. This is certainly a move in a positive direction, and like the increase in average yearly loan size, confirms that MELA loans are increasing their depth with respect to penetration of the market. However, upon closer examination the graph illustrates several peaks. These peaks happen in sporadic but logical movements. Between 1998 and 2001, Ramadan/Eid-ul-Fitr has fallen during winter (November-January). During this time, entrepreneurs are keen to take out MELA loans in anticipation of higher sales. This generally is indicative of enterprises engaged in the sale of goods, such as grocery, stationery, textiles and the like.

Figure 5: Monthly Disbursement (up to January 2002)



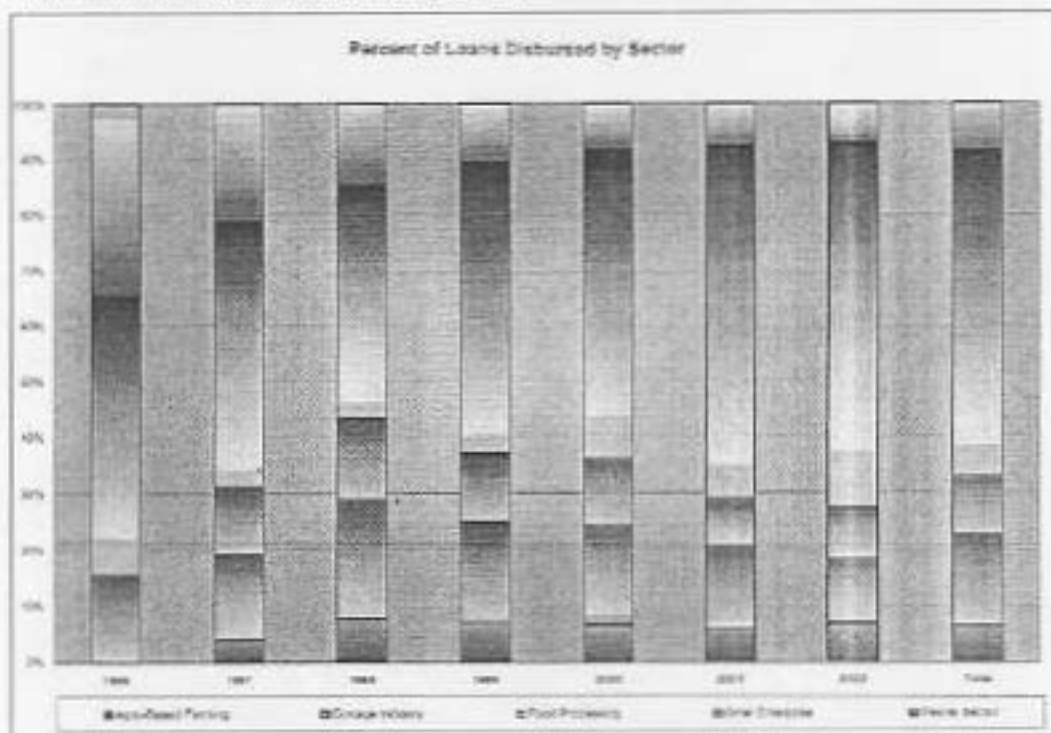
Further, there are local maximums during the months of June in 1999, 2000, and 2001. Per discussion with MELA staff, this increase in loans is expected due to the fact that during the beginning of the calendar year new branches are opened. Generally it takes about five to six months for a branch to develop the infrastructure to disburse loans. As such, it is in June that significant number of loans is disbursed as members wait in anticipation of the operations of the branch office.

### Sectoral Analysis

Since inception, MELA has offered over 26,000 in loans to some twenty industries over five sectors: agro-farming, cottage industry, food processing, other enterprises,<sup>25</sup> and the textile industry. Majority of these loans have been to the "other enterprise" sector. These industries are non-productive sectors and do little in terms of creating employment. MELA's employment creation strategies will be discussed later.

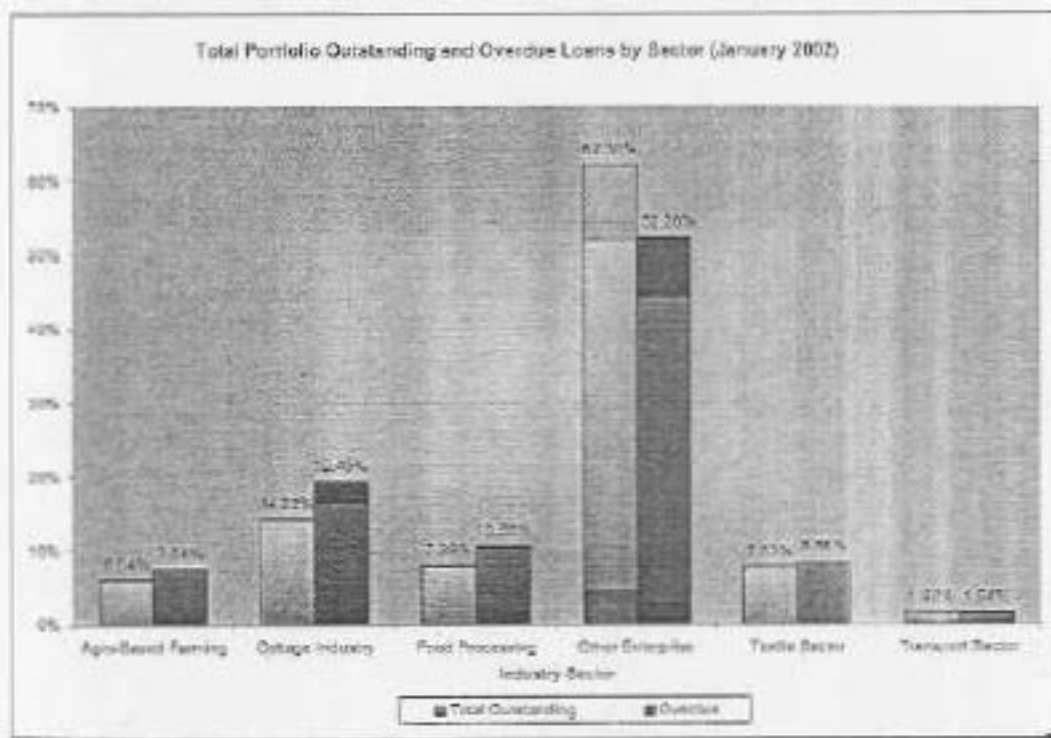
<sup>25</sup> "Other Enterprises" includes grocery, retail, traders, cloth, and service businesses. These industries, with the exception of the Service Sector, are engaged in the sale of inventoriable items. At January 2002, the service sector accounted for only 1.9% of the total loan disbursed in the month. In light of the immateriality of this amount (700,000tk.) when reference is made to the Other Enterprises Sector, it is made in reference to those enterprises engaged in the inventoriable items, unless otherwise stated.

