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TOPIC

THE SURVIVAL OF KCI MANAGEMENT CONSULTANTS (PVT) LTD IN A TURBULENT ENVIRONMENT (2010-2017)

BRIEF COMPANY BACKGROUND

- Started as a consulting firm in Europe, 2005
- Advised Barclays Bank (UK) in microfinance
- Advised UNCDF in microfinance
- Advised the Microfinance Association (MA) of the UK
- 29 July, 2010 diversified into microfinance, starting with one branch and one employee for the microfinance outfit in Zimbabwe.
- April 2017, 52 Branches
- About 6 years old now

Definition of Environmental Turbulence

- Environmental turbulence refers to rapid and sharp twists and turns in the operating space of the business.
- It measures the frequency and intensity of crises or turning points the organisation meets with.

Latitudes of Environmental Turbulence

- level 1. Predictable. Pace of change is slow. Future hardly different from past
- Level 2. Modest complexity, environment still predictable by extrapolation.
- Level 3. Increased complexity, threats and opportunities can be fairly estimated.
- Level 4. Complexity further increased due to forces of globalisation and socio-political changes, but even then there are partially predictable opportunities/threats.
- **Level 5. Extremely complex and unpredictable shocks. Unforeseen events and scenarios dominate more often than the average organisation can cope with.**

Drivers of Environmental Turbulence

- Political: Uncertainties and changes eg 2013 elections
- Economic – dollarization, limited credit lines, cash crisis, introduction of bond notes, interest rates caps, salary delays, salary cuts, company closures.

- Legal - blitz of MFIs to flash out unauthorised deposit takers , introduction of Microfinance Act, amended Labour Act, SI64, alternate outlawing and legitimisation of informal sector operators.

i) Market Creation Crisis

- Market distrusted financial institutions
- Post dollarization era had no pre-defined products for the market.

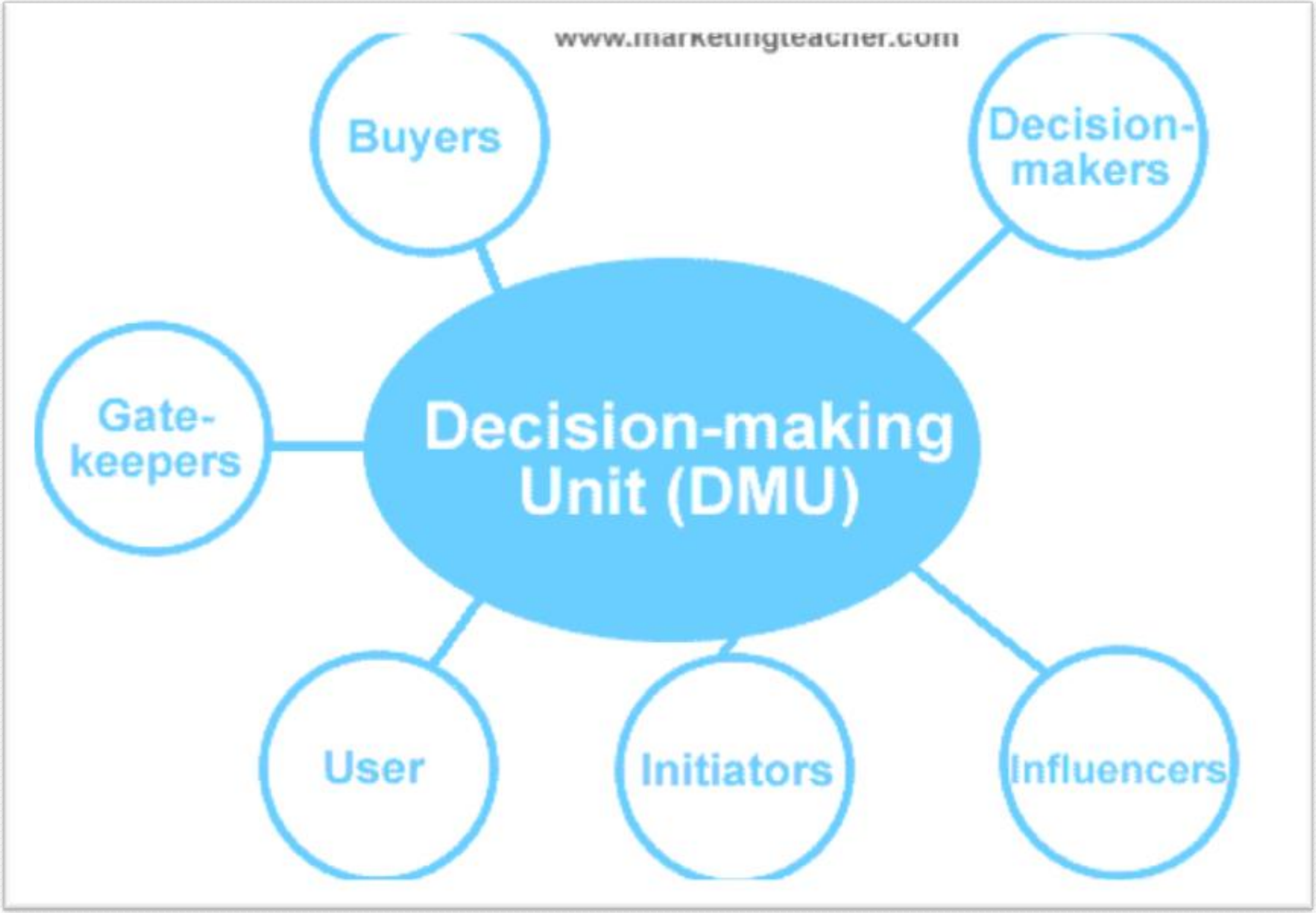
Key Questions then:

