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CASE STUDY

Bank-Microfinance Alliances: FINCA's Pilot Program for Prepaid Cards in Mexico

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Abstract

Partnerships between banks and microfinance institutions (MFIs) can enable banks to expand their outreach and increase profits and allow MFIs to broaden their range of services and reduce costs. In addition, these partnerships provide MFI clients a greater variety and convenience of services. In 2009, FINCA negotiated a bank partnership to offer its clients in Mexico a prepaid card for loan disbursements. This case study outlines the experience of FINCA in Mexico, highlighting the key steps needed to prepare for a partnership and negotiate with banks to achieve winning terms for all sides.

About The SEEP Network

The SEEP Network (www.seepnetwork.org), founded in 1985 and headquartered in Washington, DC, is an association of over 70 international nongovernmental organizations (NGOs) that support micro- and small enterprise development programs around the world. SEEP's mission is to connect microenterprise practitioners in a global learning community by bringing them together in a peer learning environment to produce practical, innovative solutions to key challenges in the industry. SEEP then disseminates these solutions through training, publications, professional development, and technical assistance.

About the Financial Services IGP Learning Network

The Implementation Grant Program (IGP) is a competitive grant program coordinated by the Microenterprise Development office of USAID. The program is a key mechanism for supporting international and local providers of microfinance and value chain development efforts. The IGP aims to push the frontier of innovation in microfinance and enterprise development and to provide USAID Missions and the development community as a whole with case studies of "good practice." Since the first IGP grants were awarded in 1995, many of these practices have been copied, expanded on, and integrated by USAID missions and practitioner organizations around the world.

The Financial Services (FS) IGP aims to expand access to microfinance and increase the financial viability of local institutions. The FS IGP Learning Network, managed by SEEP, brings together the five grantees of the FS IGP to document and share their experiences in learning products. These products are written by and for practitioners in the field of financial services. For other learning products in this series, please visit www.seepnetwork.org.

About FINCA International

FINCA International's mission is to provide financial services to the world's lowest-income entrepreneurs so they can create jobs, build assets, and improve their standard of living. FINCA International accomplishes this goal by offering small loans—averaging $503—to micro and small entrepreneurs so they can invest in and expand their businesses. As of August 2009, FINCA served 726,867 clients in 21 countries, with a loan portfolio of $308.5 million and a portfolio at risk ratio over 30 days of 3.6 percent.

FINCA began Mexico operations in 1989. As of August 2009, FINCA served 116,738 active clients in Mexico, 96 percent of whom are women, with an average disbursed loan size of $408. The MFI held over $27.5 million in outstanding loans, with an operational self-sustainability of 109 percent and a portfolio at risk ratio over 30 days of 4.6 percent. The program has 63 offices in four regions and 20 states of Mexico. For more information about FINCA International and its operations in Mexico, please visit www.villagebanking.org.

Note: All amounts are in U.S. dollars unless otherwise noted.

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Executive Summary

New technology and innovative financial products are propelling an unprecedented expansion of the frontiers of microfinance outreach, but microfinance institutions (MFIs) are not equipped to travel this new path alone. For instance, while electronic card banking is faster and more convenient for both MFIs and their clients than traditional check-based disbursal, the costs of card systems and the extensive networks on which they depend are beyond the reach of most MFIs. One way to overcome these challenges is for MFIs to partner with banks that already offer technology-based innovative products, such as prepaid cards.

Partnering with banks comes with unique advantages and challenges and can be a difficult process for an MFI. In this case study, FINCA shares its experiences, successes, and setbacks in Mexico in establishing partnerships with banks. The reader will learn the key steps of pursuing bank partnerships, as well as considerations to bear in mind and pitfalls to avoid.

In general, MFIs should partner with banks that understand the differences between microfinance and traditional banking and are willing to bridge those gaps. Likewise, MFIs should understand the exclusively commercial orientation of banks. Achieving a successful partnership also entails having knowledgeable operational, legal, and technical personnel in place on both sides of the relationship.

FINCA's decision to pursue a bank partnership was based on several goals: to reduce operational costs; offer new and useful products; increase the flexibility, convenience, and security of services for clients; and bring clients into the formal financial sector. FINCA specifically aimed to achieve these goals by adopting a card-based disbursement system and integrating it with other financial products; providing points of sale (POSs) throughout Mexico; and expanding its branch network.

While every situation is unique and FINCA's path was not without hurdles, its experience with its partner, HSBC Mexico (a commercial bank), provides key insights for MFIs considering similar alliances. These insights include:

1. Take small, manageable steps.
2. Understand how the bank views your joint activity.
3. Start the negotiations process early and prepare for lapses in communication.
4. Leverage information from all institutional levels.
5. Know your options for products and services.
6. Understand how banks work and make decisions.
7. Make negotiations a competitive process.

Introduction

In recent years, microfinance institutions (MFIs) have pursued numerous avenues for expanding their outreach and services. These include transforming into regulated financial institutions, linking with third-party agents, offering more diversified products, and expanding financial services through partnerships with regulated financial institutions, such as banks.[1]

Founded in 1989, FINCA in Mexico provides small loans, averaging $408, to over 116,738 of Mexico's lowest-income entrepreneurs (96 percent of whom are women). FINCA's five-year goals for Mexico include expanding to 25 branches and 90 points of access, and reaching 500,000 clients. To achieve these goals and lower its costs, the MFI decided to switch its disbursement method from paper checks to a system based on electronic banking cards.

This case study documents FINCA's experience in planning and negotiating a bank partnership to launch prepaid bank cards. The MFI, the staff of its partner bank, and other institutions were contacted directly for their input into the case study.[2] It organizes the decision-making that created the partnership into a framework to help other institutions, including banks, approach similar opportunities.[3] The intent of this case study is to demystify a seemingly overwhelming task by describing a practical example within a step-by-step framework.

