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Winning through Cross-Cutting: Breaking Down IFC Silos to Promote Access to Finance in Rural Bangladesh

In an increasingly congested market for financial institutions in the major cities of Bangladesh, United Leasing Company (ULC), an IFC partner financial institution, decided to go where other such institutions were not yet focusing—rural Bangladesh. This SmartLesson describes how IFC's South Asia Enterprise Development Facility (SEDF) was able to leverage internal expertise and help ULC take a first-mover position and access viable businesses in rural Bangladesh.

ABOUT THE AUTHORS

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Background

ULC, a non-bank financial institution, has been feeling the pinch of competition in a congested market. In Bangladesh, financial institutions, including banks and non-banks, are crowding into the major cities in search of business. There are virtually no spreads in corporate financing. Business in this space is more of a prestige issue. The margins are slightly better in the small and medium enterprise (SME) field, but business is becoming highly competitive. Because non-bank financial institutions are dependent on banks for a large part of their funding, their spreads are much smaller, since it is difficult to charge higher than market interest rates. Proactively, ULC is trying to be the first mover in areas where other partner financial institutions (especially the banks) are not yet focusing, i.e., rural Bangladesh. ULC requested help from SEDF in accessing viable businesses in rural Bangladesh. The ability to connect the financial institution with a bankable enterprise segment needed to be demonstrated in this case through engaging IFC's expertise in agri-business and access to finance, ranging from demonstrating knowledge about indigenous crop cycles to agri-machinery manufacturing know-how and cluster relationships.

The lessons learned from our experience as with ULC are as follows:

Lessons Learned

1) Top and middle management buy-in is necessary for any intervention to succeed; some quick wins can achieve that buy-in.

When ULC requested help from SEDF to access rural businesses in Bangladesh, SEDF suggested a cluster of agri-machinery manufacturers located in Bogra, in northern Bangladesh. This cluster was selected based on research done on the sector by SEDF's Light Engineering Sector (LES) team and based on the proximity of the cluster to ULC's branch in Bogra. However, while the senior management of ULC was open to looking at this cluster, the middle management team (comprised of the Bogra branch manager, the Dhaka-based head of the small business department, and the head of the credit department) were reluctant to consider this cluster, as they had written it off as unbankable.

In addition, the head of the small business department questioned the possibility of arriving at a viable business model with SEDF's help, since they had already tried unsuccessfully to finance these enterprises and felt that it just could not be done. We were faced with a manager who was reluctantly engaged because the senior management wanted to try it. In an effort to convince this manager and help some SMEs get access to finance, the LES team connected ULC with a few mediumsize agri-machinery firms that were in need of funds for expansion. ULC in turn assessed the companies, found them credit-worthy, and extended credit facilities to them. These initial loans enabled us to bring the small business manager on board with regard to the agri-machinery cluster in Bogra.

2) Understanding how the businesses operate is key to developing a mindset among financial institutions that encourages the financing of SMEs.

The LES team had as one of its clients the Bangladesh Engineering Industries Owners Association (BEIOA), an association of machine shop owners based in Dhaka but with members and affiliates all over Bangladesh. In Bogra, the association members were mainly agri-machinery and spare parts manufacturers— the exact target group ULC had looked at and considered unbankable. To overcome the perception of the middle management team that these SMEs in Bogra were unbankable, SEDF set up a focus group discussion between the members of BEIOA and ULC to understand each other's requirements and determine compatibility.

