



CENTRE FOR THE STUDY OF FINANCIAL INNOVATION

5, DERBY STREET, LONDON W1J 7AB  
Tel: 020 7493 0173 Fax: 020 7493 0190  
web site: [www.csfi.org.uk](http://www.csfi.org.uk)  
email: [info@csfi.org.uk](mailto:info@csfi.org.uk)

## **Microfinance Banana Skins 2008 Taking stock**

In March 2008, the CSFI published *Microfinance Banana Skins 2008*, a survey of the risks facing the microfinance industry<sup>1</sup>. It was a wide-ranging report which identified 29 “Banana Skins” based on responses from more than 300 people in 74 countries. As such, it provides a valuable “snapshot” of the MF risk landscape at a time when the industry is going through great changes, particularly the growth of competitive pressures, and mounting conflict between its commercial and philanthropic objectives.

Since publication, we have held several presentations and discussions with practitioners, investors and interested parties to follow up the report and take its findings forward.

These have included:

- A round table at the CSFI
- A workshop in London
- Two workshops in New Delhi
- A presentation and discussion with the Microfinance Club in London
- Two workshops in Washington DC.

As with the original report, these events were organised with the support of our sponsors, Citi and CGAP.

This follow-up report summarises the feedback we received at these events, in particular what they told us about the risks that were identified in the original survey: how they are perceived among different communities and what might be done to mitigate them. One of this report’s central messages is that an industry long considered to be low risk is actually like any fast-growing sector: one where risk is becoming bigger all the time, and presenting management and owners with fresh challenges.

This report also summarises the feedback we received on the survey itself; whether it was useful, and how it might be improved if, as is the current intention, a second survey is carried out in early 2009.

**David Lascelles**  
Survey editor  
October 2008

---

<sup>1</sup> The report can be downloaded free from <http://www.csfi.org.uk>.

## The big picture

### *“An industry pressed by change”*

The overall picture that emerged from the report and the debate it generated was of MF as a vibrant, growing industry with a strong sense of mission, yet one pressed by change, not all of it welcome. In particular, there is a feeling that while MF needs to keep up with the times and balance its do-good character with more commercial nous, its values were being undermined by business pressures, particularly the growth of competition. Managing these increasingly conflicting demands is widely seen as the key challenge facing the industry.

But the picture is also more complex. Many of the identified Banana Skins are connected, for example risks to funding and reputation, which makes it harder to single them out. Furthermore, the dynamics of MF differ greatly from one country to the next: growth is strong in Latin America and India, but weak in Africa; the regulatory environment is good in some countries but poor in others, investment is overabundant in some markets, scarce in others. This is a caveat against generalisation. Nonetheless, several themes emerged.

### 1. Management quality.

#### *“Not enough managers and a growing market”*

The report's finding that the uneven quality of management in MFIs is perceived to be the greatest risk facing the industry is quite dramatic, not least because a large proportion of respondents to the survey were themselves MFI managers.

Some discussants made the point that this was more of “an issue” than a risk, particularly as regards MF's ability to deal with the challenges coming down the road. But there was widespread agreement that the quality of management is questionable, and is being severely tested in the current environment, in particular by the competitive pressures created by the entry of new institutions and capital. As one participant said: “The industry hasn't been stress-tested yet, but we're about to find out”. Management also faces the challenge of growth: we should not forget that some MFIs are now very large, complex institutions running extensive branch networks with thousands of customers and dozens of different products. Managing the transition from an informal industry to one with a control culture is part of this story.

Both the London and Delhi workshops threw up some scepticism about the management finding, yet when participants were asked to rank the risks themselves, both workshops put management quality at the top of their lists.