Bank-MFI Partnerships

Context

MFIs have long used commercial bank services, primarily to deposit funds and access lending capital. These linkages have typically entailed very little integration of bank and MFI operations and activities. MFIs gain a valuable source of liquidity, cash management solutions, and a safe place to deposit funds, while banks gain the business of MFIs and earn interest revenue on loans to these institutions.

Several evolutions in microfinance made MFIs interested in new ways of doing business. One such evolution saw low-income clients demand a wide spectrum of financial services beyond loans. As a result, microfinance has become a competitive marketplace, where institutions must offer quality products at high efficiency and lower cost to attract clients and revenues. Technical and product innovations, including electronic cards and money transfers, have provided an opportunity to expand outreach and increase the convenience of both MFIs and their clients. Meanwhile, banks have become interested in moving "down-market" after seeing, via MFIs, the opportunity represented by poorer clients. Some have explored direct service delivery, often in competition with MFIs. With a few exceptions, however, this niche market has proved highly challenging for banks.

1. In this paper, the term "partnerships" refers to relationships formed with any formal, regulated financial institution. For simplicity, the term "bank" is used, although partnerships may be formed with other types of institutions.

2. A complete list of interviews is provided in appendix A. Interviews were conducted during August 2008, September 2008, and February 2009. Relevant staff members of banks, MFIs, and other industry practitioners were contacted for their input.

3. FINCA is not the first institution to pursue such relationships. Additional useful documents can be found in the "Further Reading" appendix.

Banks can offer size, systems, and management expertise to MFIs. MFIs offer experience in meeting the needs of low-income clients and the capability to process low-value transactions with customers in remote areas. Partnerships are one option to provide auxiliary financial products and services. However, partnering entails a complex intertwining of the operations of banks and MFIs. Thus, MFIs must think strategically about the nature and desired outcomes of any such relationship. The following section categorizes these challenges by identifying the benefits, risks, and challenges of these partnerships for MFIs, their clients, and banks.

Benefits for MFIs and their clients

As MFIs seek to shift the emphasis of their alliances from gaining access to current bank services to introducing new products and innovative technology, their motivations and the potential benefits of bank partnerships may be diverse (see table 1).

Table 1. Partnership Benefits for MFIs and Their Clients

Product diversification and innovation	Improved customer service
More convenient, broader services, including prepaid cards, money transfers, mobile banking, and other innovations. Leveraging a bank's network minimizes MFI investment costs and risks, and may also avoid regulatory hurdles (e.g., restrictions on capturing savings). *MFIs can attract new clients* and reach those interested in products other than loans.	*Technology* enables clients to save time and money. Clients gain increased security by accessing funds at conveniently located automatic teller machines (ATMs) and points of sale (POSs). Prepaid cards also offer the capability of tracking and analyzing customer cash-management behavior. *Transaction time* can be reduced by using a card payment system in place of a check. *Lower cost.* Successful new products can be offered to clients at lower cost.
Cost savings	**Competitive advantages**
Lower-cost electronic payments. In Mexico, prices for printed checks have increased as private banks convert to electronic systems. *Improved sustainability.* A successful partnership can improve MFI sustainability ratios, moving capital off the balance sheet, lowering expenses, and increasing revenues on existing assets. *Lower cost of capital.* Banks may be able to offer increased liquidity to MFIs, fueling growth, reducing bottlenecks, and reducing financing costs.	*Reputation and marketing.* An alliance with a well-established bank can strengthen an MFI's reputation and increase its recognition in a given market. *Customer retention.* Increased product offerings retain existing customers and draw in new ones. *Leveraged outreach.* MFIs can leverage larger bank networks to expand their outreach. *New markets.* A bank partnership may provide an MFI with access to new markets, customers, and other relationships.

Benefits for banks

An MFI seeking to partner with a bank must offer both advantages to the bank and be able to articulate them. Some of the potential benefits of working with MFIs are listed in table 2 below.

Table 2. Partnership Benefits for Banks

Market outreach	Profitability
Market penetration. MFI alliances offer banks access to the enormous market once considered "unbankable." *Replication*. After developing a new product or service delivery channel to work with one MFI, banks can adapt it to work other MFIs. *Visibility.* Partnering with MFIs may raise a bank's profile, especially among unbanked rural populations. *Compliance.* Some countries have bank quotas for microfinance or sector-specific (e.g. agricultural) lending.	*Revenue source.* Offering new products to new market segments, such as prepaid cards to MFI clients, can be a revenue source for banks, by means of fees for card activation, transaction completion, interest earned on loans before disbursement, maintenance, and other services.
Efficiency and cost savings	**Competitive advantages**
Efficient, low-cost models for serving low-income clients. Innovative solutions may create opportunities for lower-cost banking methods. These methods benefit a bank's existing clientele as well as that of partner MFIs. *Risk diversification.* Serving a new target market may diffuse risk over a greater area by reaching a wider range of clientele.[a]	*Increased competitiveness* from engaging with low-income populations. One bank spokesperson said banks that reject potential MFI partnerships could lose thousands of potential clients to the competition.[b] *Public relations.* Cultivating a "pro-poor" image by working with an MFI can be a marketing opportunity for a bank.[c]

Notes: [a] This is an important point, as it is not yet conventional wisdom, nor is it universally documented in the field of finance. The perceived approach is precisely the opposite.
[b] Interview conducted September 5, 2008 with staff of a banking institution in Mexico (not HSBC).
[c] Ibid.

Risks and Challenges

Risks and challenges for both sides are inherent in a potential partnership. These can impede, and even derail, the business case for partnering if they are not correctly addressed. The risks and challenges for MFIs and banks that were identified by FINCA and senior managers of commercial banks are listed in table 3.