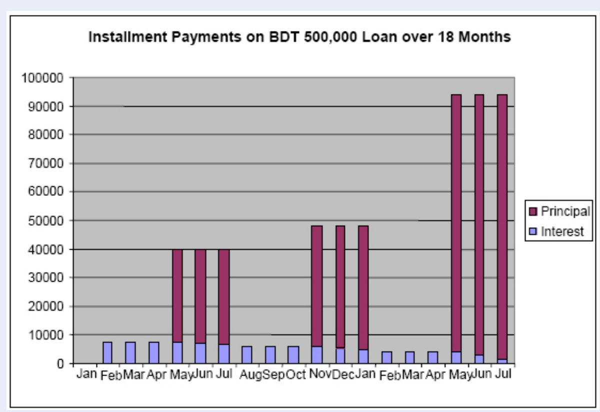
The meeting did not start easy, however. The BEIOA members were somewhat disgruntled at the time of the first meeting, feeling that it was a waste of time. Similarly, the ULC team was weary of financing association members who they felt knew little about market practices, the industry norms and drivers in this sector. But from the focus group discussion, we learned that the manufacturers sold their products on credit and received cash once the crop had been harvested and sold for cash. Therefore, it quickly became evident that the cash flow was seasonal and, as such, the entrepreneurs were only able to meet debt-servicing requirements at specific periods of the year-especially with regard to the smaller manufacturers. After advising ULC to think out of the box on loan products to SMEs, we suggested that ULC consider the cash flow of the customer in designing a product for this industry.

Marketing poster for the Mousumee (Seasonal) Loan for Agri-machinery Manufacturers.

3) Working together outside traditional silos (Access to Finance, LES, Agribusiness) allowed us to achieve a synergy that resulted in a win-win-win for us and our clients.

Ultimately, the critical success factor in SEDF's ability to come to the assistance of ULC was the data collected over several years by the SEDF agribusiness team that allowed ULC to understand the agri-machinery business better and provided the necessary weight to the findings derived from the focus group discussions between BEIOA and ULC. The detailed knowledge of the agri-machinery supply chain and constraints of local agri-machinery and spare parts manufacturers became the core value added that SEDF was able to bring to the project. Based on the research, ULC was able to develop a loan product guide in which the repayment of the loan matched the seasonality of the cash flow (i.e., not based on equal monthly installments), with the flexibility of allowing larger companies the option to repay in equal monthly installments.

The product itself, named Mousumee (meaning seasonal), is a working capital loan (maximum amount BDT 500,000, approximately US $7,350), with a tenor of 18 months due to the seasonality of the cash flow. However, given that there are companies with higher working capital needs, larger loans for longer tenor are also provided on an exception basis under the same product. This product is collateral free—in other words, no mortgage on the property is required.



The chart demonstrates graphically a sample monthly repayment schedule for the 18-month loan facility. Every month requires a minimum payment at a specific date (in order to foster the discipline of adhering to repayments on a monthly basis). During the lean months, repayment is only on the interest, whereas during the harvest months, when sales proceeds are being received, repayments include principal amounts. There are two harvests during the year for the indigenous crops (summer and winter rice varieties)—from May to July and November to January. During the first harvest (May to July), when the enterprise has not been able to benefit from the investment, the repayment amount has been kept lower, while during the third harvest (May to July of the following year) the repayment amount is much higher, as cash flow from the increased investment is also higher. However, there is the flexibility of equalizing the repayment installments during three harvest periods that this loan spans (at the request of the entrepreneur). The willingness of this financial institution to customize these loans is demonstrative of its commitment to lending to SMEs in rural Bangladesh.

The success of the project resulted from important contributions by multiple teams in SEDF, including the LES team who had sector knowledge and connections with the agri-manufacturers; the access to finance colleagues who had expertise in working with financial institutions, and the agribusiness team who provided the highly valuable research on the nature of the businesses in the sector. Truly, the most important success factor was the realization that working together made us stronger and better prepared to address the client's needs.

Conclusion

The success of this project has been threefold:

- *A group of people who were completely dubious about the financing of agri-machinery manufacturer clusters are now actively targeting these companies.*

- *In Bogra, as a result of the launch of the Mousumee product, ULC has developed a reputation as a financial institution that is serious about financing nontraditional sectors by first understanding the businesses and then proposing financing solutions. Marketing Mousumee has resulted in SMEs from other segments coming to ULC for financing. As a result, ULC has seen firsthand that its strategy of focusing on financing in rural Bangladesh is viable.*

- *ULC has developed two additional loan products that can be used to finance other clusters, based on techniques for developing the product guide that SEDF helped with.*

By leveraging our internal expertise across different groups—the value addition of this project— the total implementation cost of this project was almost negligible (approximately US $4,000). The only major expenses were the cost of IFC staff and the time cost of ULC staff who were involved in the project. The product was also launched on a very low-key targeted basis, as per ULC's conservative approach.