

# Microfinance Bulletin

## Mozambique Microfinance Facility

### Mergers: The Wave of the Future?



The Mozambique Microfinance Facility (MMF) is a program of the Canadian International Development Agency (CIDA), and implemented by Mennonite Economic Development Associates (MEDA) and Development Partnerships (DevPar).

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### The Birth of an Industry

Microfinance has exploded worldwide. Over 500 million of the world's poor have access to some type of savings or loan account in a financial entity<sup>1</sup>. The microfinance portfolio reached nearly \$21 billion in 2005; this portfolio was administered by an estimated 9000 microfinance institutions (MFIs) across the globe<sup>2</sup>.

Microfinance has metamorphosed from a strategy for poverty alleviation, largely ruled by the donor community, into an industry of its own. The industry is growing rapidly, though differently in each regional and country context. The banking industry in North America also grew swiftly, and following its expansion, began to change. Mergers and acquisitions were ripe during the 80's and early 90's, significantly reducing the number of entities in the field in an effort to bring increased efficiency, cost savings, and market share. As microfinance matures, and the paradigm shifts from subsidized credit delivery to sustainable commercial microfinance, the industry has begun to follow suit, with more and more microfinance consolidations cropping up across continents.

Delivery of microfinance can take many institutional forms.

The most common options are NGOs, cooperatives or credit unions, non-bank financial institutions (where the legal option exists) and banks. The majority of microfinance providers proceed through common institutional development stages, with mergers occurring commonly at two different junctures:

- Experimentation
- Institutional strengthening
- Rapid growth
- Merger?
- Slow growth (a new level of institutional strengthening)
- Merger?
- Rapid growth

While mergers are increasingly prevalent in microfinance, the benefits and costs of such unions are not always clear. Several studies suggest that the anticipated gains from the North American bank consolidation wave will never be realized<sup>3</sup>. The results from mergers in microfinance have yet to fully manifest themselves. Many MFIs tout increased efficiencies, though full cost benefit analysis may not yield



the same results.

Are mergers the wave of the microfinance future? Will they bring better service to clients, and sustainability to the industry? Results will undoubtedly vary case by case. If a merger is something that your institution is considering, read on to learn more about costs, benefits, and lessons learned from real life microfinance mergers thus far.

### Eye on Mozambique

The experience of MFIs in Mozambique during the last few years parallels industry development in other countries. During the past two years, three MFIs have merged into Banco Oportunidade de Moçambique (the new Opportunity International operator in Mozambique) to help establish this new, regulated bank. Merger options will continue to face

**Merger:** a combination of two or more companies in which the assets and liabilities of the selling firm are absorbed by the buying firm. Although the buying firm may be a considerably different organization after the merger, it retains its original identity.

**Consolidation:** also a union of two or more firms. However, in a consolidation, the resulting company adopts a brand new identity.

Mozambican MFIs as they attempt to grow and compete, and also as they position themselves to comply with the Bank of Mozambique's emerging regulations for microfinance.

The Mozambique Microfinance Facility (MMF) began with the objective of contributing to the reduction of poverty in rural areas through the strengthening of microfinance intermediaries in the country. This has been done through the provision of technical assistance to MFIs and government policy and regulatory bodies. Since its inception in 2000, the facility has partnered with six MFIs, offering various levels of technical and capital support, and has assisted the Government of Mozambique in the development of a regulatory category for microfinance. The new regulation created by the Bank of Mozambique (BoM), with various categories of microfinance operators, provides opportunities for MFIs to capture savings (in high demand by clients) and also facilitates access to new sources of capital for local institutions. Work is now underway to support the creation



of a microfinance industry association – a sure sign of a growing microfinance industry in the country.

### Motivation for Mergers

Microfinance institutions merge for all types of reasons. However they generally present one of the five motivations detailed below.

#### The Top 5 Reasons Why MFIs Consider Mergers:

1. Economies of scale are needed for the institution to reach sustainability, and to ensure continued financial services for the poor.

MEDA's microfinance program in Nicaragua, CHISPA, was growing rapidly. It had reached sustainability in 1998 and was anxious to continue expanding its services to the micro and small business community. However its structure as an NGO was beginning to have limitations. In order to expand its services to clients, and grow its portfolio, it needed a new form. CHISPA incorporated as a foundation in a first step toward regulation, and subsequently found three interested merger partners. In 2000, CHISPA merged with Interfin, a Nicaraguan Financiera with a commercial banking license, and gained the investment of Profund, Doen Foundation and IMI in the process. The new institution, CONFIA (now Banco ProCredit), was the first dedicated microfinance bank in Nicaragua, serving both the credit and savings needs of micro and small enterprises.