Table 3. Partnership Risks and Challenges for MFIs and Banks

MFIs	Banks
Client data ownership. Some MFIs are hesitant about giving banks access to their client data, fearing competition or client "poaching." *Regulatory environment.* MFIs must understand and comply with all relevant regulations (e.g., those on savings intermediation, money transfers, taxable income reporting). *Human resources.* Developing partnerships and new products is time- and labor-intensive. MFIs may lack the necessary staff resources. *Volume.* Unless MFI client outreach is significant, the institution may not be attractive to a bank. *Sophistication of the MFI.* Weak MFI financial systems and internal controls may make bank relationships difficult, particularly with respect to reporting and oversight. *Diversification vs. market penetration.* Exclusive partnerships and multiple partnerships carry different risks. Banks may demand exclusive partnerships with MFIs, which can produce strong partnerships, but limit client outreach. However, forging multiple alliances may demand more resources and time.	*Profitability.* New product development for an unproven market may be too risky a profit strategy for a bank. *New product development* is a labor- and time-intensive process. For example, one bank took five years to develop and launch its prepaid card product. *Infrastructure.* The limited availability of ATMs and POSs in rural areas, coupled with low withdrawal limits, can limit banks' value proposition to MFIs that have largely rural clientele. *Closed corporate culture.* It may pose a professional risk for bank managers to pursue such relationships if the company or colleagues do not value their efforts, even if it looks good on paper.
Risks and Challenges for Both Parties	
Reputation. Partnering with a new entity carries a potential risk to an institution's reputation. *Staff turnover*, including "starting over" with new points of contact, can cause difficulties for both partners, as can new priorities stemming from management changes or mergers and buyouts. *External risks and challenges.* Macroeconomic factors such as the economy, the political environment, and natural disasters can greatly affect a developing relationship.	

To increase the probability of a successful "win-win" partnership, both MFIs and banks should work to maximize the benefits and mitigate the risks for all stakeholders. Both parties should protect their own interests, but also consider those of their partner.

How FINCA Developed Its Prepaid Card Pilot

In 2009, FINCA entered into a partnership with HSBC Mexico to offer prepaid bank cards to FINCA clients. This section offers a case study of their partnership, including the preparatory steps taken by FINCA to select and approach banks.[4] The following section describes the evolution of this partnership and provides a step-by-step framework for MFIs to advance their own relationships with banks. The section culminates in an explanation of, and suggestions for, negotiations with potential partners.

Defining the context for seeking a bank partnership

FINCA faced a number of converging factors. It was seeking to advance its mission by reaching more rural, low-income clients. The MFI's new strategic plan also called for expansion into new markets, while it faced increasing competition in its existing markets. Accessing the necessary capital for growth required successful performance and profitability that could be achieved only through efficient operations and cost management.

Box 1. FINCA Mexico's Five Goals for Electronic Banking Cards

1. Reduced operational costs
2. Increased convenience for clients
3. Increased flexibility and security for clients
4. Adaptability to other new products
5. Clients brought into formal financial sector

For years, FINCA had relied on an expensive, inconvenient check system for loan disbursements. After studying local markets, as well as reviewing the options available within the microfinance industry, FINCA identified a prepaid card system as the best option for improving its services and reducing its costs. Unlike a debit card, which is linked to an individual current account, a prepaid card is electronically "loaded" with cash derived from a single pooled account managed by the card issuer.

Since FINCA lacked the resources to offer prepaid cards on its own, it sought a partner locally in Mexico to offer them. Its decision-making process was framed by its five main goals, where were to:

1. **Reduce operational costs**, avoiding the higher cost per disbursement of using checks.
2. **Offer increased convenience to clients** by enabling them to make transactions without a bank teller, thus avoiding delays and poor service. This was possible since ATMs in Mexico are numerous and readily accessible, even in remote areas.
3. **Provide increased flexibility and security to clients** by enabling them to withdraw loan disbursements in multiple tranches, rather than in one lump sum.
4. **Acquire a technological platform** (the prepaid card) **that could be applied to other new products**, such as remittances and savings.
5. **Bring clients into the formal financial sector** by introducing them to banking cards and regular use of banks.[5]

Setting the objectives and strategies for expansion

FINCA's mission mandated an ambitious growth plan; pursuit of a bank-MFI partnership was part of this plan. FINCA management prioritized four principal objectives for success: adopting a card-based payment system, offering complementary services through cards, increasing its POS outlets, and widening its network of remote branches. For each objective, FINCA identified the potential advantages and challenges.

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4. The other banks that were approached are labeled generically; only HSBC, the current partner, is named. Exploration into appropriate relationships continues with the other institutions.

5. Interview conducted September 4, 2008, at FINCA Mexico headquarters in Cuernavaca.

Objective: Transitioning from printed checks (left) to prepaid card loan distribution (right)

FINCA hoped to achieve a bank partnership that it could later leverage to offer other highly demanded services, such as savings and remittance transfers, which would provide the MFI a competitive edge.

There were challenges to offering cards as well, including a lack of MFI staff with technical knowledge of such new products and services. There was also a potential for fraud as well as regulatory limitations; both of which indicated a need to establish risk-control measures. In addition, the MFI's rural operations were more expensive due to weaker transportation and communications infrastructure.