Figure 6: Percent of Loans Disbursed by Sector



When the total portfolio outstanding and the overdue loans is disaggregated according to the five sectors, an interesting fact is noted: that the "other enterprise" category shares less than its proportional share of the overdue loans. This is generally accepted due to the nature of the sector. As previously mentioned the other enterprise sector consists primarily of traders and those engaged in the sale of inventoriable items. This industry is characterised by working capital requirements, high turnover of inventory,

Figure 7: Total Portfolio Outstanding and Overdue Loans by Sector (January 2002)

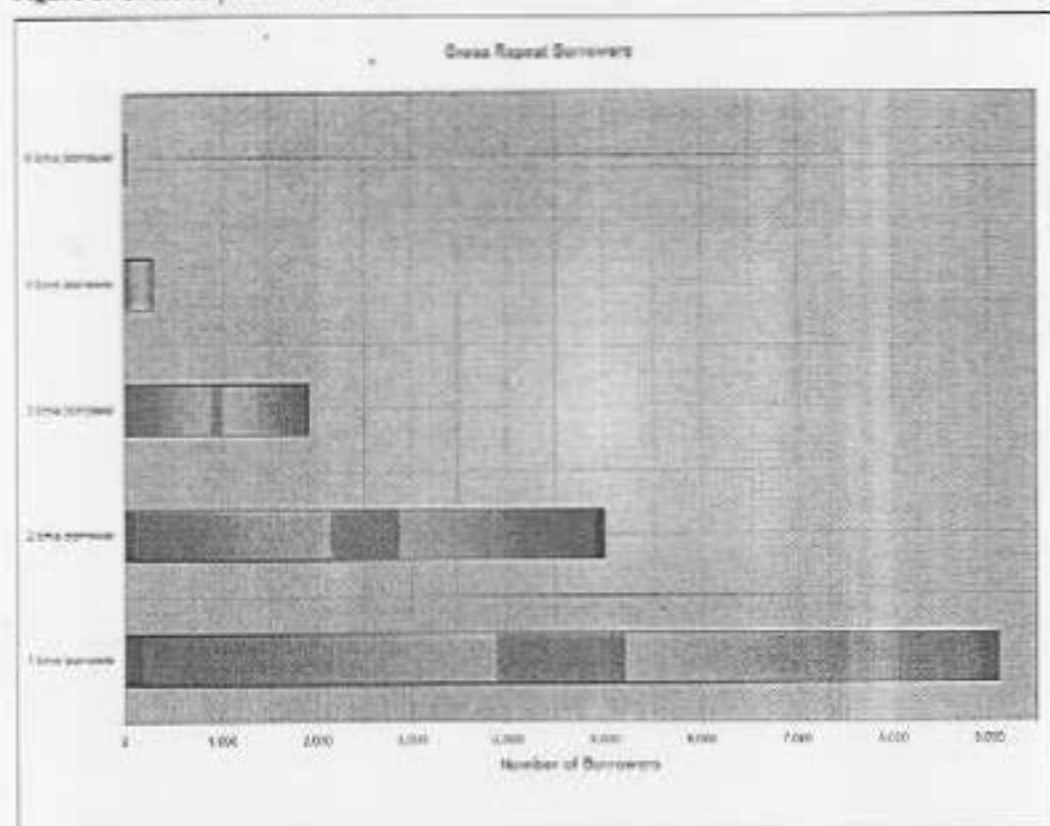


and seasonality of sales (particularly around festivals). The fact that loans are made to this group much more frequently than others is due to the fact that MELA officers are cognisant of the lower risk associated with traders and thus provide more loans to this group. This analysis notes the necessity of programme officers to be more diligent in the provision of loans to the other sectors, as well as the need to refine the current products to be more conducive to other industry needs.

### Repeat Borrowers

The importance of repeat borrowers cannot be understated. Not only do repeat borrowers provide indication of their satisfaction with MELA loans, but repeat

Figure 8: Gross Repeat Borrowers



customers indirectly maintain transaction costs low thereby increasing the operating self-sufficiency of the programme. It is difficult to fathom that MELA borrowers hold one time capital needs and thus require no further loans after their initial loan. In fact, with the awareness that majority of loans are working capital loans it stands to reason there is a continuous need for capital. The repeat borrower status is thus an indication of the satisfaction that customers have with MELA. Satisfied customers translate to loyal customers. In an industry where competition is fierce and where new MFI's are continuously competing for clients, loyalty is critical to the ensured success of an MFI. Further, with each additional new borrower the marginal cost of lending increases: that is, transaction costs will be higher as programme officers assess the risk of each new client and then further are required to chase the client in event of default. Customers who are repeat borrowers already have established a credit rating with the MFI and thus are lower risk loans.



Since inception MELA has created 16,358 borrowers and has offered 26,216 loans. The table below outlines the number of loans that have been given to repeat borrowers:

Table 1: Non-Repeat Borrowers Disaggregated by Number of Loans Taken

	Number of Borrowers	Number of Loans	Number of non-repeat borrowers
First time borrower	9,106	9,106	3,179
Second time borrower	5,006	10,012	1,231
Third time borrower	1,914	5,742	250
Fourth time borrower	304	1,216	40
Fifth time Borrower	28	140	
<b>Total</b>	<b>16,358</b>	<b>26,216</b>	<b>4,700</b>

