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microNOTE 19

Opening Markets through Strategic Partnerships – AMEEN[1]

Bank Success

For the banks, the partnership has enabled them to better utilize their liquidity and earn higher rates of return. It has provided for a new source of revenue with a limited investment in staff and infrastructure. Further, the banks have entered new market segments in which banking competition was limited or nonexistent, and thereby introduced them to new clients and their potential. Lastly, the program has allowed the banks to fulfill their social responsibility to the broader community by providing services to low-income groups.

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INTRODUCTION

Finance institutions in developing countries are implementing a wide range of linkages to reach new and more remote markets and clients. These linkages often occur between regulated financial institutions and more informal, unregulated entities serving low-income clients. The linkages represent important advancements in service provision to the low-income market, and present possibilities for providing more sophisticated or expansive financial services. Moreover, these linkages serve to overcome institutional or operational obstacles, as well as obstacles related to physical infrastructure, geography, limited population density, or regulation.

The Access to Microfinance and Enhance Enterprise Niches (AMEEN) linkage demonstrates how local commercial banks are able to outsource certain aspects of the credit process to a microfinance institution (MFI), while generating a portfolio of microenterprise clients. Through this linkage, the MFI is able to expand outreach without infrastructure requirements and secure stable sources of funding for on-lending to microenterprises. Commercial banks, on the other had, are able to enter a new market without the heavy upfront investment requirements in know-how, staffing, and technologies.

INSTITUTIONS

In September 1998, CHF International was awarded a cooperative agreement by USAID to begin the AMEEN program. A portion of the

[1] This microNOTE is based on the Accelerated Microfinance Advancement Project (AMAP) Financial Services Knowledge Generation (FSKG) report, *Opening Markets Through Strategic Partnerships: The Alliance Between AMEEN Sal and Three Lebanese Commercial Banks*, prepared by Ignacio Estévez and Colleen Green. The full report is available on http://www.microlinks.org.

Elements from the Strategic Alliance Model

- Banks finance portfolios (or a portion of them) of AMEEN
- Banks provide operational support in terms of disbursements and collections through bank branches
- Agreements negotiated that assign cost, risk, responsibility, and return to each party

Elements from the Service Company Model

- AMEEN provides loan origination and credit administration services to a bank
- AMEEN staff promotes, evaluates, approves, tracks, and collects loans
- AMEEN is not regulated or supervised by banking authorities
- Detailed agreements are negotiates with the parent bank that assign cost, risk, responsibility, and return to each

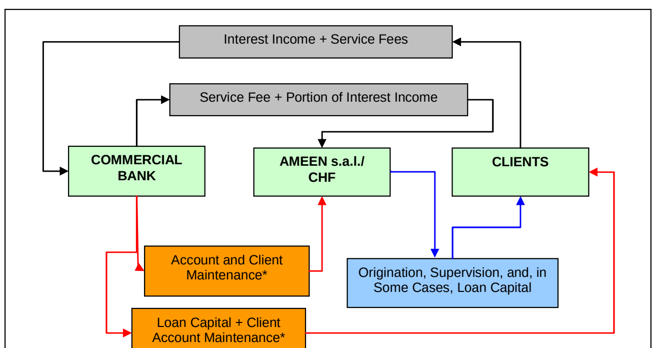
funds was used for loan capital, and the balance was directed toward technical assistance to operationalize the program.

AMEEN began to provide individual loans to micro and small clients in March 1999 through its partnership with Jammal Trust Bank (JTB).A small but high-quality private commercial bank, JTB has been in operation since 1963 and has 21 branches throughout Lebanon. JTB was selected as AMEEN's partner because of its market orientation—JTB already served the middle market, and it was interested in working with lower to middle income and poor clients—and because its vision was in line with AMEEN's.

The number of banks has since expanded to three with the additions of Crédit Libanais and Lebanese Canadian Bank.

THE LINKAGE

The linkage takes on characteristics from both the service company model and strategic alliance model, some of which are outlined in the following text box. AMEEN essentially works as a service company for the banks undertaking the promotion, evaluation, approval, tracking, and collection of loans through AMEEN loan officers based at the banks branches. The banks fund the loans, and record these under their balance sheet. In cases where a capital share arrangement exists, the percentage of loan corresponding to AMEEN is made from an AMEEN account maintained at the bank and the balance is funded by the bank and recorded on their balance sheet. As the client repays the funds, the bank is responsible for crediting the corresponding AMEEN operating account with AMEEN's share of the capital, interest, and any applicable fees. A risk sharing agreement specifies share of risk undertaken by each.