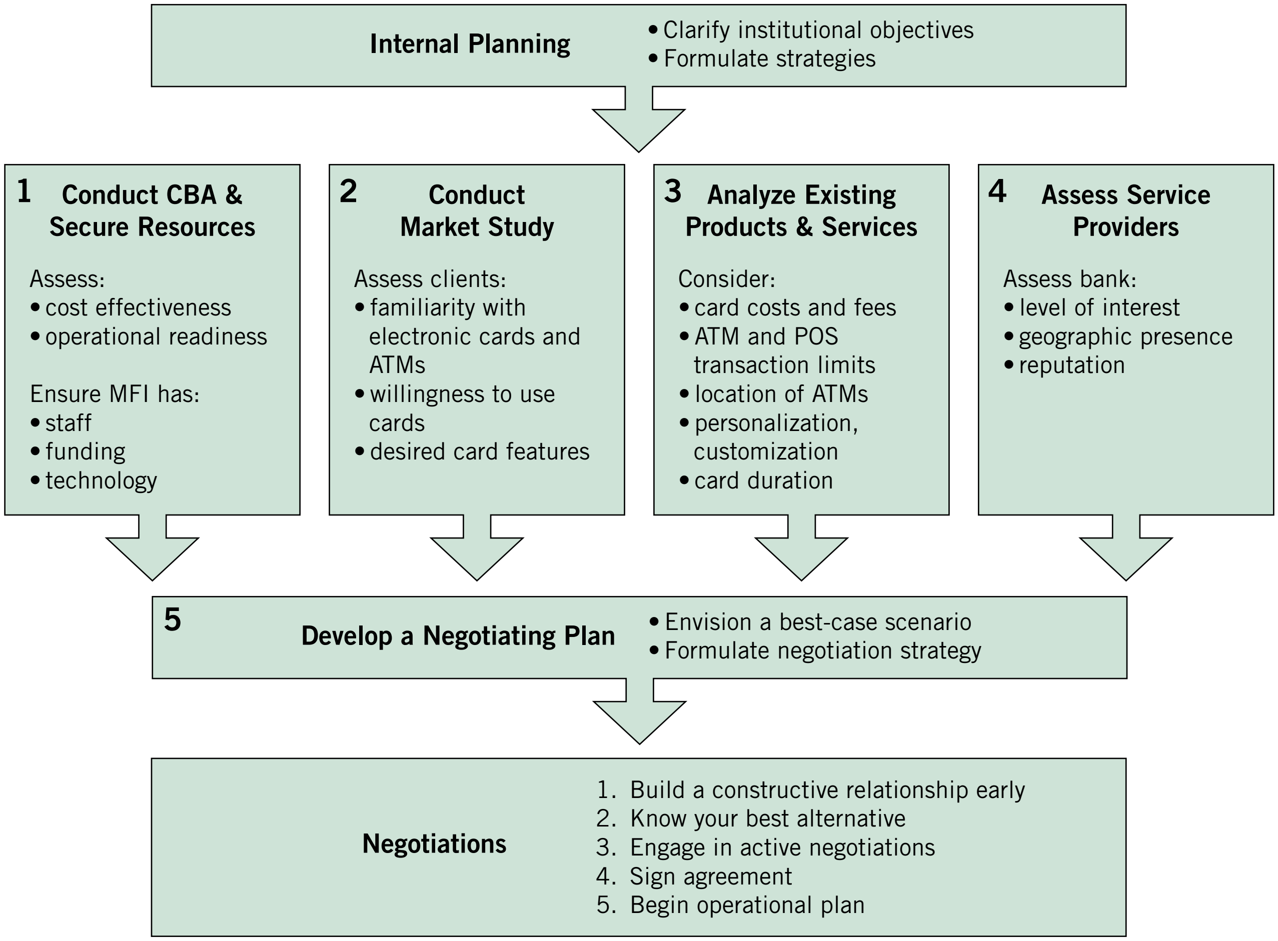
After analyzing the situation, FINCA decided it needed a partner that:

- was in the same geographical areas as FINCA clients
- had a good reputation for service
- had access to large electronic card networks in Mexico, such as Visa
- could use Internet-based connections in rural areas

C. Planning phase

After having identified clear goals, challenges, and priorities, FINCA was ready to plan for a partnership. The process would, however, be long and complicated. Figure 1 below outlines a framework for FINCA's decision-making process and the activities it undertook to identify potential partners and pursue eventual negotiations. The framework is not meant to set forth one correct sequence, but rather, to identify the key tasks and understand the time and effort involved in each step of the planning phase. It is valuable to note that extensive time and activity was dedicated to the planning process before the negotiation stage began.

Figure 1. Step-by-Step Planning Process for an MFI-Bank Partnership



1. Conduct cost-benefit analysis (CBA) and secure necessary resources. It is important that an MFI assess whether it will be able to implement a bank partnership successfully, especially whether it has the necessary internal buy-in. FINCA's first step was to ensure that the benefits of a card-based system outweighed the costs of implementation. Analysis indicated that it would be cost effective to implement a prepaid card system and that FINCA was operationally prepared to do so.

After establishing the feasibility of the new product, FINCA had to secure the required resources for development:

- *Staffing*. Involving multiple, knowledgeable staff is vital to a smooth partnership development process. FINCA began its efforts by hiring a consultant with extensive commercial banking and card product experience to be the project manager. As the MFI became more engaged in the project and understood the technical demands, it hired the consultant and involved more staff.
- *Technology*. An HSBC bank official noted that sophisticated MFIs with automated systems and processes were more attractive to banks. FINCA's quality management information system (MIS) was therefore an asset in attracting banks.

Box 2. Market Study Findings

FINCA's 2007 market study yielded several interesting findings.

Among the 3,274 clients interviewed:
- 30 percent were unfamiliar with ATMs
- 19 percent had used debit cards before
- 72 percent were literate

Illiteracy, older clients, and lower loan sizes were generally expected to be associated with lower uptake of the cards.

Clients who lived far from bank branches, experienced long waits in bank queues, or had perceived cash insecurity were more likely to consider using a card.

Rural or less urbanized regions displayed more resistance, or even open opposition to the idea of replacing checks with prepaid cards.