Management quality is the “umbrella risk” because it accounts for a series of other risks within MFIs: staffing, cost control, governance, credit risk, technology management etc. Of these, the most critical is **staffing**, which is viewed as a pervasive and growing problem because of the shortage of qualified personnel, the high turnover and the growing threat of “poaching” by new entrants. Staffing emerges at the top of a Banana Skins chart which measures risks which are seen to be both high and rising, and as such is probably the risk at which the greatest amount of resource might usefully be directed: training, career development etc.

There is also widespread recognition of the weakness of **corporate governance** in MFIs: boards are often ill-qualified, unable to give strategic direction. The remedy may lie in commercialisation with the pressures that it brings to introduce strong corporate governance and up-to-date management practices.

A further aspect of the management challenge is the industry’s growing exposure to **macro-economic pressures**. Traditionally, microfinance has been seen as a localised activity, subject only to micro-economic conditions. But that is changing. The growing dependence of MFIs, particularly the larger ones, on external funding at a national and even international level leaves them exposed to the wider capital markets, to movements in interest rates and currencies which can squeeze margins. Even at a local level, trends in global commodity prices can have a big effect on the quality of the business. Although macro-economic risk was ranked low in the survey (No 23), the feeling was that it will rise, particularly given the shocks currently rocking the financial markets. The risk of MFI failure cannot be ruled out. What impact would that have on the industry’s reputation, and how effectively could it contain the damage? These were big questions to which there was no immediate answer.

A conundrum that emerged is why investors would wish to put their money into an industry where they see management quality as the top risk issue. Perhaps it is because they perceive it as a weakness that can be corrected (the survey showed this risk as high but not rising), because they take the long view, or simply (as a ratings analyst put it), it “has to be the main concern”. Nonetheless, seminar participants made the point that MFIs are developing enterprise risk awareness, and an increasing number of them have installed risk management systems in response to a more challenging environment.

## **2. Credit risk.**

***“As markets become increasingly saturated, the risk of default is rising”***

Not historically seen as a major risk in the MF industry because of its special character and the sanctions against default, credit risk is clearly on the rise, mainly because of growing competition among lenders. The new pressures are compressing lending margins and encouraging bad borrowing habits –

and also bad debt recovery practices. This is not a risk that MF practitioners are always ready to acknowledge because it is not traditionally part of the MF “scene”, but it cannot be ignored, and is a key feature of the changing character of MF.

The nature of MF credit risk is, of course, different from mainstream banking. MF borrowers lead volatile lives and “walk the tightrope”, and therefore need understanding lenders. But though a typical borrower is seen to be a micro-entrepreneur starting a simple business, a growing proportion of MF lending is going into “cosmetics and jewellery” and other consumer uses, which is undermining the quality of the loan portfolio – as well as the purpose of MF, which in turn increases reputation risk.

With credit risk clearly on the rise, much thought needs to be given to its management, both internally (better credit controls), and externally through better public information about borrowers’ credit standing. Since the rise in credit risk can also be traced to changing behaviour on the part of borrowers (decline of group guarantees, weakening of social sanctions against default, rise in round-tripping etc.), social trends also need to be understood.

Like staffing, credit risk is seen as a widespread and growing challenge. Generally, the asset side of the MF business (loans etc.) is seen to be a greater source of risk than the liability side (savings, funding) though these carry risks of their own (see below).

### **3. Competition**

#### ***“Destructive or creative?”***

The survey shows that the growth of competition is viewed as the top risk by practitioners, but as a lesser risk by investors/observers etc. The division of view essentially boils down to whether you think competition is healthy or not.

A distinction is sometimes drawn between competition among MFIs, which is acceptable, and competition between MFIs and new entrants which is “unfair”, even “unethical”. Practitioners find it uncomfortable, and claim it is damaging the service, for example by de-personalising it, and putting profit before mission (though the more robust MFIs are determined to show that they can come out on top). Investors etc. tend to see it as a healthy force; they feel that it is producing “a better deal” for customers: better service, more products, lower prices, as well as better business practices within MFIs.