*Includes, among others, accepting borrowers' payments, maintaining accurate records, preparing daily/weekly/monthly reports for AMEEN, sending payment remainder notes to clients, and legal department involvement in delinquency cases.

PARTNERSHIP AGREEMENT

AMEEN and partner banks negotiate terms of the strategic alliance that incorporate all aspects of the processes—including the defining products, risk and funding sharing, marketing responsibilities, evaluation criteria, funding and recovering processes, revenue sharing, and loan and revenue accounting, among others. The agreements are a crucial part of the strategic alliance, not only because they provide the basis of a contract, but also because they contribute to the institutions' overall strategy. The agreements tend to be short term in nature and are continually revisited. As the program continues to grow and the number of partner banks increases, AMEEN will find itself in a stronger position to negotiate terms of the agreements.

Measures of Success

AMEEN has become the leading MFI in Lebanon because of the successful formation and growth of its commercial bank linkages. Although performance has been affected by recent political and economic instability in Lebanon, as of May 2005, AMEEN was sustainable, managing a portfolio of $6,188,125, with 7,879 clients, and was projecting 21 percent portfolio growth and 40 percent client growth by the end of September 2006.

For the banks, the partnership has enabled them to better utilize their liquidity and earn higher rates of return. It has provided for a new source of revenue with a limited investment in staff and infrastructure. Further, the banks have entered new market segments in which banking competition was limited or nonexistent, and thereby introduced them to new clients and their potential. Lastly, the program has allowed the banks to fulfill their social responsibility to the broader community by providing services to low-income groups.

INITIAL AND FUTURE CHALLENGES TO IMPLEMENTATION

Most of the challenges faced by AMEEN in the initial implementation of the program were the usual hurdles in any partnership. For the most part they involved minor issues related to bank/ branch personnel, unforeseen management information systems (MIS) adjustments, dealing with competition between AMEEN personal located in different banks within the same lending area, and client retention, which at the time of this writing was low. Larger issues faced by AMEEN in growing portfolio and expanding outreach include:

Funding. AMEEN has a limited amount for funding of loans. Agreements with banks require a share of loan funding be from AMEEN, thereby limiting growth potential. Modifications to the partnership agreements—where banks fund a greater percentage or the full amount of loans—will be required to ensure continued growth.

Centralization of loan decision making. The loan approval process is centralized within each partner bank creating inefficiencies and slowing turnaround on new loans. While loans require branch manager and AMEEN loan officer signatures, approval is through a committee of AMEEN and bank management personnel, centralized at each bank's head office.

Buy-in from branch managers and staff. Branch managers can wield a great deal of power in their respective branches/regions and, thus, are an integral part of the program. While AMEEN has worked on communicating benefits of program to branches, there is the potential for managers to resist change.

Opportunities for cross-selling. Currently, the banks are not taking advantage of the possibility to cross-sell other financial products and services. As AMEEN grows and faces more competition from other MFIs, providing added value to its clients through bank financial products may make it more attractive than its competitors.

Product differentiation. AMEEN currently offers three products to microentrepreneurs: a microenterprise loan, a home improvement loan, and a personal loan. There are only minor differences between these three loan products in terms, conditions, and the manner in which they are analyzed. As the market becomes more competitive, further product development and differentiation will be required.

AMEEN visibility and brand. Microentrepreneurs tend not learn about AMEEN from visiting the bank. Instead, AMEEN is increasing its customer base by actively marketing in poorer neighborhoods and regions and using word of mouth for referrals. Visibility of the AMEEN brand within the bank branches is an important step toward ensuring healthy portfolio growth.

Direct competition from the banks. The Lebanese banking system has a very low loan-to-deposit ratio, which is in part a result of the high-yield, low-risk investment instruments that are available to them. A yield decrease in these investments could drive banks to increase their focus on the microenterprise sector, either with AMEEN or on their own.

Exclusivity versus expansion. Given the limited size of potential demand of the microenterprise market in Lebanon (estimated between 70,000 and 200,000 micro-entrepreneurs), and as the AMEEN product becomes a significant portion of the branches' revenue, AMEEN and its partners will have to evaluate the non-compete/exclusivity clauses of their agreements.