2. Conduct a market study. A market study verifies and quantifies the market demand for a product and helps identify potential pitfalls, challenges, and opportunities. The study can also help identify which clients would be most receptive to piloting the product, as well as necessary training topics.

In May 2007, FINCA contracted a specialized research firm to conduct a market study to analyze various factors that would impact card uptake by region.[6] Based on its findings (see Box 2), the study recommended that FINCA make the transition from checks to prepaid cards gradually, starting in regions of least resistance, with an interim period of mixed disbursement systems (checks and cards). The results of this market study later enabled FINCA to approach banks with a concrete concept of client expectations for a card-based product.[7]

3. Analyze existing consumer products and services. It is critical for an MFI to have a thorough understanding of the consumer products and services available in the marketplace, as well as the attributes of these products and services. This information helps MFIs learn about different options, consider what clients would like, and understand the competition. It also informs their negotiations with potential partners.

FINCA analyzed several options for cards, based on a number of key attributes:

- cost of the physical card
- cost per transaction
- withdrawal limits on ATM transactions
- limits on POS purchases and cash withdrawals
- ATM locations
- bank operating hours
- card validity period
- card personalization

Once these specific variables were reviewed and the various institutions compared side by side, product qualities and institutional leaders emerged. (A summary of this analysis is provided in Appendix A.)

FINCA Mexico clients waiting in line, signing records, and receiving their loan checks.

6. The market study looked at client acceptance of cards, the perceived convenience of cards vs. checks, existing client familiarity with and usage of ATMs, and client literacy rates. See box 2 above.

7. During August and September 2008, FINCA performed a follow-up survey regarding card acceptance with over 2,000 clients in four branches (Morelos, Oaxaca, Michoacán, and Puebla) that served six states. Results suggested that 67 percent of clients would accept prepaid cards instead of checks. While the survey revealed the extent of client demand for prepaid cards, its purpose was actually to identify pilot project sites.

4. Assess service providers. After determining which type of product or service it most likes, an MFI should assess the different providers that offer the product. The willingness and flexibility of a bank, particularly its senior management, to work with an MFI to develop a partnership should be understood as a far more powerful driver in a partnership than either the product attributes or the distribution outreach offered by the bank.

FINCA's goal in Mexico was to expand its services to rural and underserved populations, so it was important that the partner bank have a significant rural presence, either through ATMs or correspondent agents.[8] Thus, a leading Mexican bank with a primarily urban presence would not be a good fit. A partnership with HSBC Mexico, by contrast, was appealing, since it offered significant rural coverage through correspondent agents.

In Mexico, FINCA also selected prepaid cards, as opposed to debit cards, because of a regulation against savings intermediation by nonbank MFIs and because this product would have required it to share client data with a bank. Prepaid cards had neither of these problems. However, prepaid cards were originally designed as per diem cards, not loan disbursement instruments, so several feature adjustments were necessary.

Customization and personalization of the cards were also high priorities for FINCA. HSBC agreed to allow the MFI to add its own design and print client names on its card, while the other banks did not.

5. Develop a negotiating plan. Once an MFI has completed the steps above, it should develop a best-case scenario and a negotiation plan. At a minimum, this plan should inform management of what is reasonable, realistic, and desirable from a potential partnership. By the end of its planning phase, FINCA knew its priorities for negotiating with banks: a customized, personalized, prepaid card product offered by a reputable bank that had sizable rural outreach.

D. Negotiation Phase

By analyzing the market and clarifying its priorities, an MFI can prepare itself to work much more effectively with a potential partner bank. FINCA's experience provides a number of important lessons. The following guidelines are contextual and should not be considered absolute. Relevant guidelines will vary based on local conditions—particularly the local marketplace and customs—and the type of partnership sought. While some of these steps might seem obvious, they are still worth noting for their importance to successful relationships.

1. Start by building a constructive relationship. This step includes:

- *Finding a bank that is committed to a partnership and trying to move the negotiations forward.* Trying to convince uncommitted banks to negotiate can waste resources and time. Serious, committed banks will provide timely follow-up, point out mutual interests, be flexible in negotiations, and be transparent. FINCA started by talking to banks it already knew, thanks to previous arrangements that allowed its clients to cash MFI checks.
- *Forging positive, personal relationships with key personnel at the partner bank.* These personnel ideally should be well regarded within the bank, authorized to make decisions, genuinely interested in the partnership, and have a positive impression of the MFI. Likewise, the MFI should assign qualified and motivated staff to the partnership development team. FINCA selected staff experienced in banks and card products to spearhead the negotiations; it also ensured that management was involved. It had three points of contact at HSBC, met with high-level executives, and provided feedback on time. With the second bank, relations were similarly positive, but the bank decided to suspend negotiations because its product did not meet FINCA's needs. At a third bank, despite positive initial relations, FINCA's only point of contact resigned, and communication lapsed for several months.

8. Correspondent agents are banks or other financial institutions through which a small or foreign bank works to expand its services, usually in a geographic area where it has limited direct presence. These agents enable banks to increase their business using the correspondent's existing products or infrastructure, without incurring the usual costs of expansion.

2. Know your best alternative to a negotiated agreement (BATNA). As with any negotiation, MFIs must specify what they seek from a bank partnership, what their priorities are, and what their "walk-away" situation is. A BATNA is essentially the next-best thing an MFI could do without the particular partnership.[9] It implies knowing what other products, services, and competition are in the market, and helps an MFI negotiate because it can weigh a bank's offered terms against these alternatives.

Prior to negotiations, FINCA knew the few key areas critical to the success of the project and aimed to secure the most favorable terms possible for these areas during the negotiations.

3. Engage in active negotiations. Once the MFI has done its homework and completed planning, it is in a stronger position to engage financial institutions in active negotiations. This stage begins when a bank presents a detailed business proposition for the new product. The MFI must accept, reject, or negotiate the terms.