2. Economies of scale allow for cost efficiencies, and build a stronger institution, which can offer improved financial products to its clients.
3. Donor or parent NGO funding is drying up, and few capital or cash options exist to fund operations and growth.
4. A different legal structure is required to facilitate access to new capital sources, such as savings or direct investment.
5. Competition for clients is too tight and/ or the market is saturating.

The costs and benefits of a merger vary naturally from case to case, depending on each unique situation, institutional type, merger motivation, and country context. Some typical examples of each follow.

### Benefits

- Scale: bringing cost savings and efficiency gains
- Complementary strengths help to overcome institutional weaknesses
- Institutional sustainability (or survival)
- Access to new markets
- Increased diversity in lending

### Common Reasons for Merger Failure<sup>4</sup>

- **Conflicting corporate cultures** – when two organizations combine to form a single entity, they bring with them two unique cultures. It is often this “softer”, human side of the merger that creates such conflict that cannot be overcome.
- **Overestimation of synergies** – when merger partners move beyond the discussion stage, into due diligence and detailed negotiations, they sometimes find that the perceived benefits of the partnership are not strong enough to warrant the costs involved.
- **Inadequate due diligence** – if due diligence is not conducted in a thorough and objective form, MFIs may find surprises regarding financial health of their potential partner. If the problems are too great (such as an exceptionally poor quality portfolio), the merger will fail.
- **Slow/poor post merger integration** – while the process of merging is important, success is often dependent on how well two organizations operationally merge together and subsequently function as one, following their integration.
- **Poor leadership or management** – people are the cornerstone of a successful business. For a merger to succeed, strong leadership through the process is critical, as is excellent management following integration.



**The Right Partner:** MEDA's MFI, Kulane Ka Ntwanano, first started lending in Maputo in 1998. By 2003, competition had intensified in Xikelene Market, and Kulane's donor funding options were drying up. MEDA decided a merger would be an excellent solution to Kulane's future, contingent on finding the right partner, of course. MEDA first considered a tri-party merger, however after several months of intense negotiations, it became clear the difference in institutional cultures was too wide to bridge. MEDA then entered discussions with another partner – one facing similar challenges to Kulane in the areas of growth and resources. After a comprehensive due diligence study and further talks, MEDA determined that the two institutions brought similar weaknesses to the table, and decided that it needed to continue the search. Then Opportunity International entered the scene with an aggressive strategy for growth and a compatible mission, and Kulane successfully merged with Banco Oportunidade de Moçambique (the local OI network member) in 2004. Choosing a partner can be a challenge, but in this case, clear priorities for partnership, and patience, paid off.

ingredient for merger/consolidation success. When negotiations stall, keeping a focus on the common mission can get things back on track.

- Begin with the end in mind – before merging, consider what you would like the merged entity to look like at the end of the process. This can help facilitate partner identification and also smooth the operational challenges that arise throughout the process.
- Conduct meticulous due diligence on your partner, preferably through an independent third party. Knowing the institutional strengths and weaknesses will help planning and management of the merger process (and may alert you that the potential partner isn't the right one).
- Maintain absolute honesty with your partners throughout the process, particularly regarding potential problems with staff or portfolio. Due diligence is important, but does not always pick up all problems (such as data integrity or past legal issues), and a close relationship is the best chance to mitigate such risks.
- Merging during times of institutional crisis or country-wide instability is not recommended. However if there are no other options, then be aware that such turmoil will require increased time and flexibility from all parties involved.
- Prepare a Letter of Intent early in the process to mark the official commitment of each

markets, and possible reduction in risk

- Increased range of services for clients
- Improved opportunities to access capital

## Costs

- Institutional culture change may affect staff morale and eventually performance
- Staff job losses, often at the level of management, who have invested in making the merger work in the first place
- High investment of time and money; the resulting benefits can take longer to manifest
- System changes can be intensive and painful
- Client retention may initially suffer

## Merger Mechanics: Lessons Learned and Keys to Success

Learning from past successes and failures will spur the microfinance industry on to

facilitating better mergers and consolidations, which ultimately cost less and result in exponential benefits. The lessons below are a culmination of MEDA's experience conducting mergers in Tanzania, Mozambique, Nicaragua and Haiti as well as from Elissa McCarter's book, "Tying the Knot", which draws on 14 documented merger case studies.

Three keys to success permeate each of categories listed below.

### 1 *Clients are first priority.*

Keeping the mission of microfinance at the forefront, and focusing on improving (or in some cases, maintaining) service to clients can help the merger team navigate bumps that will inevitably arise along the path.