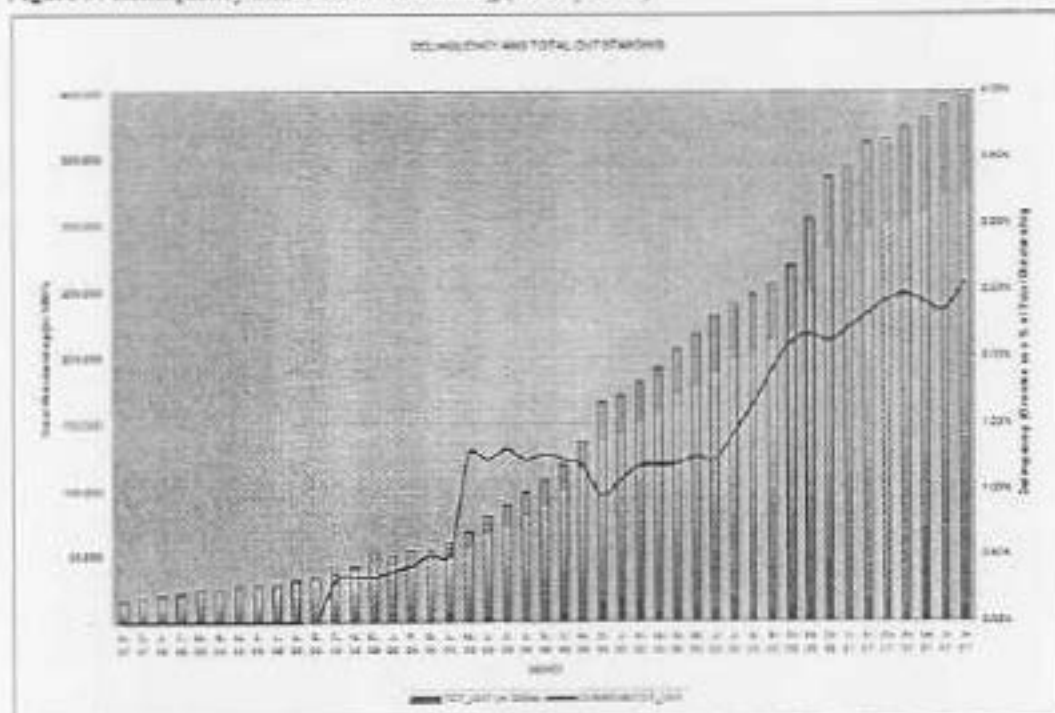
The column to the far left depicts the number of borrowers who have not continued on to the next level of lending. That is, of the 9,106 borrowers who are currently on their first loan, 3,179 of the borrowers did not go on to take a second loan. Likewise, of the 1,914 borrowers who have taken out third loans, 250 loanees did not proceed to a fourth loan. The fact that of the 26,216 loan almost 20% did not renew their loans may be of concern to MELA. The reason for this requires significant amount of research, and it may be an avenue that BRAC may wish to explore in the future. As an aside, however, when loans expire or are repaid in full, it may be desirable for MELA PO officers to perform exit interviews with the clients. This will allow MELA to continuously hone its products and provide meaningful service to its clients.

However, it is easy to rationalise that the poor are not a homogeneous group with broadly similar needs. In fact the poor are a dynamic and vibrant group who require non-cookie cutter solutions to their problems. Recognising the heterogeneity and diversity of the group is determinant in the success of a micro-finance product.

## Portfolio Quality

Since the inception of the MELA programme, significant strides with respect to increasing the breadth of the customers served have been made. This includes providing small-medium capital to over 16,000 borrowers (currently almost 12,000 borrowers are outstanding) which has evolved into the creation of over 22,000 additional jobs (both part-time and full-time) in over 20 business sectors. The number of borrowers has been steadily increasing at an average of over 3% per month since July 2000. With the increase in the outreach there has been a concurrent disproportionate increase in the number of borrowers who are defaulting. By July 2001, the number of borrowers that were delinquent on loans was 828 (8.88%), and over the past year the number of overdue borrowers has been increasing by 6% per month. Peak percents of overdue borrowers approached 10% in November 2000. While MELA has experienced erratic behaviour with respect to the number of borrowers that are defaulting, there exists a clear trend that the percent of default borrowers is in fact increasing.

Figure 9: Delinquency and Total Outstanding (to July 2001)

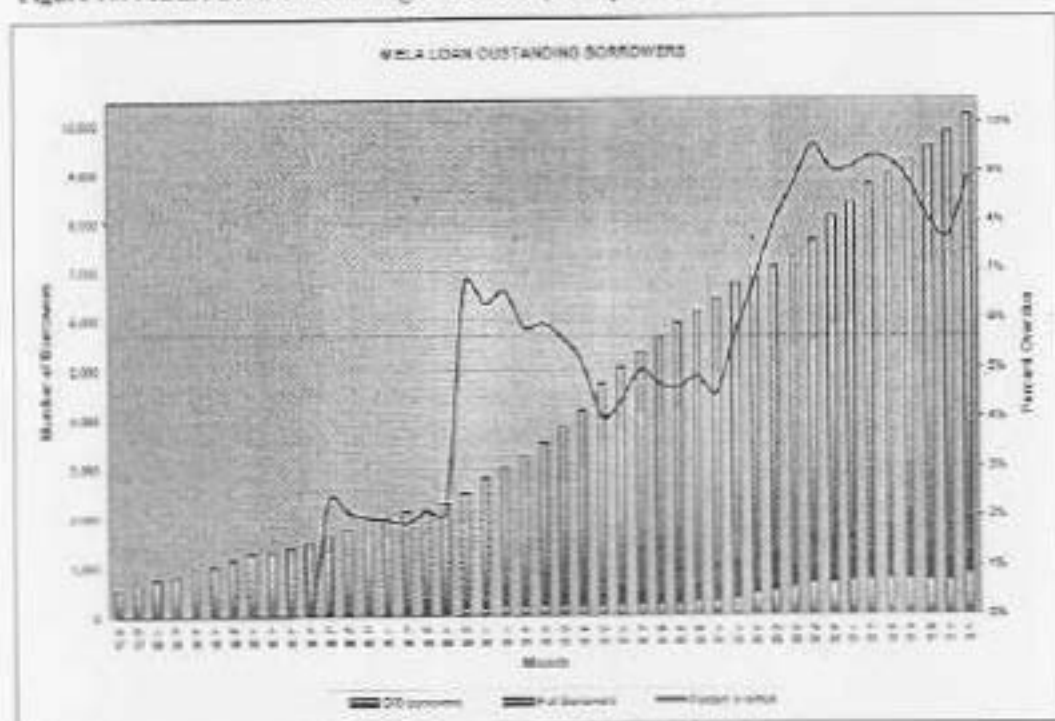


manageable, it is evident that a strong default culture is beginning to emanate among the MELA programme participants.



Still further, since the infancy of the MELA programme, the total portfolio outstanding in July 2001, reached almost 400 million takas with the cumulative loan disbursement reaching almost 1 billion takas. At the same time however, overdue rates reached 2.5% by March 2001, which translated into a Portfolio at Risk of 6% of the TPO. Despite the fact that the delinquency rates are currently relatively minimal and manageable.

Figure 10: MELA Loan Outstanding Borrowers (to July 2001)



The remainder of this paper will be dedicated to a discussion on the four product types that BRAC may wish to inject into its current lending technology. The development of these new products adopts a sectoral-based approach to lending with a product for preferential clients.

## V. INVENTORY SUPPLY LOAN

This loan product has been developed as an incentive to retail clients to accelerate their payments and reduce their interest outlays. It also reacts in response to the complaints received from the loanees regarding the above average effective interest rate paid by them to BRAC. It reduces the loan term from 24, 18, or 12 months to a six or three month term, which reduces the entrepreneurs cash-interest outlay without adjusting the standard 15% interest rate.