- What microfinance products does the market need?
- How do we create market acceptance in a market where MFIs were just re-emerging?

MARKET CREATION

- Research and development-Built product models on the basis of Participatory Action Research-involving prospective clients in product design.
- CEO personally involved hands-on in product design and in building linkages with suspecting communities (Kotwa and Gokwe experiences)
- Use of vernacular in both marketing and stationery before it became a legal requirement
- Employed local opinion leaders/influencers in marketing and borrowers screening.(see below)

MARKET CREATION:EMPLOYING INFLUENCERS



Stewardship Theory applied in Market Creation

- Influencers employed by KCI to gain market acceptance had the trust of both KCI and the target market they came from/represent
- Emphasis for KCI was on building the trust and social capital of a core group already trusted by the target market
- Influencers earned the ear of the market that KCI employees and management could not
- By being trusted by both KCI and the market, influencers gained higher than normal levels of acceptance in selling the KCI agenda/products, even in initially objecting markets

Application of the Stewardship Principle

- The rationale for employing influencers as stewards recognises a fundamental principle in services marketing that the seller must be accepted on the basis of trust first before their product is accepted

ii)Capital Crisis [I]For Start-up

- Post-dollarisation there were generally no credit lines for MFIs
- Most MFIs including KCI were new and un-bankable ventures, from a conventional banking perspective
- The history of total industry collapse of the MFI industry haunted MFIs and this did not help matters in them trying to raise capital
- Most if not all MFIs were under-capitalised and a number of them turned to unauthorised deposit-taking for capitalisation
- Some banks regarded MFIs as competitors that they would not fund
- KCI founders did not have cash resources to bank-roll the business

Team Entrepreneurship and Networking Theories employed in Resolving Capital Crises

- Entrepreneurship team=Two or more individuals joining together, co-owning and co-managing a new venture. It is also known as a venture team.
- KCI Microfinance emerged as a team venture.
- Networking theory holds that X has access to resources owned by Y, if both are connected.

The two theories at work in raising capital

'A' the founder knew 'B' but 'A' could not raise capital alone in the pre-existence stage, even though he had the expertise. The Bank and 'B' were part of 'A' network circle. (Diagram below).

'B' (co-director) knew 'A' but 'B' lacked the vision and capabilities to create a new growth-oriented MFI and had no expertise in microfinance. But 'B' had the collateral and a good knowledge of conventional banking. The Bank and 'A' were part of 'B' network circle.

