

# Finance for all:

Wedded to fintech, for better or worse



A CSFI 'Banana Skins' survey  
of the risks in financial inclusion



CENTER for  
FINANCIAL  
INCLUSION

ACCION

CSFI  
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Financial Innovation



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The Centre for the Study of Financial Innovation is a non-profit think-tank, established in 1993 to look at future developments in the international financial field – particularly from the point of view of practitioners. Its goals include identifying new areas of business, flagging areas of danger and provoking a debate about key financial issues. The Centre has no ideological brief, beyond a belief in open markets.

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## Preface

It's all about technology... In the past, our Finance for All surveys (and, before that, Microfinance Banana Skins) flagged credit risk, overindebtedness and 'strategy' as the chief threats to development of a viable sector serving the financially excluded in poorer countries. That was all very plausible; if, in the case of overindebtedness, more than a little controversial.

But, in all cases, the top risk was pretty closely followed by others – by reputation risk, by corporate governance issues, whatever.

This year is very different. The gap between technology risk and the No2 risk, strategic risk, is massive. Indeed, using our (admittedly) rather crude score out of ten, the gap between technology and strategy is bigger than the gap between strategy and the No10 risk (over or under-regulation). It hasn't come from nowhere; in 2016 technology risk ranked No4. But it has swept the board this year; coming top of the pile for service providers, support providers, investors, regulators and observers, and topping the list in Latin America and Africa (though it was a tad lower in Asia and the Middle East).

So, what is it? And how big a threat is it really?

Disaggregating responses (of which we had 300, from more than 70 countries), it is clear that there is concern about:

- the cost of new technologies (and the cost of employing those who are needed to develop and run them);
- their vulnerability to “failure, mismanagement and hype”;
- the pressures to adopt new technologies for fear of being squeezed out of markets, which can lead to investment in inappropriate technologies pushed by “cowboys”;
- the reputational (and financial) risks associated with systems outages and hacking; and
- the difficulty of maintaining data integrity, particularly in countries with relatively weak legal and regulatory frameworks.

This doesn't mean that new technologies should be eschewed or abandoned; as our respondents repeatedly emphasised, they can make it possible to reach parts of the less formal economy that conventional methods cannot, and they have the potential to revolutionise the financial inclusion industry for the better. But these technologies also pose a big risk and a big challenge, and it is not self-evident that the benefits will always outweigh the very real costs.

That's the main message of this, our sixth report on the risks facing the financial inclusion industry since 2009. But, it is not the only one. Among other takeaways, it is worth emphasising:

- the sharp rise in perceived political risk;
- the increasing difficulty that the financial inclusion industry faces in attracting and retaining talent; and
- increasing concerns about criminality.

That said, the biggest concern has to be the potential downside to the technological revolution that is sweeping the industry.

As noted, this is the sixth report that we have published on the issues facing those who are fighting financial exclusion in poor countries. As in the past, authorship has been split between Keyur Patel, an independent writer and consultant, and my colleague David Lascelles, now the CSFI's Emeritus Fellow. My thanks to both – and to the Center for Financial Inclusion at Accion and to the Citi Foundation, without whose engagement and support this report (and its predecessors) would not have been possible.

**Andrew Hilton**  
Director, CSFI

## Foreword

Technology is facilitating lower costs, fostering innovation, and enabling positive transformation in the financial inclusion sector. The increasing diversity of business models and scaling of financial services is responding to creatively meet ever-changing client needs. “Fintegration”, the integration of new fintech models into their core business, and digital client acquisition are seen as the way forward for many banks and other established providers. The evolution of tech-centric business models has been the foundation of new sectors, such as renewable energy with pay-as-you-go models for solar. But despite these tangible benefits, we must remain aware that the promises of these technology-enabled models may also bring potential dangers to the client, which could result in increased exclusion rather than inclusion.