The length of the negotiation depends on the number and complexity of issues to be discussed, and the readiness of both parties to reach and implement an agreement.

The negotiations between FINCA and HSBC took over 16 months; the timeline was delayed by other responsibilities of FINCA staff, the hesitancy of HSBC to meet FINCA's varied technical requests, and the need for Visa Inc. to approve all issues relating to the production or appearance of the cards.

Key issues successfully negotiated with HSBC included:

- *Costs.* HSBC and FINCA agreed on a reduced cost per card, from 20 to 16 pesos (about $1.20 in 2009), and a lower cost per transaction, from 5 to 4 pesos (about $0.30).
- *Card withdrawal limits*. The parties resolved to increase the limit on withdrawal transactions for FINCA clients from 5,000 to 6,000 pesos.
- *Card expiration*. HSBC agreed to extend the cards' validity from 24 to 30 months. This extension reduced per-client card reissuance fees for FINCA and its clients, and was consequently more convenient.
- *Card design*. HSBC initially suggested that the HSBC "Cheque Inteligente" card design was standard and non-negotiable. FINCA successfully pressed HSBC to accept a FINCA card design. The face of the card now features the MFI's logo, colors, and design.
- *Card personalization*. For low-income clients, a prepaid card is a status symbol, and the market study showed that clients wanted their names on the cards. HSBC initially did not want to allow personalization, but ultimately agreed to print clients' names. FINCA anticipates that this feature will increase the cards' uptake and popularity.
- *Client data security*. Initially, HSBC wanted access to the data of each FINCA client holding a prepaid card. However, FINCA successfully negotiated terms that allowed FINCA to maintain the confidentiality of these files. Shielding this information also lowered the risk of HSBC using the data to target FINCA clients.

9. BATNA is a term coined by Roger Fisher and William Ury in their 1981 bestseller, *Getting to Yes: Negotiating Without Giving In* (New York: Penguin). More information is available at the Web site, www.batna.com (accessed August 2009).

Standards Cheque Inteligente design

FINCA's custom Cheque Inteligente design

FINCA's key bargaining chip was making a strong business case—demonstrating to the bank the potential of issuing perhaps more than 60,000 cards. FINCA also committed to purchasing the first 20,000 cards, in exchange for securing their personalization.

4. Sign agreement. If negotiations are successful, an MFI and bank sign an agreement or contract. This agreement is usually developed by the bank and outlines product offerings, the processes required of each party, and other general rights and obligations. It is vital that the MFI have strong management and good legal representation. The institution and its management should be very clear about the nature of the document and its content. If the MFI is unhappy or uncomfortable with the document, it should not sign it. It is also vital to ensure that the written document tracks the agreements made during negotiations.

In this case, HSBC submitted to FINCA a standard contract for prepaid card clients. Both parties modified the document through two rounds of negotiations. An additional, legally binding agreement, to be renewed annually, laid out the specific terms of the product as negotiated (such as those involving personalization and data security).

5. Begin operational plan. Once an agreement is signed, MFI managers and operations staff formulate a timeline for implementing the new product or service. The timeline should be realistic, given challenges and existing obligations. Throughout implementation, MFI managers and key personnel should meet regularly and keep senior management apprised. Meanwhile, maintaining open and honest communication with the bank partner is crucial.

FINCA used funds from a Visa Foundation grant to implement the new cards. The same staff members who were involved in the negotiations continued to work on the project during implementation; the MFI's senior managers also remained intimately involved in supervising the rollout. The operational work plan included a detailed timeline for training FINCA staff and clients on the cards, piloting and evaluating the cards, and establishing benchmarks for client uptake. (For a detailed timeline sample, see Appendix B.)

The Bank Perspective

A mutually beneficial partnership requires that an MFI understand the bank's perspective. This understanding needs to extend to issues that may be new and even uncomfortable for an MFI to consider. MFIs need to realize who is across the table, what they want, and how they operate.

In preparing this briefing, FINCA staff members held interviews with staff from HSBC and two additional banks (see Appendix C for details). The goal of these meetings was to gain additional insight into the processes of planning, preparing, and negotiating a partnership from the bank's perspective. Below are the most salient points gathered from these conversations.

Box 3. The FINCA "Cheque Inteligente" Card

Following market studies and negotiations, FINCA produced a customized version of the HSBC prepaid "Cheque Inteligente" card. Each card features FINCA Mexico's logo and colors and is personalized with the cardholder's name. The card costs 16 pesos and is valid for 30 months. Each transaction with the card costs 4 pesos and the withdrawal limit is 6,000 pesos. Cards can be used at bank ATMs, Telecomm outlets, or for direct purchases at participating stores. In response to the needs of a largely illiterate client base unfamiliar with this type of technology, FINCA developed a usage guide and formal training that was to incorporate into existing client training. It also produced wallet-sized ATM guides for portable use.

The money for the cards is distributed from a single pooled account managed by FINCA. To protect its clients and its business, the MFI maintains the confidentiality of prepaid card client data.

A. How do banks decide to work with an MFI?

Before investing time and effort in developing a partnership, banks generally want to make sure an MFI is strong and stable. Banks also tend to look for high-volume operations. The more clients or the greater the value of an MFI's portfolio, the more attractive it is to a bank.

The banks interviewed showed a clear preference for partnering with MFIs with which they had pre-existing relationships. This way, the partnership only deepened the relationships. One bank representative said it strongly preferred to work with MFIs whose financial standing, institutional stability, transparency, and operational history were already known to them—thus raising the confidence and "comfort level" of the bank.

