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PRESS RELEASE

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Microfinance needs to face reality Overindebtedness and weak strategy among the top risks

The risk of client indebtedness dominates the list of concerns about the future of the microfinance industry, according to a new risk survey.

The CSFI's latest **Microfinance Banana Skins** report, *Facing reality*, charts the risk perceptions of more than 300 practitioners and close observers of the microfinance scene in 70 countries. The survey was prepared by the Centre for the Study of Financial Innovation (CSFI), an independent London think tank, and funded by the Citi Foundation and the Center for Financial Inclusion at Accion.

Two thirds of the respondents rank overindebtedness among their top concerns – a persistent issue given that it was also top of the previous Banana Skins survey in 2012.

The survey also reveals strong concern about the ability of microfinance providers to meet the strategic challenges facing the industry in areas such as client management, product development and technological change.

Although the extent to which micro-borrowers are overindebted is not exactly known, many respondents say the

Microfinance Banana Skins 2014

(2012 position in brackets)

Rank	Risk	Score out of 10
1	Overindebtedness (1)	7.5
2	Credit risk (4)	6.9
3	Competition (8)	6.9
4	Risk management (6)	6.8
5	Governance (2)	6.7
6	Strategy (-)	6.7
7	Political interference (5)	6.5
8	Management (3)	6.5
9	Regulation (9)	6.4
10	Staffing (14)	6.3
11	Financial capability (-)	6.2
12	Product risk (-)	6.2
13	Macro-economic risk (13)	6.1
14	Client relationships (7)	6.1
15	Technology management (16)	6.0
16	Income volatility (-)	6.0
17	Transparency of objectives (11)	5.9
18	Funding (17,19)	5.8
19	Liquidity (10)	5.8

problem is growing and that it poses both a financial and a reputational risk to the industry.

Respondents say that overindebtedness is a symptom of deeper weaknesses in the industry, for example in micro-lenders' governance and management, internal controls, and awareness of clients' financial needs and capacities. Seven of the top ten risks identified by the survey relate to the ability of microfinance institutions (MFIs) to manage a sound and growing business.

One of the main drivers of overindebtedness is reported to be competition (No. 3) which is alleged to be driving down lending and ethical standards in the micro-loan business. Although the risk of political interference in the industry is easing (down from No. 5 to No. 7), reflecting the cooling of controversy about the industry in countries such as India, respondents warn that it could rebound.

The other major area of concern flagged by the survey lies in strategic planning. With strategic risk at a high No. 6 position, respondents say that insufficient thought is being given by the industry to its future at a time when major changes are taking place in its market through new entrants, technological innovation and calls for new products.

Many potential risk areas such as client relationships, products and technology management are seen as having little urgency, particularly by the industry itself. The Banana Skins report says this suggests that these risks are being underestimated "which is itself a risk". It adds that these are among the realities "which need to be faced" if the industry is to get to grips with its future.

David Lascelles, survey editor, said: "Microfinance is arguably at a critical juncture in its evolution from a specialised service to a mainstream financial provider. The risks identified by this survey show the pressing need for strong management of the business and a clear vision of the future".

Philip Brown, Risk Director at Citi Microfinance, commented: "The report rankings show perceived concerns over increased competition and depth of client understanding as well as having the related risk management, governance and strategic thinking to achieve sustainable growth. The continued growth and success of microfinance has influenced a growing number of specialised and mainstream financial institutions to extend their products and services beyond just credit, to new client segments. Responsible expansion of product and client outreach is dependent on the evolution of business models and credit methodologies that are client centric, supported by data, credit bureaus and regulatory frameworks that recognise clients' needs and aspirations, but also their capabilities."

Deborah Drake of the Center for Financial Inclusion stated: "The 2014 MBS highlights the complexity of a maturing industry evolving towards financial inclusion through multiple pathways and actors. New business models are emerging which will improve access to product and service quality for clients. This year's report contributes to the important discussion of risks in a transforming industry that is 'facing reality' and moving forward."

The 80-page report provides a commentary on each of the 19 risks that are identified in the survey, and breaks down responses by type and region, providing detailed views of the concerns by geography and different classes of respondent. It also includes a detailed analysis of the condition and prospects for microfinance by industry experts Sam Mendelson and Daniel Rozas. They conclude that, despite the recent threats to its existence, microfinance is an industry "which can still learn, innovate and adapt."

Hard copies of **Microfinance Banana Skins 2014** are available free from CSFI, 73, Leadenhall Market, London EC3V 1LT, UK. Tel: +44 (0)20 7621 1056 or via email: info@csfi.org.uk. The report can also be downloaded free from www.csfi.org.uk, www.citimicrofinance.com and www.centerforfinancialinclusion.org

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NOTES TO EDITORS

Microfinance is the practice of providing small scale financial services to the poor, mainly loans. The business originated in Asia 40 years ago, and has grown rapidly to the point where there are now 10,000 MFIs in the world spread across all continents. The 1,000-plus largest MFIs who report to the Microfinance Information eXchange (MIX) have 92m borrowers and 70m savers. Total assets of these MFIs amount to \$136bn.

The Centre for the Study of Financial Innovation is an independent London-based think tank which researches trends in the financial sector. www.csfi.org.uk

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