This year’s report, “Finance for All: Wedded to fintech, for better or worse”, centres on the role of technology in achieving access to finance for all. The survey of 300 respondents from across the globe reveals a pervasive concern that the technology-fuelled tectonic shift in financial service provision brings with it both positive and negative impacts, and highlights the need for an enabling and aligned regulatory environment that will protect client interests.

It is no surprise that the top risks identified in the survey are Technology and Strategy. Neither risk is unknown, but the exponential rate of technological change today compared with the logarithmical organisational changes of the past make the identification of risk and alignment of strategy much more challenging. Technological risk is no longer only about providers’ focus on efficiency and client effectiveness. The risk now includes the impact of technology on client behaviour, and responsiveness to external country-specific drivers such as government digital and inclusion imperatives, related platforms and specific policy initiatives.

As with all CSFI Banana Skins surveys, the results provide valuable insight into the diverse views amongst different types of respondents and geographies. However, a key message of the report is that technology risk must be evaluated on its own and not viewed simply as a part of enterprise risk management. We see the pendulum swinging from a “known” or generic understanding of technology risk to an unknown risk that is much more complex, intangible and unpredictable.

We expect that “Wedded to fintech, for better or worse” will advance risk awareness, stimulate debate and guide action by stakeholders. This may include focussing governance at the board and market levels on the business and strategic implications of technology risk and in particular on data collection, management and usage.

We extend our thanks to David Lascelles and Keyur Patel for developing and writing the 2018 Finance for All: Banana skins survey, and thank the many respondents from 70 countries who shared their perspectives with us.

**Deborah Drake, Center for Financial Inclusion at Accion**  
**Philip Brown, Citi Inclusive Finance**

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This report was written by **Keyur Patel** and **David Lascelles**

## About this survey

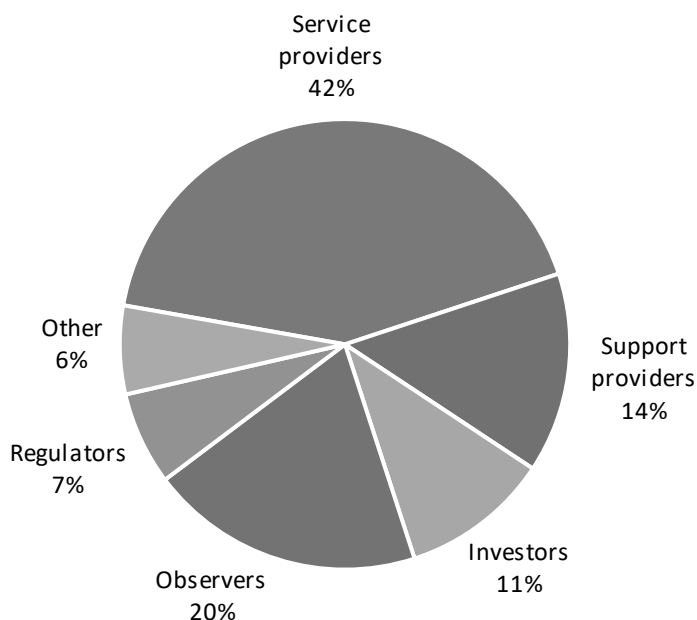
The process of financial inclusion has travelled a very long way since the first microfinance institutions (MFIs) were created back in the 1970s. Then, the focus was on providing small cash loans to local entrepreneurs in the context of tight-knit societies and personal contact. The arrival of new technology over the last decades has changed all that. While traditional MFIs still exist, the bulk of the business has shifted to commercial banks, fintech companies and even non-financial institutions such as telephone service providers. These new entrants are able to exploit new techniques of electronic communication and data management to reach millions of new customers, dramatically extending the reach of financial inclusion and the range of products available.

The prevailing view is that new technology is a boon to financial inclusion. However, as new structures and business methods take shape, it is also becoming clear that technology brings new risks, not least failure by service providers to understand it and use it prudently.

*Finance for All: Wedded to fintech, for better or worse* describes the risks in the development of financial services for the financially excluded – now defined as people who have only limited access to banking, savings and insurance, or none at all. The findings are based on survey responses from 300 selected practitioners, investors, regulators and observers in 70 countries from February-May 2018.