### **Preconditions for Product Development**

#### **Market Conditions**

It has been noted that majority of loans are being made to grocery stores, retail outlets, and the like. In fact at January 2002 more than half of all loans were made to industries that engaged in trading activities of which majority of, if not all, loans were used to buy supplies and inventory. Moreover, it has been recognised by the programme officers that retailers and traders experience lower default rates, and thus many of the programme officers are directing their marketing efforts to these retail clients. The reason for the low default rate among retail clients is quite simple: inventory and supplies have a high turnover rate and thus the risk of default on a loan is quite minimal relative to other activities such as manufacturing which generally have longer gestation periods. Still further retailers stockpile inventory and then unload it during the short high season (Durgha Pooja, Eid, etc.). In this manner, majority of sales occurs within a three-month window surrounding the major festivals, which lends itself to the conclusion that within this short operating cycle entrepreneurs should be able to make accelerated payments.

The development of a supply-inventory loan is prompted by the concern of MELA loanees that interest payments are excessively high. During interviews with MELA loanees it was evident that the largest concern that the loanees had with MELA was in regards to interest payments. Currently MELA offers a flat rate interest of 15% per annum, which translates to a 28% effective interest rate over the period of one-year. This interest rate is considered relatively high compared to commercial banks although less than local moneylenders. While it is recognised that the ease and swiftness of obtaining a MELA loan is a value added service that should be paid for it also acts as a deterrent for other entrepreneurs who would rather not pay such exorbitant interest rates.

#### **Institutional Capacity**

Such a loan product is very easy to introduce into the current lending technology as BRAC's current capacity elements do not vary significantly from the technology that is already in place. In fact, it does not require any alterations to the current lending technology and administration. That is, MELA officers must continue to be prudent officers who can manage multiple loans. In this manner no new system need be implemented but rather an extension of the current MIS system to include six or three month terms. Due to the short operating cycle of the businesses, it is imperative that programme officers recognise which businesses and industries host these short operating cycles.

## **Product Analysis: Characteristics and Delivery**

### **Target Market and delivery**

The target markets for the inventory-supply loan are MELA's retail clients with seasonal cash needs. This target segment includes retail oriented micro-entrepreneurs working in industries characterised by high seasonality and quick operating cycles. The seasonality is defined by campaign-driven sales peaks (during Eid and Pooja) and by product-specific demand fluctuations (such as sweaters in winter). The six-month/three-month inventory supply loan is designed specifically for the purchase of supplies or raw materials in preparation for these peak sales periods.

This loan must be specifically targeted to those who are engaged in trading activities due to the fact that traders/retailers are able to realise greater income during the high season and thus make accelerated payments.

### **Terms and pricing**

In order to provide mental ease to loanees who have become apathetic to MELA loans it is recommended that MELA adjust its current loan product to include a six-month or three-month repayment period. In this way the loanee is receiving the same amount of loan, and although he or she must make larger and accelerated payments, he or she will be outlaying less for interest. For example, if a 100,000tk loan is disbursed over a 12-month period, the loanee will be required to repay 115,000tk including interest. That translates to a 9,583tk monthly payment. If the same loan were disbursed over a six-month period at an interest rate of 15% per year, the loanee would be required to repay only 107,500tk including interest. This translates to a monthly payment of 17,916tk. The immediate concern with this product is that the loanees do not have the ability to meet these accelerated and high payments. On the contrary however, it is generally accepted that majority of businesses occurs during a three month window surrounding Eid or Durgah Poojah. Since this season is when majorities of sales occur it would stand to reason that the loan payments mimic the income that is generated from that loan. Further, it would make it easier for the loanee to meet its payment schedule because the payment is made when the money is earned rather than expecting the entrepreneur to smooth and save income over a period of a year.

The largest concern with this type of loan is that it does not support MELA's objective of creating wage employment. It is in MELA's interest to invest in and encourage more productive sectors (for example manufacturing) which have employment growth capabilities. In consideration of this it is recommended that MELA reduce the ceiling on this type of loan from 200,000tk to 100,000tk. In this way, only those that genuinely require such loans will want to take advantage of it.

A borrower can take out an inventory loan for up to 100,000tk. It is priced at the same interest rate as the general loan, and backed by the same guarantee. Six-month/three-month inventory loan is a short term-loan intended for intended specific sales events. Borrowers can choose a term of three or six months depending on either a campaign-specific or product-specific.

### Risk Management

The most significant risk associated with providing a loan with such a short term occurs in event that a programme officer assesses the operating cycle incorrectly. That is, the programme officers assess the operating cycle shorter than it in fact is. In this event, the delinquency rates will likely increase significantly. It should however be left to the loanee to determine his/her own operating cycle with the assistance of the programme officer.

### Results and Benefits

- Because the loan term is shorter, MELA will be able to turnover its loans more efficiently, which will result in lowering the risk associated with disbursing loans.
- Under the new terms of the loan MELA will be able to increase its scope significantly. Using the example of a 100,000tk loan, if a loan were to be made of this amount under the current 12-month option, only one entrepreneur will benefit. However, if the same loan were disbursed over a six-month term, MELA would be able to disburse the loan to two entrepreneurs with the same amount of resources.
- Cost minimisation and efficient use of resources is naturally a consideration for MELA while designing any product. By initiating the loan of six-month terms, MELA will not have to significantly alter its current loan disbursement process (includes appraisal, business knowledge, etc.) as the infrastructure is already in place to sustain such a loan. MELA may have to consider reprinting costs and photocopy costs of the new form to include a "check box" for the six-month/three-month loan, however no new training costs will be entailed.
- By creating a loan product tailored to its most "successful" clients, the retailers, MELA will be able to retain these clients and avoid the risk of losing the clients to other competitors such as Proshika, ASA, etc.

#### Box 4: Inventory/Supply Loan Product Summary Terms

Loan Amount	20,000tk - 100,000tk
Interest Rate	15% per annum; 7.5% per six-months; 3.75% per three months
Loan Term	six months or three months
Target	Retailers and Traders

## VI. AGRICULTURAL LOAN

This agricultural loan product is designed for small farm owners who live in rural areas of the country. The terms of this loan are specifically tailored to the seasonal needs of its target market, including interest only grace periods and balloon end-payments tied to the harvest cycle. This area should only be available in certain areas where agro-based enterprises have a comparative advantage.