LESSONS LEARNED AND RECOMMEN-DATIONS

Many of the lessons learned from the AMEEN partnerships with the three commercial banks illustrate the importance of good project planning and management. The partnership had all of the key elements in place to ensure the initial success of the alliances. As the program develops and competition increases, areas will have to be revisited and adjusted to better meet overall goals of all partners—particularly AMEEN, which is focused on increased outreach to the microfinance sector.

1. **Selection of an appropriate partner bank.** The selection of an appropriate partner bank is crucial, as banks must be able to provide the funding/share risk, but also must have a compatible vision of the market and its potential.
2. **A detailed agreement with each bank partner that outlines roles and responsibilities of each partner is essential**. The contract must clearly define the roles and responsibilities of both partners. No partnership should be viewed as static; alliance agreements must be reviewed and re-evaluated regularly. Institutions must expect shifts in priorities, vision, and power. Institutions that resist these changes—rather than accommodate them—will watch their alliances crumble.
3. **A clear understanding of bank expectations of the product and sector.** There are cases where banks may enter the sector solely for philanthropic reasons. The potential of the sector will not develop adequately if the reasons for entry are also not profit-driven.
4. **A risk-sharing agreement at the start-up phase.** Banks in general tend to be risk-averse, and tend to view serving the low-income market as risky. One of the crucial issues for the success of the program was the seed funding provided to AMEEN by donors, which funded the start-up costs and a portion of the loan portfolio/risk. This element allowed AMEEN the time to show successful and sustainable results and thereby cause banks to increase their participation and reduce counterpart risk requirements.
5. **The goal of increasing value added for the partners and clients.** Banks carry an array of products that could increase the sector's profitability and ensure that the client maintains an ongoing relationship with the bank and AMEEN.
6. **Differentiating microfinance from other bank products.** AMEEN has managed to differentiate itself from its partner banks while being identified as part of the bank by its clients. Microfinance products vary from other products typically offered by banks, most notably in terms of price. This pricing difference needs to be considered for it can cause some animosity toward the bank when clients note the higher costs and reduced flexibility of microfinance products.
7. **Planning for necessary MIS adjustments.** Compatibility in MIS is often overlooked. AMEEN and the partner banks are able to manage financial and portfolio matters primarily as a result of compatible MIS that are able to efficiently communicate.

A SPECIAL NOTE ON THE ROLE OF DONORS

As mentioned above, USAID was crucial in the start-up and success of the AMEEN program. The start-up funding provided by the donor not only allowed AMEEN to cover its operational expenses for the start-up phase and until sustainability was reached, but also allowed AMEEN to create the risk/capital-sharing model that enticed banks to enter the market. These kinds of subsidies continue to be important in working with banks because most financial markets are not yet competitive enough for the banks to work with this market segment on their own. Moreover, many of the methodologies and operational efficiencies developed for microfinance have yet to be adopted by the banking systems. Donors play an important role in transferring know-how between and among these financial-sector players.

FUTURE OF THE AMEEN/PARTNER BANKS ALLIANCE

At the time this study was conducted, there were no discussions of dissolving any of the bank partnership agreements. The banks have been pleased with the results of the program and have, in most cases, expanded their participation. To ensure continued growth and a positive image in market, AMEEN will need to solidify its standing with the partner banks and negotiate medium- to long-term agreements.

Additionally, because of its limited equity base and fund sharing arrangement, AMEEN may wish to consider other equity partners, including the banks. At least one bank partner has indicated a potential interest in taking an equity stake in AMEEN or a similar service company. The service company model, in which a bank owns the microfinance service company, has been successful elsewhere in the world, most notably with CREDIFE in Ecuador. This model allows for the independence of the microfinance program, while it gains the benefits and efficiencies associated with a regulated financial institution, including the ability to provide a wide range of products and services, maintain sufficient liquidity for on-lending from deposits and the inter-bank market, and expand the possibilities for efficiencies and growth from scale through existing branch networks.

Finally, AMEEN and the banks have considered other joint arrangements. While regional expansion is part of AMEEN's strategic plan, the success of the program has led to discussions with banks into international expansion onto countries where partner banks have operations.

As microfinance becomes more competitive and expands globally, this bank model has vast potential; it leverages advantages of regulated financial services while continuing to better serve the poor.