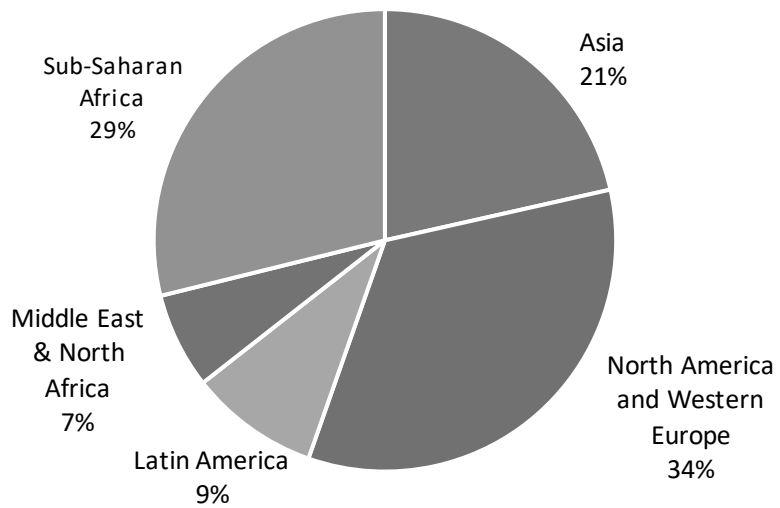
The questionnaire (reproduced in the Appendix) was in two parts. In the first, respondents were asked to describe, in their own words, their main concerns about the sector over the next 2-3 years. In the second, they were asked to rate a list of potential risks by severity on a scale of 1 to 10. Replies were confidential, but respondents could choose to be quoted by name.

The breakdown by type of respondent is as follows:





The breakdown by geography is as follows:



The breakdown by countries is as follows:

Afghanistan	1	Germany	4	Pakistan	8
Argentina	1	Ghana	12	Palestine	4
Australia	1	Guatemala	5	Paraguay	1
Austria	1	India	30	Peru	5
Bahrain	1	Indonesia	1	Philippines	5
Bangladesh	1	Ivory Coast	2	Romania	1
Belgium	2	Japan	2	Rwanda	1
Brazil	1	Jordan	1	Saudi Arabia	1
Burundi	1	Kenya	11	South Africa	6
Cambodia	3	Lebanon	1	Spain	3
Cameroon	1	Luxembourg	2	Sudan	1
Canada	3	Malawi	4	Switzerland	10
China	3	Malaysia	1	Tanzania	7
Colombia	3	Mali	1	Thailand	1
Costa Rica	1	Mexico	4	Tunisia	2
Denmark	1	Morocco	3	Uganda	4
Dominican	2	Mozambique	1	UK	30
Ecuador	1	Multiple	1	Uruguay	1
Egypt	6	Myanmar	1	USA	39
Ethiopia	10	Nepal	4	Venezuela	1
France	1	Netherlands	4	Zambia	1
Gabon	1	Nicaragua	1	Zimbabwe	5
Gambia	1	Nigeria	16		
Georgia	3	Norway	1		

## Summary

The financial inclusion business is undergoing profound changes, many of them for the good. But they are also introducing new risks. *Finance for All 2018* analyses and ranks the risks – or banana skins – that potentially face service providers in this sector using responses from 300 practitioners, investors, regulators and observers from 70 countries in the first half of 2018.

**New technology is much the greatest risk...**

The headline message is that **the wave of new technology sweeping through the financial services market is seen as much the greatest risk** to the financial inclusion business. This may seem ironical given the power of technology to do good, but it is seen as a development which has both its bright and its dark sides.

While technology opens the way to huge growth in the provision of financial services, it contains risks of its own. Chief among these is the risk that providers will fail to understand and exploit it effectively and place themselves at risk. Weakness in **strategy** (No. 2) is seen as a major potential pitfall which could damage poorly managed institutions. By facilitating access to credit for less sophisticated customers, technology could also lead to irresponsible borrowing and debt difficulties (No. 4 **credit risk**). It may also attract providers who are more interested in commercial gain than social goals, or those who are unable or unwilling to design products specifically for this market (No. 6 **product risk**).