### Preconditions for New Product Development

#### Market and Macro Conditions

The economy of Bangladesh draws its strength and stability primarily from agriculture<sup>26</sup>. Bangladesh's fertile soil and normally ample water supply have created optimal conditions for the cultivation of rice and jute, among fruits, vegetables, and other grains. Most Bangladeshis earn their livings directly or indirectly from agriculture and thus efficient management of agriculture is very crucial for her socio-economic development. In fact, the agricultural sector in Bangladesh comprises 30% of Bangladesh's GDP, 63% of the labour force, and over 75% of the export earnings mainly from raw jute and jute products.<sup>27</sup>

Table 2: Basic Information on Agriculture in Bangladesh

Area of Bangladesh	147,570 sq. km
Total Population (Jan. 1999)	129.1 million
GDP (1998-1999)	755.73 billion Tk.
GDP Growth rate (1998-99)	5.2%
Agricultural Growth rate	5.0%
No. of Rural Households	17.83 million
No. of non-Farm Households	6.03 million
No. of Farm Households	11.80 million
No. of Agricultural Labour Households	6.40 million
Small Households	80% (9.42 million)
Medium Households	17.50% (2.08 million)
Large Households	2.50% (0.3 million)
Cultivated Area	17.77 million acres
Cultivated Area per Households	1.5 acres
Cropping Intensity (1996-97)	174%
Irrigation Area	8.59 million acres

Source: *Virtual Bangladesh*

Despite the country's large dependency on the agriculture sector as a source of labour, income, and sustenance, BRAC has been unable to offer influential support to this very large market in terms of providing MELA loans. At January 2002, agricultural sectors accounted for only 6% of the entire loan portfolio;

<sup>26</sup> *Virtual Bangladesh: Economy: Agriculture*, Virtual Bangladesh, 17 Jan. 2002

<[www.virtualbangladesh.com/economy/agr.html](http://www.virtualbangladesh.com/economy/agr.html)>

<sup>27</sup> CIA, *supra*, note 9 at 10.

Table 3: Agricultural Sectors Loans Disbursed (January 2002)

	Loan Disbursed	% of Total Portfolio
Agro-farming	2,944,480	0.60%
Dairy Farming	14,730,288	2.99%
Pisciculture	3,358,368	0.68%
Poultry	8,861,164	1.79%
Subtotal	29,892,298	6.04%
MELA TOTAL	494,819,856	100%

Source: BRAC MIS Department

The agriculture year begins in late February, when the weather is dry and getting warmer. Over a period of several weeks each field is ploughed three or four times using a wooden plough and two oxen, one man can plough 0.02 hectares in an eight to ten hour workday. In addition to ploughing, field preparation for irrigation involves construction and maintenance of plot boundaries half a meter high, using earth and weeds from the field.

While rice and jute are the principal crops, sugar cane, potato, pulse, tea and tobacco are also important crops. Generally, Bangladesh has two principal crop production seasons annually, but the IRRI (International Rice Research Institute) variety of rice production has added a third season. In this way loan turnover will increase to two/three times per year.

With the rapid increase in population and very high pressure on land in Bangladesh, which is one of the most densely populated countries in the world, it is no longer possible to expect the traditional farming system to evolve into an intensive system of production. Increased productivity of agriculture requires continued support of modern agricultural research, its usefulness, timeliness and relevance.

It is therefore in the interest of MELA to assist in this endeavour. MELA can assist by creating a loan product that is specifically designed for farmers, particularly those micro-enterprise farmers. Farming has a very specific set of requirements and cycles, which are currently not supported by the standard loan.

**Box 4 : Newspaper Clip: The Independent, April 7, 2002**

"Prime Minister Begum Zia Khatun said that in an agrarian economy like (Bangladesh's), rural and labour-intensive economic programmes should be the cornerstone of (its) development strategy. She asked the policy makers to lay emphasis on agro-based enterprises which would provide massive employment opportunities."

The Independent, Poverty reduction strategy paper, April 7, 2002

**Institutional Capacity**

In order for this product to operate successfully MELA will need to hire loan officers with expertise in agriculture as a critical part of the loan underwriting process in regions where agriculture has a comparative advantage. This person would be dedicated exclusively to the agricultural loan because of the specialised nature of the loan product. The variability of the climate-dependent markets is entirely different from the relatively predictable conditions that a commercial micro-enterprise faces. Specialised expertise will be required to understand how to value the agricultural assets appropriately and to predict risk prudently. With such irregular payment terms



(for example, interest only with balloon end payments), initial analysis of the borrower's sectoral expertise and character will be a critical risk management tool. Further, MELA will need an internal systems staff and a sufficiently robust management information system to amortise and track non-standard loans with such grace periods and balloon-end payments.

### Product Analysis: Characteristics and Delivery

#### Product Market and Delivery

This product has been designed to penetrate deeper into the micro-enterprise market particularly the agricultural sector. Loan officers can market this product through direct outreach to potential clients, including visits to the field and to the weekly agricultural markets where these products are traded. This proactive, personal promotional effort is important for MELA to successfully penetrate this new market in a manner that communicates the client-focused nature of its operations.

#### Terms and Pricing

Repayment terms are designed to match the harvesting season of the client's particular agricultural product. Most repayments are structured with extended interest-only grace periods and balloon payments at maturity that coincides with cultivation. In an effort to maximise the flexibility and attention to borrower's needs (and loan purpose), maturity can range from 30 days (working capital) to two years (equipment purchases).

#### Box 6: Dairy Farming Loan Structure Illustration

Generally, when a dairy cow is purchased, it is known that the cow must be kept 'dry' for a period of two and a half to three months. That is, during this period, the cow cannot be milked until it has given birth. Further, it is well known that cows do not give standard amounts of milk on a daily basis and actually the amount of milk diminishes over the eight months following birth. In the case of dairy farming, the use of a loan for the purchase of a foreign dairy cow yielding on average 15 litres of milk per day should follow the following repayment schedule:

Month	Monthly Milk Prod'n	Principle Payment (Tk.) <sup>25</sup>	Interest Payment (Tk.)	Total Payment (Tk.)
0	-	(30,000)	-	(30,000)
1	-	-	375	375
2	-	-	375	375
3	-	-	375	375
4	450 L	5,263	375	5,638
5	450 L	5,263	375	5,638
6	450 L	5,263	375	5,638
7	315 L	3,684	375	4,059
8	315 L	3,684	375	4,059
9	315 L	3,684	375	4,059
10	135 L	1,579	375	1,954
11	135 L	1,579	375	1,954
	2,665 L	30,000	4,125	34,125

<sup>25</sup> Principle Payment is calculated on a pro rata basis of the production cycle.

For example, in the fourth month:  $(450/2,665) \times 30,000 = 5,263$

Interest Payment is calculated per annum:  $30,000 \times 15\% \times 11/12 = 4,125$

The agricultural price should be consistent with the normal micro-enterprise loan. Due to the higher capital cost of investing in agricultural equipment it is recommended that MELA increase the ceiling on these loans from 200,000tk to 300,000tk, but maintain the same interest rate at 15%.