B. How can MFIs facilitate the process of working with a bank?

Bank officials noted that MFIs should do three key things:

1. *Develop a strong institutional vision for innovation.* An MFI should already have a vision of where it wants to go and how it wants to get there, and it should not shy away from change.
2. *Be prepared to move forward.* The best MFI partners have staff that have the necessary technical knowledge and understand both MFI and banking operations. They also have automated systems to facilitate the processing of card transactions with bank systems.
3. *Be flexible.* Flexibility expands the range of potential alternatives for implementation.

C. What role do commercial and social impact considerations play in partnership selection?

Banks primarily seek to increase profits, so a high-yielding potential revenue stream is a major consideration. As noted above, a positive working relationship is also an important factor for both a bank and an MFI. Relatively speaking, social impact considerations (e.g., serving the unbanked poor) were least important to banks. Both the banks interviewed explained that social issues were the purview of their international headquarters, which see microfinance as a corporate social responsibility issue. For their Mexico offices, however, the primary objective was to form commercially competitive relationships that offered opportunities for profit.

Lessons Learned

The following lessons are offered to MFIs that are considering or trying to establish a partnership with a bank:

Lesson 1. Take small, manageable steps toward long-term partnerships. MFIs might want to start relationships with banks via simpler ventures, such as check-cashing privileges for clients. This approach can build a bank's trust and confidence in an MFI.

Lesson 2. Understand how the bank views your joint activity. The degree of bank involvement varies in MFI-bank partnerships. As providers of banking cards, commercial banks generally consider themselves to be product suppliers rather than partners. As a result, banks may not be prepared or able to adjust their operations to those of an MFI, and may instead expect the MFI to fit its operations in with those of the bank.

Lesson 3. Start the negotiations process early; be prepared for lapses in communication. The negotiation of partnerships and new products is a highly complex process that can easily be delayed. MFIs should initiate negotiations as soon as planning and preparations are adequately completed, designate multiple points of contact on both sides, and not expect immediate success.

Lesson 4. Leverage information from all institutional levels. Technical staff must spearhead the project. These staff should include qualified personnel who understand both parties' operational systems and other relevant topics. Decision making should also consider input from all relevant levels of MFI staff to ensure maximum buy-in and effectiveness. This may include asking credit officers how to maximize new products, asking accountants and financial controllers about the consequences of linking with banks, and querying staff at headquarters and in other countries (where applicable) about similar initiatives.

Lesson 5. Know your options for products and services. Potential partners may offer excellent products, but MFIs should rigorously evaluate their specifications and how well they meet MFI needs and maximize client benefits. Whenever possible, MFIs should seek pre-existing products that meet their needs; where these do not exist, MFIs must have clear, concrete demands for new products.

Box 4. Constructive Collaboration: FINCA and HSBC in Chiapas

In Chiapas, pay day for many employees fell on the same days that FINCA clients received their loan checks. FINCA clients consequently faced extremely long lines at the bank. The HSBC branch also often ran low on cash on those pay days—even running out of cash one day.

Once the HSBC branch flagged the issue to headquarters, the HSBC account manager approached FINCA to discuss potential solutions. To remedy the situation, FINCA decided, as a matter of policy, to disburse its loans a few days before or after pay days. This open communication and mutual understanding resulted in a practical solution that benefited both HSBC and FINCA clients.

Lesson 6. Understand how banks work and make decisions. Both an MFI and a bank need to understand each other's needs. This understanding makes it easier to overcome roadblocks in negotiations (see Box 4 above). MFIs should also recognize which issues are non-negotiable for banks. Banks are subject to tight regulations and established internal controls and systems; thus, some processes cannot change. For example, FINCA negotiated to maintain the security of its client data, but HSBC needed some form of access to comply with anti-money laundering and terrorist financing monitoring requirements. With this understanding, FINCA allowed HSBC to access client data upon request, while specifically prohibiting its use for marketing purposes.

Lesson 7. Make negotiations a competitive process. An MFI may already have a comfortable and constructive relationship with one bank. However, this should not preclude a healthy, competitive negotiating process. Less familiar banks may prove more cooperative or offer more attractive products. FINCA initially expected to work with one particular bank, but met an unexpected lapse in communication and less favorable terms than expected. Allowing banks to compete against one another allowed FINCA to develop a partnership according to its needs, one chosen out of a full spectrum of options.

Conclusion

Partnerships between banks and MFIs carry benefits and risks for each party. Success, moreover, is not assured. However, preliminary data on the partnership between FINCA and HSBC have been promising. From the bank's side, HSBC has a new source of revenue and has achieved name recognition among previously unbanked clients (through ATMs). For FINCA, recent CBA estimates show that the MFI has experienced cost savings with prepaid card clients in either the fifth loan cycle (with the cost of training included) or the third loan cycle (without training costs).[10] For clients, the benefits are clear:

- Out of 100 prepaid card clients who were surveyed, 86 found the card cheaper than the check and 93 planned to use it for their next loan cycle.
- Rural clients in Cuicatlán, Oaxaca save about $23.26 per loan using the card.
- Urban clients save about $1.15 per loan, in terms of the time they save not standing in line at the bank.[11]
  As a result, FINCA and HSBC seem to be at the start of a successful partnership, largely due to thorough market research, adequate staffing, clear priorities on the part of FINCA, as well as mutual understanding between the two institutions. Thus, FINCA can expand its services and stay competitive; HSBC receives a new source of revenue; and FINCA clients have a new, secure, and convenient product.

Other MFIs seeking to expand their product offerings through bank partnerships should prepare thoroughly for this demanding process. Before engaging directly in negotiations, MFIs are advised to initiate relationships and build trust with banks slowly. MFIs also need to assess and perhaps build technical capacity; know the products and services available on the local market; and tailor their negotiation strategy to meet their needs and those of their clients. Some flexibility is advisable, but MFIs should strive to make the best business case possible to secure their desired terms.

FINCA staff and clients. FINCA Mexico.