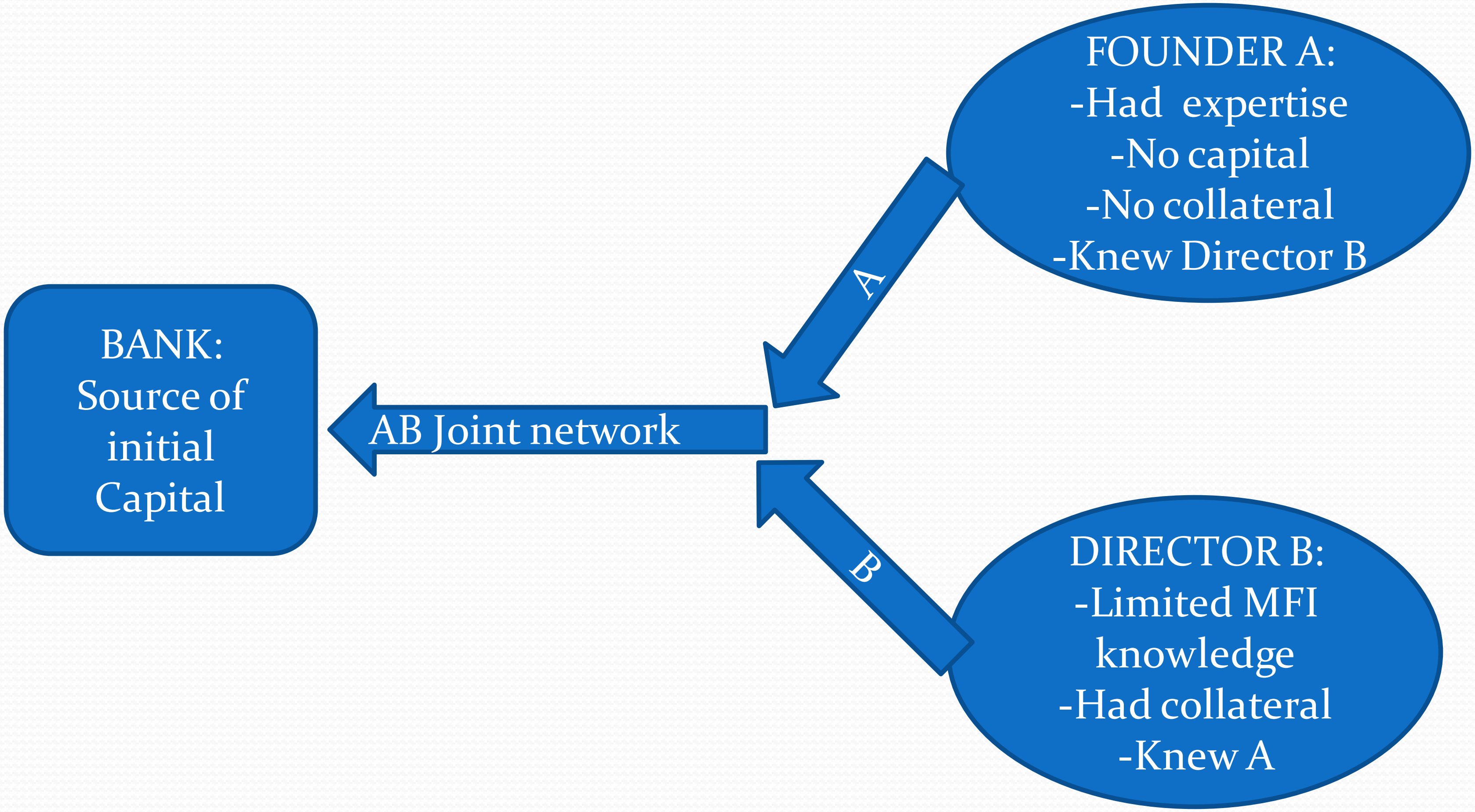
Although both 'A' and 'B' were well networked to the bank individually neither could, alone, raise capital from the bank for want of institutional credibility

-Only the **AB joint network node** activated the bank for capital, the team posing as a credible institution (where none existed).

-The team provided checks and balances and loan was repaid and subsequent re-borrowings financed growth.

-This helped KCI to avert the 2012 closure of deposit-taking MFIs

Capital Crisis: Team Entrepreneurship and Network Theories at Work



iii) Capital Crisis [II]: 2013 Election-Induced

- Market inspired not to repay loans because of debt write-off promises by major parties in the electioneering period
- Clients suspected that the Zim dollar might be re-introduced and it was safe to hold onto the US$.
- KCI lost capital and revenues due to non-performing loans

How KCI emerged

- Reborrowed from bank ‘X’ on the basis of a credible track record
- Another Bank ‘Y’ approached KCI with an offer of a credit facility and that provided additional buffer.
- A new shareholder was brought on board on KCI’s strength of institutional credibility, team entrepreneurship and networking theory- collapse was averted.