There is some expectation that competition might be curbed by consolidation, by a waning of outsider interest etc. But generally, this is expected to become an enduring feature of MF, and therefore strongly formative, and something with which the industry will have to come to terms. Indeed, some discussants made the point that competition penetration was still very low, and had a long way to go.

## 4. Mission drift

### *“Structural hypocrisy”*

Although not ranked high on the Banana Skins list (No 14), this issue lies at the heart of the MF debate, particularly the pressure for change. The survey provoked much discussion, some of it quite passionate, about the need for MF to stick to its mission: to serve the poor, to resist commercialisation, to keep out the big banks. This view was particularly strong among the NGOs, many of whom had a vision of an MF industry whose ethics and strength of purpose would shield it from unwelcome intrusion.

Is growth a good thing? On the one hand, it increases the reach of the service, it allows MFIs to “grow” with their customers etc. (The Russian example, cited in the report, of an MFI shutting down because its customers had outgrown it is very striking). But growth also risks leaving the neediest behind, and makes it less likely that the service will ever reach those for whom it was intended.

Yet the “realist” view holds that these commercial pressures are not only there, but irresistible, even welcome insofar as they help introduce better business practices and innovation, particularly in the areas of management and technology. To deny their existence would be foolish. In Delhi, it was admitted that many MFIs have already yielded to these pressures, and to pretend that they were still committed to their original mission would be “structural hypocrisy”. If this hypocrisy was exposed, the whole industry might suffer **reputation damage**, which could affect funding, political risk and other dependencies. The need for the MF industry to substantiate its “double bottom line” impact through research was therefore stressed. It was suggested that “mission evolution” would be a better phrase that conveyed a more positive sense of purpose.

But how do you strike the balance? There are no hard and fast rules: it must be up to individual managements and MFIs to find the double bottom line. There was a feeling that MFIs were “torn” between their conflicting missions, and needed help to stem the drift: from international agencies, NGOs and their own governments (though this last possibility was not generally seen as promising: see section below on political interference). One participant said it was “easier to instil social skills in a financier than the other way round.”

Is the focus on MFIs misdirected? The essential goal of microfinance is the supply of services to the poor, not the survival of MFIs as institutions, and the current concern with the health of MFIs may be a distraction from the fundamental purpose. A separate, though related point, is that technology might enable well-resourced commercial banks to leap-frog MFIs and reach the target market directly. MFIs might thus end up becoming disintermediated and obsolete.

## 5. Funding

***“The need is not for more money but for more commercial MFIs”***

One of the survey’s surprise findings was that the risk in funding is seen to be too much of it rather than too little. This is not generalised (eg too much in Latin America and too little in Africa, a lot going into big MFIs, less into smaller), but is nonetheless widely recognised as a potential threat. It is adding to the problems of excessive capacity, competition, new entrants and commercialisation/mission drift, and accelerating character change in the industry. There is even a view that it is destroying the essence of MF, which is to allocate scarce resources where they are most needed.

Although this raises the near-term challenge of creating sufficient capacity to absorb the inflow (an area where a lot of work is already going on), there is also the future risk that this flow might suddenly be shut off, because of changing investment fashion, worsening MF reputation, the emergence of new aid channels etc.

For professional investors, MF is not a philanthropic venture but an “asset class” with its own characteristics. One of the pluses is its perceived lack of correlation with the wider investment world: i.e. it moves differently and therefore offers diversification possibilities for investors. However a topical question – which may be answered in the credit crunch – is whether this is still so. As we have seen, MF is increasingly exposed to the currents of world markets and may be dragged down with them. If so, its investment appeal will weaken.

The industry’s exposure to “investment concentration risk” is therefore potentially worrying. The need to diversify investment sources is rising up the agenda, as is the feeling that investors should be more rigorous in their assessments. However both these concerns, if pursued, carry the opposite risk that the interest of current investors will cool off. Many discussants felt that MF should seek to move more towards local funding sources. In India, for example, there was seen to be scope for more local equity funds.