Going forward, many of the principles that are crucial to successful negotiations also apply to maintaining a positive relationship with banks. These principles include transparency and open communication, involvement of both technical staff and senior managers, and knowledge of clients' evolving needs. By following these guidelines, banks and MFIs can continue working together over the long term, leveraging their respective strengths to create situations beneficial to both institutions and their clients.

10. The cards are good for eight loan cycles. Note that this limitation is solely based on the cost of cards versus checks and does not consider the difference in operational costs or increased or decreased revenues due to popularity of the cards. FINCA Mexico is looking at ways to further reduce the cost of the card, including consolidating the paper training materials.

11. Survey and analysis conducted by FINCA in Mexico, 2009.

Appendix A: Comparison of Bank Cards in Mexico

Bank/Product	Advantages	Disadvantages
HSBC "*Cheque Inteligente*" (prepaid card)*	• Personalized card (with client name) • HSBC willing to negotiate on product cost and design • Withdrawal limit per day: 6,000 pesos (US $378)—larger than competing banks) • Card activated for up to 3 years • Can feature FINCA's card design	• Lowest distribution of ATMs in rural areas • Can only be used at ATMs, and not with human tellers
Bank 2 Prepaid card	• Can feature FINCA's card design • Card activated for up to 5 years. Can be used at both ATMs and with human tellers	• Withdrawal limit per day: 4,000 pesos • Card cannot be personalized with the client's name • Low distribution of ATMs in rural areas • Can only be used at ATMs (not with branch tellers), unless MFI shares client data with the bank
Bank 2 Debit card	• Greatest distribution of ATMs in Mexico • Can be used at both ATMs or with human tellers • Can be linked to other products offered by the bank	• FINCA's client becomes the bank's client • Unable to obtain answers on the requirements • Withdrawal limit: 5,000 pesos • Requires linkage with personal account at partner bank, which is a risk to the MFI • Debit card could have been misinterpreted by regulating authorities as indicating that FINCA was intermediating savings • Cost includes payment of an annual commission • Cards cannot be personalized with client's name
Bank 3 Debit card	• Card already tested by businesses with massive disbursement • Card activated for up to 4 years	• Personalization of cards unlikely • Withdrawal limit of 5,000 pesos • Mostly urban presence has limited value to FINCA clients • Requires linkage with personal account at partner bank, which is a risk to the MFI • Debit card could have been misinterpreted by regulatory authorities as indicating that FINCA was intermediating savings

Note: * FINCA Mexico selected this product based on its superior service offerings.

Appendix B: Bank-MFI Partnership Timeline

Activity	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Qtr 1	Qtr 2	Qtr 3	Qtr 4
Phase 1: Planning								
Secure proper staffing								
Market demand study								
Analysis of available products and services								
Analysis of service providers								
Phase 2: Negotiation with Bank								
Negotiation with bank partners								
Finalize and sign contract								
Phase 3: Preparation for Pilot								
Develop training materials								
Client and staff training								
Install necessary systems								
Phase 4: Pilot Project								
Project pilot								
Pilot evaluation								
Make adjustments based on evaluation findings								
Roll out								

Appendix C: List of Interviews

Name	Position	Institution
FINCA MEXICO		
Gonzalo Puente Ibarnegarray	Executive Director	FINCA Mexico
Ricela Muñoz Salomón	IGP Project Manager of Technological Innovation	FINCA Mexico
Maxima Ayuala	Supervisor *(Cuernavaca)*	FINCA Mexico
Ivan Briceño	Loan Officer (*Cuernavaca)*	FINCA Mexico
Rosa Najera Martinez	Loan Officer (*Cuernavaca*)	FINCA Mexico
COMMERCIAL BANKS		
Juan Carlos Barreto	Product Manager	HSBC
Cash Management Officer Corporate and Investment Banking		Bank 2
Cash Management Officer Subdirector Corporate Business		Bank 2
Corporate Official		Bank 3
Third-party Agents		
Fatima de la Borgoya	Manager: Morelos	TELECOMM Telégrafos
Learning Networks		
Ivana Fertziger	Microfinance Specialist	AFIRMA
Drew Tulchin	USAID Financial Services IGP Learning Network Facilitator	Social Enterprise Associates The SEEP Network

Appendix D: Further Reading

The following resources provide further information about bank-MFI partnerships:

Ananth, Bindu. 2005. "Financing Microfinance—The ICICI Bank Partnership model." *Small Enterprise Development* 16, no. 1: 57–65.

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Martin, Carlos. 2008. "Going to Scale with Housing Microfinance: The Role of Commercial Banks." microREPORT no. 92 (March). microLINKS Web site, USAID, Washington, DC, www.microlinks.org/ev_en.php?ID=22878_201&ID2=DO_TOPIC. Accessed June 6, 2009.

Nirula, R., and A. Kumar. 2005. "ICICI Bank in Microfinance: Breaking the Barriers." Asian Development Bank Institute, Asian Development Bank, Manila, Philippines. Available on the CGAP/ Microfinance Gateway Web site, www.microfinancegateway.org/p/site/m//template.rc/1.9.29480. Accessed June 6, 2009.

"Report on India Workshop Proceedings: Linkages and Partnerships in Microfinance—Symposium and Training Workshop." 2006. Banking with the Poor Network, Brisbane, Australia. Available on the CGAP/ Microfinance Gateway Web site, Washington, DC, www.microfinancegateway.org/p/site/m//template.rc/1.9.26143. Accessed June 6, 2009.

USAID (U.S. Agency for International Development). "MD Overview: Commercial Bank and MFI Linkages." n.d. microLINKS Web site, USAID, Washington, DC, www.microlinks.org/ev_en.php?ID=12673_201&ID2=DO_TOPIC. Accessed June 6, 2009.

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