iv) A Capital Crisis [III]: Salary delays / Salary cuts/ Company closures/ Retrenchments (2014 – 2016)

- Company closures included; Greenfuel, Steel Makers, Zimasco, Ziscosteel, Sable Chemicals etc
- Salary delays eg the entire civil service
- Salary cuts eg Telone , Econet etc

The impact on KCI included:

- rise in arrears
- fall in sales
- adverse impact on cost : income ratio
- loss of capital

KCI Response

Our environmental analysis defined these as catastrophic structural changes in the economy beyond the control of customers and therefore:

- Up to some point in time, we had significantly covered for these losses by a small but reasonable margin of self insurance that we collected from our customers, before the Central Bank outlawed it.
- We are accommodated salary delays by not charging any penalties for salary delays
- We partially suspended operations at some severely affected branches to avoid fixed cost burden (eg Checheche)

v) Debt Collection Crisis: The Microfinance Act on Debt Collection

- It outlawed collection of pledged assets without a court order
- The incidence of default rose

KCI Response

- Complied and retrenched the entire debt collection workforce (7 people)
- Use of legal process for big loans was introduced
- For smaller loans, we insisted on credible cross-guarantourship or tangible collateral.

vi) Market Continuity Crisis: ill-defined Legal status of informal sector operators and Introduction of SI64

- Entire markets destroyed,

(Paradox-hero and villain status of vendors)

- Many customers driven out of business by SI64

Resulting in:

- decline in sales
- rising arrear
- bad debts
- loss of capital.

KCI Response

- Reduced loan sizes in order to minimise concentration risk
- We reduced our proprtionate exposure to informal sector
- Re-scheduled loan repayments without imposing surcharges for period extension
- Delisted certain categories for lending e.g. grocery and blankets importers
- Strengthened security requirements in order to buffer KCI against such environmental shocks

vii) Cash crisis and bond notes

- Created incapacity to pay
- Created reluctance to pay especially towards the introduction of bond notes as clients withheld the US$.

Results same as the above

RESPONSE

- Migration to the adoption of soft money

viii) Operational Sustainability Crisis: Interest Rates Caps

Interest rates caps :

- Flouts the Client Protection Principle that forms he bedrock of sound MFI practices
- Economic rules on the efficient operation of free markets in price-setting and resource allocation ignored

Interest rates caps resulted in:

- Adverse impact on cost : income ratio
- Currently is the single biggest threat to KCI operational sustainability

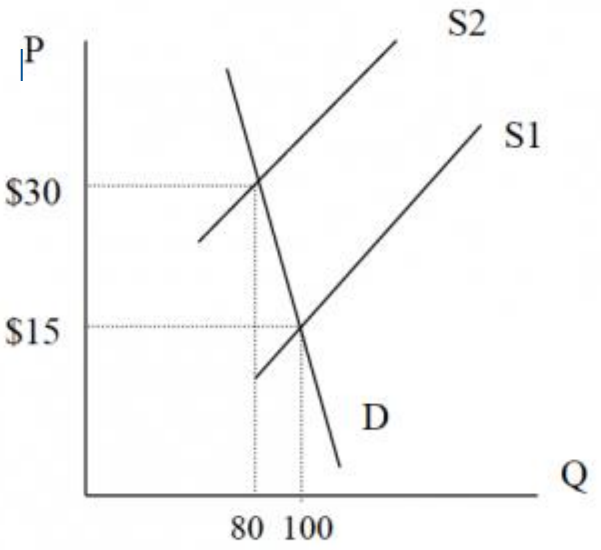
Response

- Closing down a number of our rural branches that have failed to break-even eg Chiendambuya
- About a third of the workforce will be retrenched in the next 6 months
- Lately, money transfer costs are now borne by the respective client in full.
- We are relocating many of our offices to lower-cost sites
- We are negotiating with landlords for cuts on rentals