**... but political risk is rising**

Another striking result is the sharp rise in concern about **political risk** (No. 3, up from No. 12 in the previous survey in 2016), i.e. interference by governments in the form of rate capping, debt waivers, subsidies etc. This follows several recent incidents in different parts of the world which could be linked to an exceptionally busy election calendar, but also suggest that providers in the popular banking markets make easy political targets. Another aspect of the public environment, **regulation** (No. 10, up from No. 16), is also a growing concern. People are worried that regulation, while improving generally, may not be able to keep pace with the rapid changes seen by the market.

Risks linked to the institutional weakness of service providers were highlighted by the relatively high score given to **governance** (No. 7) and **management risk** (No. 9).

### Finance for All 2018

(2016 position in brackets)\*

Rank	Risk	Score out of 10
1	Technology risk (4)	7.20
2	Strategy (1)	6.73
3	Political risk (12)	6.63
4	Credit risk (8)	6.61
5	Risk management (2)	6.57
6	Product risk (7)	6.51
7	Governance (9)	6.50
8	Talent (15)	6.49
9	Management (10)	6.49
10	Regulation (16)	6.38
11	Macro-economic risk (6)	6.13
12	Crime (20)	6.09
13	Client relationships (14)	6.06
14	Competition (13)	6.04
15	Client acquisition risk (-)	6.04
16	Reputation (18)	6.03
17	Funding (19)	6.02
18	Service delivery risk (-)	5.89

\*In the survey *Financial Services for All 2016*

Concern about access to **human talent** (No. 8) is also rising as competition for staff increases. Another fast-rising risk is **crime** (No. 12, up from No. 20), with fears about cyber crime and fraud high on the agenda.

Among lesser or falling risks, a notable case was **macro-economic risk** (No. 11, down from No. 6) due to growing optimism about the economic outlook – though rising interest rates are a concern as the industrial countries end quantitative easing. **Reputation risk** was considered low at No. 16, but it was widely recognised that exploitative practices in some quarters are damaging trust in service providers. Risks in the area of **funding** (No. 17) were also seen to be relatively low.

These risks are all analysed in greater detail in the report.

## Key points

1. Technology is having a huge impact on the financial inclusion business, for good and ill. It is facilitating growth but making excessive risk-taking more likely, particularly by encouraging people to over-borrow.
2. Technology is opening the door to new entrants, including those whose motivation may be short-term and commercial. The character of the business may be changing into one that is more profit-driven and volatile. “Mission drift” is a rising concern.
3. The scope for financial inclusion may be limited by some people’s “rational” desire to remain outside the formal economy.
4. There is a risk that current trends could lead to fewer services and products being offered in non-urban areas because of poor profit prospects.
5. The availability of human talent at all levels, governance, management and staffing, is being reduced by competition.
7. Concern about crime, particularly cyber crime, fraud, hacking and data theft, is rising. The perception that microfinance institutions are too small to attract criminals is changing.
8. While regulation is generally improving, its ability to create a level playing field for different types of competitor is questioned.
9. Many of these changes pose a threat to consumer protection, which needs to be strengthened.

A breakdown of responses by type of respondent and by geography provides a different way of looking at these results.

By **type**, all respondent groups placed technology risk at the top. Those in the business of service provision tended to give a higher ranking to risks in the operating environment, such as political risk and regulation. Outsiders, such as investors, analysts etc., stressed institutional risks such as management and governance weakness. This was particularly the case with regulators.

By **geography**, there were notable regional areas of emphasis. Political risk was stressed in Asia, credit risk in Sub-Saharan Africa, regulatory risk in Latin America, and internal oversight of institutions in MENA. Respondents in advanced economies had a sharper focus on strategy and product risk than those in developing economies, but were less concerned about credit risk, competition and funding.