#### Risk Management

The Risk exposure for the agricultural products is highly dependent on the skills and expertise of the loan officers and their ability to accurately appraise the harvesting cycle and property value. Using specialised farm equipment as security introduces the risk that the resale value in the event of default would be lower than the initial appraisal. In addition, because the equipment is movable, it can be hidden when the time comes to redeem the collateral in case of default. At times, MELA may want to ask the borrower to pledge additional assets or insist on a co-signer to provide an alternative recourse in the event of default, based on the same criteria as its commercial micro-credit. The staggered, back end payment structure also exposes BRAC to risk in the event of a meagre harvest because of poor cultivation or misuse of loan funds. To manage this risk, MELA can disburse money in tranches tied to loan use verification, for less experienced borrowers.

#### Results and Benefits

##### Box 7: Experience of *Cajas Municipales de Arequipa (CMA)*, Peru

*Préstamo agropecuario* [agricultural loan] has had a remarkably low default rate because of its long testing period; carefully designed terms; and the expertise of its chief loan officer, who managed a family farm for many years before joining CMA. In the two years *préstamo agropecuario* has been available, there have been no write-offs and CMA has never had to sell any of the collateral put up as guarantee to recover a loan payment. The delinquency rate (over 30 day past due) of *préstamo agropecuario* was 2.65 percent in 1997, its first full year of operation and dropped to 1 percent for the first half of 1998. It has grown from an initial volume of 118,000 soles (US\$45,000) in the last quarter of 1996 to 2.89 million soles (US\$1.05 million) by year-end 1997. It grew by an additional 50 percent (8.4 million soles or US\$2.86 million) in just the first half of 1998.

Source: *Brand, Monica* (1999)

Delivering products targeted at the agricultural sectors is a cost intensive endeavour because of the less developed systems of communication and transportation infrastructure, the personalised nature of the initial marketing outreach, and time consuming analysis. Nonetheless, it is anticipated that this product will soon cover its costs because of the higher average loans size, low default rate, and vast untapped demand in this neglected market. With the assistance of a dedicated MELA officer with expertise in the agricultural sector, MELA will be able to offer technical expertise to the farmers in terms of sharing best practices etc.

##### Box 8: Agricultural Loan Product Summary

Loan Amount	100,000tk-300,000tk
Interest Rate	15% flat per annum
Loan Term	Dependent on the agricultural item
Target	Small-Medium Farmers



## VII. MANUFACTURING LOAN

In the recent past, MELA has been under criticism for not meeting its initial objectives and targets with respect to the provision of technical assistance and employment creation to micro-entrepreneurs. From the social and economic development perspectives, MELA should be investing and directing funds to more productive sectors which create employment and at the same time provide technical services to those that require them. This criticism is the impetus of the "manufacturing loan" product that has been developed to meet these goals. The product includes organising industry members into co-operative groups, allowing for collateral guarantees of loans, and sharing of technical assistance and ideas to fellow group members.

### Preconditions for New Product Development

#### Market and macro conditions

MELA loans have only minimally penetrated the industrial sector. At January 2002, the following information was available:

Table 4: Manufacturing Sectors Loan Outstanding (January 2002)

Sector	Amount Outstanding	% of Loan Portfolio	Multiplier Effect
Chemical & cosmetic	4,595,449	0.9%	0.90
Engineering and allied industries	28,130,573	5.7%	1.0
Powerloom	4,599,733	0.9%	0.90
Plastic & rubber industries	6,395,273	1.3%	1.10
Handloom	8,039,917	1.6%	2.40
Wood & wood product	18,752,986	3.8%	1.60
Subtotal	70,513,931	14.3%	0.92
MELA Total	494,819,856	100.0%	

Data Source: BRAC MIS Department

Only 14% of the MELA loan portfolio is invested in the manufacturing sector. Through consultations with District Managers, Programme Officers, and MELA manufacturing entrepreneurs, there are several reasons for lack of interest on part of manufacturers for MELA loans:

- 1) The largest investment of productive sectors is that of machinery. Certainly machinery, not raw materials, is the most costly input into the manufacturing process together with the large set-up costs (including employee training and site set-up costs). It is generally agreed that MELA loans are unable to meet the needs of manufacturing clients due to its low ceiling of 200,000tk.
- 2) Most manufacturing clients are experienced in their respective fields and have access to other forms of capital primarily from the commercial banking sector.

From the point of view of these customers, there is very little value-added benefit from MELA loans.

- 3) As discussed below, the MELA programme officers do not target the productive sector due to the fact that their payment patterns are not as diligent as retail sector entrepreneurs.

In light of these observations, it is recommended that MELA create a specific product that will attract more productive sectors.

The multiplier effect in the far right column of the above table defines the percentage of total employment generated in a business divided by the percentage of total disbursement made in that sector. As employment creation is one of the stated objectives of MELA, the employment multiplier effect is an important measure of the success of the programme. The handloom sector is the highest employment-generating sector, with a multiplier effect of 2.40. Comparing the productive employment multiplier effect to that of the grocery and stationery sector, we will see that the grocery and stationery employment effect is only 0.7, yet this accounts for over 27% of the entire loan portfolio. It is at this level where the dilemma is accentuated. It is the productive sectors that tend to have the higher default rates, while the retail and traders exhibit much more diligent payment habits. The fact is that those industries with higher turnover rates (retail, traders, etc.) are more able to make steady loan payments, while those industries with longer gestation periods require alternative payment methods.<sup>29</sup>

In Bangladesh, Small and Medium Enterprises (SME's) are significant contributors to manufacturing growth and employment creation. Although official records of SMEs are not readily available, several studies estimated that there are around 27,000 medium sized enterprises and around 150,000 small-scale enterprises.<sup>30</sup> Comprising 80 percent of manufacturing establishments, SMEs account for 80 percent of the labour force and 50 percent of output of the sector.<sup>31</sup> The share of SMEs in the manufacturing sector in terms of fixed capital, gross investment and sales is 48 percent, 33 percent and 40 percent respectively.<sup>32</sup> SMEs provide vital linkages to enterprises, particularly in the high growth export sector and also form part of the core business activities in rural and urban areas.<sup>33</sup>

#### **Institutional Capacity**

Among MELA officers a very strong risk-averse culture prevails. Certainly, MELA programme officers are less likely to approve loans for those businesses with whose industries the officers are less comfortable. Those officers that are more familiar with a specific industry would better understand the issues of companies engaged in that industry and be able to provide more meaningful service. The implementation of a manufacturing loan is quite comprehensive and thus will require programme officers that have a strong understanding of manufacturing type industries and strong analytical, problem solving, and organisational abilities. Generally these employees

<sup>29</sup> Phase IV, *supra*, note 5 at 7.

<sup>30</sup> Bangladesh Resident Mission, *Quarterly Economic Update Bangladesh*, Dhaka: Asian Development Bank, September 2001. [Hereinafter "ADB"].