Funding includes savings which are a large source of MF business but did not receive enough attention in the survey, in some people’s view.

## 6. Technology

***“The ability to manage technology separates the winners and losers”***

Although technology is seen as the way to better management, tighter cost control and wider distribution, the picture is far from clear. There have been fruitful developments in mobile phone use to reach clients, for example. But much of the industry is still at the stage where it is easier and cheaper “to send someone out on a bicycle with 50 forms”. Clearly, there are no general

principles for such a diverse industry, and the application of technology needs to be thoughtfully managed.

Might the industry divide into low-tech, local “facilitators” or agents with strong personal connections to their clients, and high-tech remote providers of products and funding? This was one future business model that was put forward. It would at least accommodate the industry’s clear desire to retain local mission on the one hand, and modernise and grow on the other.

## 7. Regulation/politics

### *“The dark side of Nobel prizes...”*

The unhelpful hand of government did not emerge as a generalised problem in the survey, more as one pertaining to particular jurisdictions. But where political interference or inappropriate regulation are present, the effects can be strong and damaging. This is the case in India, for example, whose country response put political interference high on the list.

The feeling is not necessarily that politicians and regulators are hostile to MF (though this does seem to be so in Andhra Pradesh); it is more an inability or lack of desire to understand MF. This is encouraging insofar as it implies that a greater public relations effort might pay off. The initiative for correcting the problem is seen to lie with the MF industry: in developing a better dialogue with regulators and politicians, providing evidence of the value of MF services, and mobilising wider popular support. This would include the need to be clear as to what MF “is about”. For example, it is frequently criticised for “not creating jobs”, yet this is not part of MF’s purpose. The message would also be that governments should be sensitive to the needs of the poor, but not “pro-poor” in the sense of creating a bias towards the needy because that route quickly leads to interest rate controls, directed lending etc.

The impact of structural change on this issue is seen as mixed. The entry of commercial banks is widening the service and bringing down costs. But this also exposes the sector to charges that big banks are “exploiting the poor”, and adding to industry-wide reputation risk.

## 8. Identifying strengths

One of the purposes of the survey and the discussions was to identify the necessary strengths in successful MFIs and how to promote them. The results, not always very clear-cut, include:

- **Good management:** a strong sense of direction: knowing where the institution is going and how to get there. Ability to inspire but also create efficiency and discipline. Good management includes an element of PR: getting the right messages out. Obtaining good

management means professional training, career structures and remuneration, therefore expense.

- **Strong governance**, by which is meant independent, experienced, informed individuals able to give guidance and direction to MFIs. These are needed to provide support for management, and nurture respect for the institution in the community, official circles etc. But difficult to achieve. The individuals are simply not available in many countries.
- **Good staffing**. Employing people with the skills in management, lending, customer relations etc. With retention the major problem, this means providing good working conditions, career prospects, adequate remuneration etc. Staff shortages also point to a strong need for training. Again, a big area of expense, though one which could be pooled through collective training schemes.
- **Credit skills**. With credit risk strongly on the rise, as well as fraud and borrower cynicism, the ability to manage credit is likely to become a key determinant of a well-managed MFI. This also comes down to training, but also to institutional issues like better industry information on borrowing.

In general, successful MFIs need to be clear about their roles: about how to achieve independence, to balance their missions, to make the right contacts to win support, business and funding. Those that whinge or seek hand-outs are unlikely to have these attributes.

## 9. Methodology

The Banana Skins approach to risk identification proved very stimulating in the discussions that we held: it was found to be novel, provocative, even daring insofar as the report included sharp comments from named individuals. Generally it was felt that it had achieved its objective of promoting awareness and understanding of risk. This view is supported by the many positive comments that were received, and the liveliness of the workshops and seminars.

But it also attracted questions and criticism.