## Health warning

A number of points should be borne in mind when drawing conclusions from this report. One is that the results reflect the perceptions of respondents and are not forecasts or measures of likelihood. There is also a tendency, in surveys of this kind, to focus on the negative and overlook the positive. Linked to this is the risk of generalisation in a varied business.

## What people are saying

*This selection of quotes from responses highlights many of the themes in this report*

The depersonalisation of lending, i.e. only algorithm and technology-based lending, [could lead] to a new wave of overindebtedness among end-users. Traditional microfinance is not working as successfully as in the past, and the days of very high repayment rates among low income borrowers are numbered as access to finance has become simple [and] more widespread and available from different sources...

**Fund manager, Germany**

The use of technology has huge potential in reaching and servicing the unbanked, yet we cannot do it without a probable increase in the inherent risk of failure of systems or infrastructure, data breaches and leakage of information. These pose a threat to cyber security, while the multiplicity and network of providers involved in providing finance could blur lines of accountability that could pose risk to consumers.

**Regulator, Philippines**

Most of the new providers operate across borders, leading to challenges in regulating them. Digital products such as digital credit have the potential of operating over a wide market scope. Measuring their scale and impact can be difficult, thus developing legislation governing their use is equally challenging. This may pose systemic risks.

**Joyce Murithi, senior manager, MicroSave, Kenya**

The primary risks on the horizon include a) the 'black mirror' potential of deeper exclusion and/or exploitation of low-income clients who are brought into the formal sector through digital channels/solutions, but without adequate enfranchisement through control and access to their own data profiles, b) crowding-in of new investors and players in the fintech space, with the risk of repeating the 'microfinance bubble' phenomenon, and c) related to this, overheated expectations of quick, high-value returns driving exploitative and ultimately unstable digital business models.

**Jesse Fripp, general manager, Aga Khan Agency for Microfinance, Switzerland**

I think the main risk is the drift from focusing on providing poor and low-income people with access to real financial services (savings, credit, insurance etc..) to the focus on talking big numbers (e-wallets, nano loans etc..) to show that the big gap has been narrowed significantly. Fixing the failure of the financial sector over so many decades will take time, and the assumption that it can be solved in 3-5 years or even 10 years is wishful thinking. While we should worry about the outreach growth rate and try to include the 2+ billion people in the financial system asap, we should not compromise on the quality of those services and the fact that poor and low-income people need real services and not a game of figures and numbers.

**Mohammed Khaled, senior operations officer, IFC, Egypt**

## Who said what: by type of respondent

**Service providers:** *People who work in financial inclusion service provision, e.g. banks, MFIs, non-bank financial institutions, payment services, telecommunications etc.*

### It's technology...

- |    |                         |
|----|-------------------------|
| 1  | Technology risk         |
| 2  | Political risk          |
| 3  | Credit risk             |
| 4  | Strategy                |
| 5  | Risk management         |
| 6  | Regulation              |
| 7  | Talent                  |
| 8  | Competition             |
| 9  | Management              |
| 10 | Product risk            |
| 11 | Macro-economic risk     |
| 12 | Funding                 |
| 13 | Reputation              |
| 14 | Client relationships    |
| 15 | Crime                   |
| 16 | Governance              |
| 17 | Client acquisition risk |
| 18 | Service delivery risk   |

Service providers see the arrival of new technology posing the greatest risk to their business because of its complexity, the high cost of investment it entails and the profound changes it is bringing to financial services. Many respondents commented that failure to master new technology could mean elimination from the market.

Philip Brown, managing director, risk, at Citi, said: “There is no longer one business model fits all. Digitisation has brought in new players and models. It has changed expectations and the risk landscape for clients and both existing and new players.”

These changes would test the quality of management and strategic planning in financial institutions which was seen to be very uneven.