<sup>31</sup> ADB, *supra*, note 30 at 34.

<sup>32</sup> ADB, *supra*, note 30 at 34.

<sup>33</sup> ADB, *supra*, note 30 at 34.

will be those who have received commerce degrees and are more equipped to deal with risk.

In terms of management information system, this product is a modification of the already established micro-finance village organisation model and thus the robustness of the current system will provide a sound foundation on which to absorb this new model.

### **Product Analysis: Characteristics and Delivery**

#### **Target Market and Delivery**

Naturally, there are certain regions in Bangladesh where comparative advantages exist in these productive sectors. For example, in the Tangail region, manufacturing industry is most prevalent; while in the Chittagong area forestry is the most prevalent industry. By acknowledging the comparative advantage that each region has, BRAC will be able to allocate its employees with backgrounds in specific areas to those regions. In this way, the entrepreneurs will benefit from the expertise that the programme officer has in forestry (for example). BRAC will also benefit because a greater percentage of the loan portfolio will be disbursed to productive sectors where it will be realising more fully its goals.

It is recommended that BRAC transplant its group formation model, to that of the manufacturing industry, by organising manufacturing entrepreneurs into groups. This idea is adopted from the notion of a "trade association" but on a smaller scale. For example, if in a region where forestry is the predominant industry, MELA can facilitate the organisation of the entrepreneurs into this larger scale village organisation with representatives from each company. Monthly, this organisation can meet to discuss various issues surrounding the industry, such as best practices, improved buying patterns, etc. The MELA programme officer, who is knowledgeable in the area, will be present to offer independent advice and act as the independent facilitator. The organisation can appoint a President who is responsible for communication with the MELA officer. The role of the MELA officer will be to collect the monthly payment from each member.

The target market for the "manufacturing loan" is manufacturing clients who operate in areas with a high concentration of similar industries. This target segment includes growth-oriented and established industries. It will be the responsibility of the MELA PO to assemble potential clients and introduce to them the concept of the "trade association."

#### **Terms and Pricing**

A manufacturer should be able to take out a loan up to 500,000tk to support expansion of his or her business with flexible repayment terms. This product excludes the purchase of raw materials and inventory supplies. The purpose of this loan is to facilitate employment creation through the expansion of the manufacturing that is best accomplished through capital acquisitions. If members of the trade association do not need loans, they are still able to participate in the trade association.

The loan price should be set at 15% flat as normally expected while the operations should be as such: monthly a manufacturing group should meet where common issues

can be discussed such as supplier and buyer issues. In this way, members can collude with respect to setting of prices and receive greater discounts in mass purchasing power as well as find a regular stream of customers. Because of the group model, members can cross guarantee loans and as result of this increased level of protection the loan ceilings can be increased to 500,000k. A member who does not receive a loan will still benefit from the sharing of ideas and technical skills, and will be able to engage in economies of scale.

#### **Risk Management**

Because of the "trade association" format, there is an added layer of comfort for MELA in event of default. For this it should be within the propensity of BRAC to increase the ceiling of this loan to 500,000k. This may, at the same time, encourage manufacturers to take out MELA loans.

#### **Results and Benefits**

- By focusing on services in which the productive services will find more benefits, BRAC will be attracting such productive entrepreneurs that will in turn create more employment and increase the scope of its clients.
- In the past MELA has done very little (if any) in terms of "assistance" to its members. This "trade association" will help MELA achieve more of its objectives, and at the same time rely more on the knowledge of the entrepreneurs themselves rather than on the expertise of the programme officers and external consultants.
- Customers will benefit from the programme through of the economies of scale that are created. Members of the organisation will be able to share best practices, engage in communal-mass buying practices, and create linkages with other industries.
- The largest concern on part of the industry entrepreneurs is that they are unwilling to leave their businesses for extended periods of time and participate in training sessions. This notion of the "trade association" is more client focused as it brings the programme officer to the "trade meeting" monthly to collect payments as well as allowing the members to meet on their own terms and at their own convenience.

#### **Box 9: Manufacturing Loan Product Summary**

Loan Amount	100,000k-500,000k
Interest Rate	15% flat per annum
Loan Term	12-24 months
Target	Manufacturers
Forum	Trade organisation, technical assistance, industry trained Programme Officers

## VIII. PARALLEL LOAN

MELA has currently been in operations for almost five years. Within these five years, it has established for itself a clear market presence. However, as MELA loanees become more adept at undertaking MELA loans, their needs are becoming more sophisticated. Many of MELA's loanees are currently in their third and even fourth round of MELA loans. Still, many after their second round of MELA loans see little benefit in the MELA loans. In order to retain these clients that have exhibited diligent loan payment behaviour patterns it is recommended that MELA create a "parallel" loan product that will be available to borrowers during rapid growth expansion phases. A parallel loan is an imitation line of credit facility whereby a borrower in good standing can take on additional, short-term credit during peak season or during rapid expansion phases, but within a term loan structure. Under this loan product MELA will be willing to offer automatic credit to clients with a proven repayment history, which provides instant access to funds of a specified amount.

### Preconditions for New Product Development

#### Market Conditions

This product has been developed as a complement to the current standard MELA product and in response to client need. Due to restrictive credit policies, MELA programme officers are unable to offer multiple credits, and thus clients are left to seek credit from informal moneylenders during rapid growth expansion or peak seasons. Clearly there exists a profitable opportunity for MELA to engage in.

As discussed in the financial trend analysis, MELA repeat borrowers are key to the success of the MELA programme. Not only do repeat borrowers undertake larger loans as they become more sophisticated, but repeat borrowers also less risky due to the fact that they have established a credit history with the Bank. In this way the costs of delinquency are lower, as there are fewer delinquency.

#### Institutional Capacity

The key institutional capacity elements required for successful implementation of the parallel credit include prudent loan officers who can manage multiple loans and a robust management information system that produces the information required to identify high quality borrowers. The risk of such a product can be managed through precise benchmarks (minimum requirements) that qualify certain borrowers as preferential based on their repayment records. Having a reliable management information system is critical to manage this risk, as are seasoned loan officers who can make prudent judgements about when to make exceptions.

Fortunately for BRAC, a strong and comprehensive MIS exists which will facilitate the injection of a parallel product line. By designing a quickly revolving, short-term loan that has a streamlined underwriting process, MELA will be able to offer its parallel loan product, which has many of the same benefits as a traditional line of credit without re-engineering its systems.



## **Product Analysis: Characteristics and Delivery**

### **Target Market and Delivery**

The target market for this product are MELA's preferential customers who are currently in their third to fourth round of MELA loans and who have exhibited diligent repayment patterns. In this manner, MELA will be providing incentive to its new customers to maintain good payment patterns for comfort that in their third-fourth round they will have access to additional credit. A special emphasis should be placed on those clients who are involved in growth-oriented micro-enterprises with seasonal cash needs and quick operating cycles.

