



# Transformation: The Challenges

*Expanding Financial Access in Africa  
Conference*

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*Lehigh University, April 19, 2010*

# What is Transformation?

The process of a credit-focused MFI (either an NGO or a project) creating or becoming a **regulated (deposit-taking) financial intermediary**

# What is Transformation?

| Change in...             | Before  | After   |
|--------------------------|---|---|
| <b>Regulatory Status</b> | Not supervised or regulated by central bank   | Supervised and regulated by central bank  |
| <b>Legal Form</b>        | Local foundation, charitable organization, trust, NGO, company limited by guarantee | Limited liability company, <i>société anonyme</i> , private company with private risk capital |
| <b>Capital Structure</b> | Non stock, non profit   | Private risk capital, shareholders, for profit  |
| <b>Products</b>          | Credit only (in some cases remittances); no public deposits                         | Credit + savings  |

# Major Types of Transformation

1. Transform from NGO to for-profit entity  
→ Primarily to attract equity investment
2. Transform from unregulated to regulated  
→ Primarily to be permitted to attract savings deposits

# Both types of transformation result in



- **More professionalism**
- **Greater oversight**
- **Ability to attract more lenders and investors**
- **Change in ownership**
- **Growth**

# Drivers behind Transformation

- **Access to new sources of capital**
- **Compliance with new regulatory schemes**
- **Ability to offer more products to clients, e.g., savings**
- **Competitive advantages in market**
- **Desire for institutional sustainability**
- **Desire for growth**
- **Prestige**

# Preparing and Planning for Transformation

- **Policy Framework**
- **Legal Issues**
- **Ownership and Governance**
- **Strategic and Business Planning**
- **Human Resource Management**
- **Customer Service and Operations**
- **Management Information Systems**
- **Internal Control and Audit**
- **Financial Management**
- **Funding Structure**
- **Deposit Mobilization**

# Transformation = Change Management

- **Change #1: Transformation implies ceding to a broader group of stakeholders**
- Change #2: Transformation facilitates an expanded product offering, thus broadening the institution's client base
- Change #3: Transformation leads to significant changes in human resource requirements
- Change #4: Transformation requires compliance with regulatory requirements, adding significant costs to operations

***Shareholders as new stakeholders***

# Change #1: Transformation implies ceding control to a broader group of stakeholders

## Key Issues:

- Legal Form
- Relationship between Parties
- Choosing an Investor:
  - NGO Ownership
  - ESOPs
  - Founding directors
  - Other investor types
- Governance Implications



# Choosing an Investor: Strategic vs. Financial

## Strategic

- Bring expertise, connections
- Primarily concerned with vision, mission, target market, product mix, market share, social impact
- Will want board seat and some degree of influence over management in organization
- In extreme cases, may want to take over organization

## Financial

- Concerned with bottom line; less concerned with mission and vision
- Interested in using board representation to ensure healthy financial return
- Can have shorter term investment horizons
- Looking for clear exit strategy



# Role of NGO after Transformation

- **Shareholder of new company but what else?**
- **Should not compete with new company**
- **But should use its dividend income wisely**
- **Consider:**
  - **Financial education for**
  - **Business training for microfinance borrowers**
  - **Job training**
  - **Business**

# Key Changes to Transformed Entity

- **Ceding control to new stakeholders such as investors and regulators**
- **Expanded product offerings**
- **Human resources**
- **Costs of transformation and perhaps increased operating costs**
- **Taxation**
- **More professionalism**

# Governance Challenges

- **Some overlap in the boards of directors of the NGO and the new company is OK, but too much overlap may be a problem**
- **Transformed institution may need new skills and more formal procedures**
- **Some NGO board members may be less appropriate for new company**
- **Other board members may be motivated by prestige of a regulated institution**

# Transformation may be tough choice

## GOOD

- Access to new sources of capital
- Deposits as new product for clients
- Growth

## BAD

- Taxation of profits
- Compliance with regulatory requirements
- Expensive
- IT challenges

# Uganda Microfinance Limited: Process and Challenges

- Started as NGO in 1997 as research project of 2 founders, one an American, one a Ugandan
- Grew quickly, reaching over 20,000 in first 5 years with portfolio over \$3 million; funding largely sourced from donors
- Regulatory environment evolving at same time, culminating with introduction of Microfinance Deposit Taking Institutions Act of 2003, creating new tier for deposit taking microfinance institutions. **Regulatory environment became enabling but also complicated and slowed down transformation process.**
- **Significant amount of donor funding** (USAID, EU, DFID, Novib, etc) available to support transformation efforts
- **Alignment of stakeholder interests** particularly founders huge challenge
- **3 years of transformation preparation**, culminating in issuance of MDI license in June 2005

# Transformation resources

***Transforming Microfinance Institutions: Providing Full Financial Services to the Poor***, Johanna Ledgerwood and Victoria White, World Bank

***Aligning Interests: Addressing Management and Stakeholder Incentives During Microfinance Institution Transformations***, Calmeadow and Center for Financial Inclusion

***Transforming NGO MFIs: Critical Ownership Issues to Consider***, Kate Lauer, CGAP Occasional Paper, #13