But service providers also saw risks in more traditional areas. Striking was the high score they gave to political risk, which they said was increasing in two ways. One was failure by

governments to create a sufficiently stable political environment for financial inclusion to flourish. This was linked to the risk of poor regulation, which was also rated high by this group. The second was direct government interference in the market through rate capping, debt waivers, taxation etc. Tenie Eric Ouattara, managing director of FDH Bank in Malawi, described this risk as “huge. The politicians are changing policies and regulations without proper consultation or the involvement of key stakeholders.”

Credit risk was a strong concern. Although credit assessment is becoming more rigorous, respondents feared that other pressures, particularly competition, would force down lending standards. Respondents were concerned about “unfair” or “predatory” competition. Multiple borrowing and overindebtedness also remain high level concerns. The responses showed that credit risk was seen to be higher by commercial banks than by microfinance institutions, whose business has traditionally seen loans perform well.

Although mentioned as a concern, crime, in particular fraud and cyber attack, was ranked as a relatively low risk. “The key is the ability to manage risks. As the number of experts and technology are increasing in the market, crime is manageable.”

**Support providers:** *People who support financial inclusion service providers as networks, associations and through grants and technical assistance*

**... Same again.  
The loss of  
“human touch”**

- 1 Technology risk
- 2 Regulation
- 3 Strategy
- 4 Talent
- 5 Credit risk
- 6 Risk management
- 7 Political risk
- 8 Macro-economic risk
- 9 Governance
- 10 Management
- 11 Product risk
- 12 Crime
- 13 Funding
- 14 Service delivery risk
- 15 Client relationships
- 16 Reputation
- 17 Client acquisition risk
- 18 Competition

People who provide support to financial service suppliers showed a clear concern for risks that might jeopardise the goal of financial inclusion. While they welcomed the possibilities created by new technology, they also stressed the downside, for example the loss of human touch in automated mass marketing, a shift away from tailored products towards one size fits all, and a growth of high indebtedness.

Ethan Loufield, director of strategy and operations at the Center for Financial Inclusion in the US, said “Financial services are not inherently good or bad, but they can be designed and delivered in ways that target positive outcomes. And while many providers are trying to do this, when you look under the hood at what’s happening in practice you find that many such providers have a very difficult time measuring and articulating what the positive outcomes might be.”

One of the specific concerns mentioned by respondents was that these trends could cause customers to shy away from dealing with financial institutions.

Barry Cooper, technical director at Cenfri in South Africa, said there was “a strong emphasis on digitisation of financial services with little regard for the nuanced, sequential steps required to digitise lower income and harder to reach people, resulting in hardship and dropping out of the formal systems in favour of more efficient and increasingly more sophisticated and trusted informal or parallel financial systems.”

One of this group’s main concerns was that regulation could become an obstruction to better performance. Gerhard Coetzee, lead financial sector specialist at CGAP in the US, said that “regulation is always behind innovation, not only in terms of timing, but also because of archaic instruments, and an inability to muster technology to assist.”

Striking was this group’s low concern about the potentially damaging impact of excessive competition. Many of the respondents felt the risk was the opposite: too little competition preventing innovation and good value.

## Investors: People who invest in financial inclusion

### It's hard to manage risks in the new environment

- 1 Technology risk
- 2 Risk management
- 3 Credit risk
- 4 Political risk
- 5 Competition
- 6 Governance
- 7 Strategy
- 8 Talent
- 9 Product risk
- 10 Client relationships
- 11 Macro-economic risk
- 12 Management
- 13 Reputation
- 14 Regulation
- 15 Funding
- 16 Service delivery risk
- 17 Client acquisition risk
- 18 Crime

Investors in the financial inclusion business were concerned about the ability of the institutions which they invested in to manage their risks at a time when these are growing and changing rapidly. Jerome Savelli, head of market and credit risk at Symbiotics in Switzerland, said “We see this risk as being quite high, as our view is that risk management practices are not adapting fast enough to the changing environment.”

Investors wanted to be sure that they got a return on their money, and that their investment was making a difference, but the balance between these two aims varied. Some respondents concentrated on risks that could jeopardise profits, such as bad debts, rising costs and excessive competition. Others focused on risks that might deflect their investments from the goal of financial inclusion, such as political interference, poor regulation and mission drift.