There was scepticism about the methodology (how robust were the statistics, how representative the sample etc?), though it was explained that the Banana Skins approach is more a form of presentation to stimulate thinking and discussion than a statistically rigorous process.

Some people felt that it contained a bias towards the negative: i.e. respondents were only asked to think about bad things. A fair point, though it must be in the nature of such surveys to contain that bias. But other people thought the survey might contain a positive bias insofar as successful MFIs

were more likely to respond than unsuccessful ones. The report itself strove to be balanced by including positive quotes where possible.

Another criticism was that the responses were tilted towards “northern investors” rather than “southern practitioners”. It can certainly look that way: many of the best quotes come from English-speakers in the northern hemisphere. But the breakdown of responses shows practitioners to be the largest group (37%). Investors also have a legitimate voice in this debate, and the fact that many of them live north of the Equator is inescapable.

There were also questions about how the CSFI assembled the list of Banana Skins for respondents to score (answer: using a panel of experts), and how it distributed the questionnaire (answer: through a list provided by the CSFI, the sponsors and the Microfinance Information eXchange).

We found that many of the comments and questions we received stemmed from the novelty of the Banana Skin survey to the MF community (it is no longer so novel in the mainstream banking industry where the survey has been running for 15 years) rather than fundamental doubts about the value of the exercise. Although a small number of discussants felt that its rankings presented a misleading picture of the industry and supported it with dubious statistics, the majority said they had found it very helpful: a small number even said it was the most refreshing piece of research they had read on MF. We receive similar comments about our mainstream banking survey, but for most people there it has become a familiar and eagerly awaited annual event.

## **11. Next time**

It is not the intention that Microfinance Banana Skins should be a one-off event. Much of the value of the Banana Skins approach lies in tracing the changing risk landscape over time, seeing which risks rise or fall. Furthermore, familiarity should ease the questions and doubts thrown up by the first round. The more respondents and readers understand the process, the stronger the survey will become.

The plan is to run a second survey in the first half of 2009, for which comments were sought in the discussion groups as to the questionnaire, distribution and presentation.

On the list of risks, the present one was generally thought to be sufficiently comprehensive, though some people would like to see further refinement, for example by distinguishing between debt and equity funding risk, or probing the savings side of the business. However one of the strengths of the Banana Skins approach is simplicity: we find that excessive refinement confuses rather than clarifies the result.

There was also a lot of interest in local break-outs: what respondents in India or East Europe said, or how investors in North America responded, how big MFIs rated compared to small ones. These can always be supplied, but it

might not be useful to clutter up the report with them (some commentators thought it already had “too many statistics”).

A further issue was whether the report had covered a wide enough universe. The sponsors' intention was to focus on MFIs that were profitable and capable of upscaling, which limited the sample. But discussants were interested to learn what MFIs had to say further afield, particularly Africa which was poorly represented in the response. Another group that was underrepresented was the regulators. Extending the survey to credit unions and co-operatives was also suggested.

One purpose of this follow-up report is to obtain further feedback. If you have any comments, please send them to [info@csfi.org.uk](mailto:info@csfi.org.uk).

## **10. Conclusions**

On balance, the CSFI and its sponsors have been very gratified by the survey and the feedback we have received. The report clearly put its finger on the main challenges facing the industry, even though there was disagreement about which were the greatest. It also attracted a lot of media attention and succeeded in stirring up useful discussion not just in the workshops and seminars we organised, but further afield in training sessions etc.

Above all, it has given us something to build on: both in the sense of identifying ways in which microfinance can continue to prosper in increasingly difficult times, and in providing a basis for our own ongoing work in this area.

Preparations for the second round of Microfinance Banana Skins will begin shortly with a view to running the questionnaire in the first quarter of 2009. One of the measures of success in ventures like these is the strength (and breadth) of the response. We very much hope to cull greater numbers for MFBS 2, and look forward to seeing the next snapshot of the MF risk landscape.