A Few Guiding Notes

SOME OF THE MANAGEMENT ANALYSIS TOOLS APPLIED IN REACHING CERTAIN DECISIONS

Demands for loans is price in-elastic: Basis for Response to Rate Caps



Revenue was
$15 * 100= $1,500

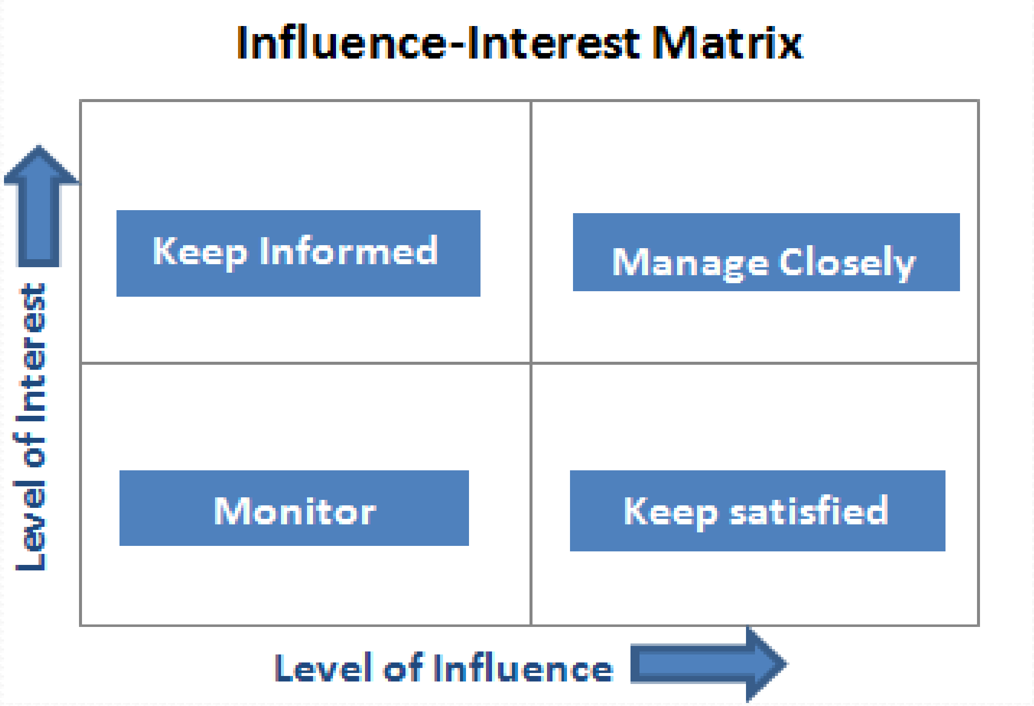
Revenue is now
$30 * 80= $2,400

PED = -20% / 100%
= -0.2

The Effect of a Fall in Price

Generally in the MFI sector for now, the loss in revenue due to a price decrease is more than the gain in revenue due to increase in quantity sold. This was piloted at 5 KCI sites and it was proven that for now the demand for microfinance loans is price inelastic. This guided the decision to close branches that were predicted to go into loss-making positions once rates were slashed.

Stakeholder Matrix: Basis for Decision Making in Dealing with regulatory matters



Stakeholder Matrix Applied

In dealing with matters of regulatory nature, response had to consider that the Central Bank has both high levels of interest and high levels of power/influence hence compliance is the only option. This is how the Stakeholder Mapping Matrix is employed in dealing with survival issues in the organisation

Conclusion

The operating environment has been made complex by the degree of unpredictability and the need for the organisation to react swiftly and appropriately to secure survival. KCI has survived on just that.

Thank you

Industry wide milestone turbulences- KCI

- Market entry crisis/Creation of markets at start/ emergence– total collapse of the industry during the Zim dollar era, destroyed market confidence and trust
- 2009 Dollarization - emerge in an environment where formal sources of capital were limited which forced MFIs to take deposits. Forced others to die.
- Cash crisis and bond notes- created a wait and see attitudes. Withholding of repayments, reluctant to borrow. Market rejection of soft money…. Effects- loss of capital, adverse impact on cost : profit ratio due to reduced sales, bad debts
- 2013 elections- market reluctant to pay. rise in arrears and decline in sales
- Salary delays / salary cut/ company closure/ amended labour act– rise in arrears, fall in sales, adverse impact on cost : income ratio, loss of capital
- Interest rates caps- reduced margins due to price inelasticity of demand
- Introduction of the microfinance act- outlawed recovery of assets without court order… increase in arrears especially for big loans .. It makes the granting of small loans close to nonsensical especially where it needs to recover through courts.
- Introduction of SI64- many borrowed customers went out of business causing decline in sales, rising arrear, bad debts and loss of capital.
- Outlawing and legitimization of vending operations -- destruction of market.. Hero and villain status of vendors (paradox) leading to increase in cost and creating bad name.

- blitz of MFIs to flash out deposit takers- created uncertainty because we did not know the scope and objective of the mission