Some respondents in this group were concerned that institutions were not giving enough thought to strategy to ensure their survival and growth. Catherine Bolinger, senior risk & compliance officer at Accion in the US, said: “Strategic risk is ever-evolving and requires the same, if not more, attention as other key risks, such as credit risk. There are myriad innovative business models that are looking to disrupt the traditional banking model, which, while major commercial banks may have the resources to compete and/or adapt, many MFIs do not. At the industry level, I feel that more discussion is needed to openly and honestly discuss strategy on a much larger scale, as it may be the only answer to avoid profit-driven business models taking over without care for the end client.”

This group also gave a higher than average score to competition risk, fearing that it could drive down standards. A respondent from Latin America said: “The entrance of new providers, especially non-regulated ones, can lead to over-indebtedness.”

Areas where investors showed less than average concern included product risk, management, regulation and crime. On product risk, Matthew Sparkes, lead investment and risk counsel of Blue Orchard Finance in Switzerland, said: “I believe that traditional micro-finance providers know their clients and the good ones will adapt their offering to compete with emerging technology and service providers. However, this is an acute risk for less established or nimble institutions, and also for emerging companies with advanced understanding of tech platforms but less comprehensive understanding of their customers and those customers' needs.”



**Regulators:** *Officials who regulate financial institutions active in the provision of financial inclusion services*

**The risk of transitioning to a digital - based future...**

- 1 Technology risk
- 2 Management
- 3 Governance
- 4 Risk management
- 5 Strategy
- 6 Product risk
- 7 Credit risk
- 8 Client acquisition risk
- 9 Talent
- 10 Service delivery risk
- 11 Funding
- 12 Political risk
- 13 Client relationships
- 14 Competition
- 15 Crime
- 16 Macro-economic risk
- 17 Regulation
- 18 Reputation

Regulators focused strongly on the ability of service providers to manage the transition to digital-based services while maintaining service to the financially excluded. The top five risks on their list all related to the competence of financial institutions to manage risk, strategy and technology.

An advisor to regulators, based in Peru, said: “The main risk I see relates to the sector massively embracing digital financial services as the silver bullet for ending poverty and financial exclusion. ... Digitalization carries its own risks, as supervisors are barely catching up with how to monitor new service providers and other financial institutions participating in the financial ecosystem to provide the new digital products and services.”

The risk of a loss of service to low income customers was high among their concerns. This could be caused by “mission drift” as providers moved to more lucrative parts of the market, or a failure to engage with people who were

financially illiterate and to offer appropriate products. One respondent said that the financially excluded existed not necessarily because they lacked access to the formal financial services market but because they consciously chose to remain out of it. This was often a “rational decision” because the advantages were not clear.

Weak management could also lead to failure. A bank examiner in West Africa said that the main risk facing the sector over the next 2-3 years was strategic risk. “Poor corporate governance practices by senior management of the financial institutions has led to capital erosion, and many of them are at risk of being insolvent within the next three years.”

Regulators also expressed concerns about overindebtedness and the quality of funding for service providers. On the other hand they were less concerned than the bulk of respondents about political and regulation risk, and risk to reputation. Pia Bernadette Roman Tayag, director at Bangko Sentral ng Pilipinas noted that political risk in the Philippines is “relatively high”, but said: “On the use of technology to reach the unbanked and underserved, the BSP employ a test and learn approach – [there is a] mechanism in place that allows regulated entities to operate innovations in a ‘live environment’ under controlled conditions, and without the immediate burden of complying with rules and requirements usually associated with the activity”.