### 2 *Communication is paramount.*

Mergers can be complicated processes that evolve almost daily. Ensuring precise, regular

communication between partners, negotiators, management, staff and of course clients, will help pave the way to success.

### 3 *Flexibility is a must.*

Even with scrupulous planning, the steps to completing a merger can change from one day to the next. Partners may back out, management may quit, or political leaders may fall, throwing countries and economies into crisis. Flexible attitudes on all fronts allow teams to negotiate through challenges towards the final goal.

## Motivation, Negotiation

- Consider closely your reasons for a merger – mergers can be an expensive solution to internal problems. If you are sure it is a viable option, then carefully examine what you bring to the table, and search for partners that will be complementary.
- Compatible missions have proven to be an essential

party to *consider* a merger. Following this, prepare a Memorandum of Understanding with your chosen partner to outline how the process will work. Include specific goals and timelines, as well as an expiry date for the document. The MOU can help guide planning as well as keep negotiations on track.

## Human Resources

- Enlisting the services of an objective (preferably third party) advisor can facilitate smooth negotiations, and provide moral and technical support to management throughout the merger process.
- The importance of continuity in leadership and management should not be underestimated.
- Staff members often fear for their jobs and their futures during a merger. Creating buy-in and trust at all staff levels is essential for success. Frequent, consistent communication can facilitate buy-in, and designing plans and events that encourage participation helps maintain productivity and morale during the time leading up to, and during, integration.
- Increased or new bonuses, incentives, termination packages and guarantees of job security (where possible) should be planned and worked at in advance.

**Motivating Staff through a Merger:** When MEDA's Microenterprise Business Development Program (MEBDP) decided to merge with Tanzania's National Microfinance Bank (NMB), staff were worried about their futures. "Will I have a job after the merger? If not, why should I continue to work hard in the meantime?" MEBDP's management was prepared however, and worked hard to put each person's fears to rest. They launched a "Merger Time Incentive Scheme" which included incentives for staff to maintain portfolio quality, and tied performance to job opportunities with NMB. MEDA pledged premium severance packages for all staff, and offered guarantees of, at minimum, an interview with NMB for all staff. The strategy was successful, and following the successful portfolio transfer and merger, 95% of MEBDP staff were still employed. Those who did not accept positions with NMB stayed on with MEDA in Tanzania in other program capacities, or chose to search for other opportunities.

Secure staff are less apt to engage in fraudulent activities due to disengagement or a perceived gap in management control, and they are better able and motivated to guide their clients in any transition process.

## Clients

- Find a way – a symbol, image, or idea – to help your clients

understand and connect to the merger. This piques interest and encourages understanding and ownership of the process.

- Communicate with your clients frequently, and succinctly. It is imperative that all clients receive a uniform message, and have a chance to ask questions regularly.
- Offering clients a chance to

**Marriage!** When MEDA's rural microfinance program in Haiti, REKO, decided to merge with Fonkoze, one of its greatest concerns was how to smoothly transition its clients. Spread across the country in geographically remote areas, the predominantly illiterate client base relied on their REKO loan officers for business advice and support. The solution came after a joint staff meeting – REKO and Fonkoze decided that they best way to share the news of their upcoming merger was to perform a skit for the clients about a *Maryaj*. The skit, performed jointly at community meetings across the country, featured two clients getting together in a marriage (maryaj) with each client bringing different attributes. The skit broke the ice, and got clients asking questions and sharing ideas. The symbol of marriage stuck through the whole merger, and was a powerful way for clients and staff to connect and embrace the change.

share their opinions on the merger, and a choice as to whether they will participate can facilitate buy-in. Helping clients to feel consulted and empowered can smooth the transfer from one institution to another.

## Also of Consequence

- The clearer, more efficient, and tidy your operations are, the more quickly a consolidation or transfer can take place. Planning for a merger in the midst of significant organizational upheaval or crisis can hinder success. However also be aware that there is no perfect time for a merger to begin.
- If donors are part of the equation:
  - o Don't give up if you receive initial negative feedback from donors
  - o Educating your donors on the process helps to build buy-in
- What your merger and new institution look like at the end of the process will likely be somewhat different from what you planned for and expected. As long as your mission and clients remain at the centre of the process, flexibility and open-mindedness can go a long way.

## Endnotes & References

<sup>1</sup> Helms, Brigit. *Access for All*, CGAP, 2006.

<sup>2</sup> Ibid.

<sup>3</sup> Dymski, Gary A. *The Bank Merger Wave: The Economic Causes and Social Consequences of Financial Consolidation*, ME Sharpe, 1999.

<sup>4</sup> McCarter, Elissa. *Tying the Knot: A Guide to Mergers in Microfinance*, CRS, 2002.