### **Terms and Pricing**

A borrower in good standing can take out a parallel credit for up to 20% of the existing loan. It is priced that the same interest rate as the personal loan, and backed by the same guarantee, if its value is sufficient coverage for both loans.

Under this scheme, the borrower will not be required to pay for an additional application fee or appraisal process as the additional parallel loan will be repaid in tandem with the current loan payment. The collateral of the initial loan will secure the parallel loan.

Because it is still a term loan backed by similar guarantees, parallel loan should be held on the books and provisioned for like any other micro-enterprise credit. Because the credit is generally of a small amount, with significantly less risk than other products, guarantees for the parallel loan can range from a legally binding promissory note (allowing MELA to seize household assets) to a salaried co-signer in which case the MELA can dock wages.

Borrowers can choose a term of 30, 60, or 90 days and the repayment frequency is similar to that of the initial loan. Borrowers can renew the parallel loan once the balance is paid off in full, as long as the initial amount is continuing to be paid as scheduled.

### **Risk Management**

Only those clients with a demonstrated history of repayment meeting specific performance benchmarks are eligible for the parallel loan. For example, borrowers on their most recent loan must have averaged a delinquency rate of 2.5 days or few over all the payments with no more than eight days late on any given payment. Repeat borrowers may have cumulatively no more than seven days late on the last parallel loan. Any client with a previous loan that had been restructured or written off is ineligible for the product.

MELA can manage its exposure to multiple credits by limiting the amount to no more than 20% of the previously approved loan. Still the additional credit must be fully covered by the existing guarantee, or the borrower must pledge additional security.

#### Box 10: Cajas Municipales de Ahorros y Créditos

Cajas Municipales de Ahorros y Créditos-Arquitas (CMA) in Peru has been able to effectively introduce a similar product into their current lending technology, known as *crédito paralelo*. In their experience, *crédito paralelo* is a popular product among its preferential clients. Its delinquency is not tracked separately from micro-enterprise loan, although calculations indicate that delinquency hovers below four percent and is less than the delinquency rate of the overall micro-credit loan portfolio. The loan officers view the product as an effective marketing technique to attract well-performing, growth-oriented micro-enterprises while providing incentives for on-time repayment. In addition, this flexible credit assists in client retention.

Source: Brand, Monica (1998)

#### Results and Benefits

- As clients become savvier they will require more comprehensive loan products to meet their needs and thus may seek out other credit facilities with other institutions. In order to retain the loyalty of these customers that have exhibited sound payment histories, BRAC should instigate such a product.
- There will be no need for additional collateral or guarantees of the loan because an additional loan will not be given but rather an extension of the initial loan will be granted.
- The transaction costs of providing this parallel loan will be minimised to the streamlined credit assessment and delivery.

#### Box 11: Parallel Loan Product Summary

Loan Amount	20% of current loan
Interest Rate	15%
Loan Term	30 days, 60 days, 90 days
Target	Preferential Clients

## IX. CONCLUSION

As MFIs mature and grow, they are gradually becoming aware of the importance of diversifying and expanding its product line. The concerns evolve with the development of the institution from "Who do I want to reach?" and "What products can I sell?" to "How do I become profitable" and in the final stage to "Is my clientele the right clientele?" "Do I have the right mix of products?" and "Should I diversify

either my clientele or my products?"

### Box 12: Top 10 Lessons for Successful Product Development

1. Solicit client feedback throughout the process to refine the product continually.
2. Expect problems to arise along the way.
3. Generate institutional buy-in early and continually throughout the product development process.
4. Test the product in actual market settings and expand slowly.
5. Make realistic cost-revenue projections to prepare for the financial impact of adding another product.
6. Make sure systems have sufficient capacity and flexibility to manage and track new products.
7. Provide appropriate training and incentives to staff to ensure effective implementation.
8. Cancel the project if external or internal conditions are not conducive to new products.
9. Identify a product champion who will maintain momentum throughout the development process.
10. Create a client-centered institution.

Source: Monica Brand, *New Product Development for micro-finance institutions*.

Each of the products discussed in this report has its distinct challenges and characteristics that dictate its contribution to the institution. However, taking a client-centred or target-market perspective in product development allows the institution to more intelligently allocate resources to focus on the components that will generate the most demand, and if done right, profits.

The key value of this client-centred approach is its ability to design products that meet the

needs of their consumers; thereby addressing both the financial and social objectives of micro-finance institutions. Focusing on what is of value to the client influences both the operational efficiency as well as product design, increasing client satisfaction and retention, and hence profitability and sustainability for the institutions.



Product Characteristics	Current MELA Loan Product	Inventory Supply Loan	Parallel Loan	Agricultural Loan	Manufacturing Loan
Target Market	Successful group members of BRAC; women with entrepreneurial abilities; local artisans; non-RDP members with credit needs.	Retailers and merchants (those engaged in the sale of items on a margin), businesses with campaign driven needs/demand specific needs.	Customers in 3 <sup>rd</sup> /4 <sup>th</sup> round of MELA loans who have exhibited diligent repayment patterns, and have current loan outstanding.	Small-Medium farmers including dairy farmers, poultry farmers, pisciculturists, and agro-farmers.	Manufacturing companies with established experience within a trade association forum and potential for business expansion.
Eligible Uses	Restricted to business-type activities	Inventory items and raw materials	Unrestricted, but designed as emergency credit.	Working capital; fixed asset investment (including farm equipment, agricultural inputs, livestock)	Fixed asset investment (including machinery and equipment).
Loan Size - Minimum - Maximum	20,000tk 200,000tk	20,000tk 100,000tk	20% of current outstanding loan.	100,000tk 300,000tk	100,000tk 500,000tk
Repayment Terms	12, 18, 24 months  Monthly equal payments	3, 6 months  Monthly equal payments	30, 60, 90 days  Monthly repayments together with initial loan payments	1 to 24 months  Based on harvest cycle (initial, interest only grace period with ending balloon payment.)	1 month to 36 months  Flexible repayment terms
Guarantees	Personal guarantees; title to deed	Personal guarantees; inventory backing.	Guarantees from existing loan must cover 100% of both outstanding balances.	Farm equipment, including purchased asset	Guarantee by collateral and fixed assets.
Pricing (and other fees)	15% flat rate  1% of loan amount appraisal fee	15% flat rate  1% of loan amount appraisal fee	15% flat rate  no additional fees	15% flat rate  1% of loan amount appraisal fee	15% flat rate  1% of loan amount appraisal fee; Annual membership fees

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