**... and “mission drift”**

**Observers:** *People who observe the financial inclusion business as academics, consultants, industry experts etc*

**Executive focus on the bottom line?**

- |    |                         |
|----|-------------------------|
| 1  | Technology risk         |
| 2  | Governance              |
| 3  | Product risk            |
| 4  | Strategy                |
| 5  | Credit risk             |
| 6  | Talent                  |
| 7  | Management              |
| 8  | Risk management         |
| 9  | Client acquisition risk |
| 10 | Crime                   |
| 11 | Political risk          |
| 12 | Reputation              |
| 13 | Regulation              |
| 14 | Client relationships    |
| 15 | Macro-economic risk     |
| 16 | Service delivery risk   |
| 17 | Competition             |
| 18 | Funding                 |

Observers of the industry shared the general concern about the risks in new technology, particularly its ability to do harm as well as good. Many respondents in this category felt that technology would remove the personal touch from a business which traditionally relied on it to reach the financially illiterate. There was also concern that technologically-driven service providers would ignore the financially excluded and concentrate on more lucrative mass markets.

Stephen Wanjala, executive director of Housing and Development Finance Consultants in Kenya, said: “The focus now is the bottom line and this is what social investors are demanding, hence institutions are left with no alternative but to focus on the segment that builds the portfolio fastest, and who is that but the medium income target group?”

Observers gave a higher than average score to two specific risks: product risk and governance. The concern about products was that fintech would encourage the development of “one-product-fits-all” resulting in a loss of service diversity and quality. For financial inclusion to

succeed, service providers had to understand client needs and tailor their products accordingly.

Peter Pledger, chief executive of the National Skills Academy for Financial Services in the UK, said: “The sector has a challenge to be understood and relevant to low income clients. While work is underway in schools to improve financial capability, there is a pressing need to support young adults and older people who did not receive such education in the past.”

**Hard to handle change...**

The high scores given to governance and management risks reflected the view that financial institutions would have difficulty handling a heavy agenda of change. Ernest Dzandu of CDC Consult in Ghana said that “In my view this is the mother of all risks. This is not about to change anytime soon. Owner/shareholder directors who do not understand microfinance are on the boards; directors are largely family and friends; directors do not participate in training sessions and no one holds directors accountable when MFIs fail. A strong board could ensure all other uncertainties are covered by adequate controls”.

## Who said what: by geography

### Asia

**Political risk  
is top for  
Asia...**

- |    |                      |
|----|----------------------|
| 1  | Political risk       |
| 2  | Product risk         |
| 3  | Technology risk      |
| 4  | Strategy             |
| 5  | Credit risk          |
| 6  | Talent               |
| 7  | Risk management      |
| 8  | Service delivery     |
| 9  | Funding              |
| 10 | Management           |
| 11 | Regulation           |
| 12 | Competition          |
| 13 | Reputation           |
| 14 | Client relationships |
| 15 | Crime                |
| 16 | Governance           |
| 17 | Client acquisition   |
| 18 | Macro-economic       |

Respondents in Asia emphasised political risks, including turbulent elections in Pakistan and unpredictable events such as demonetisation in India. Gaurav Gupta, chief operating officer of Ananya Finance for Inclusive Growth, said: “The main risk that microfinance and small & marginal financing institutions will face will be political risk, whereby governments and politicians announce populist measures such as loan waiver schemes. [These] are a disincentive to pay back loans by low-income borrowers, including those who can and are willing to repay the loans.”

Product risk ranked higher in this region than it did globally, with respondents warning of a “one size fits all approach”, “products developed without factoring in customer insights” and “a lack of willingness to serve the lower income segments”. So, too, was the risk that service providers will fail to recruit and retain talent. Bilal Ahmad, managing director of BAZ Consultants in Pakistan, warned of “poor quality of products due to lack of knowledge causing drain of capital”.

Several respondents in Asia framed the risks around new technologies and digitisation in terms of consumer protection. This was also the only region we surveyed where service delivery risk was high in the table, reflecting concerns about the quality of partnerships as the number of service providers in the industry spirals upwards. “The multiplicity and network of providers involved in providing finance could blur lines of accountability that could pose risk to consumers. This includes issues on transparency and effective redress mechanisms”, said a regulator in the Philippines. A rural banker in India warned of the “the cost of litigation with the advent of digitisation of many activities... proper consumer protection and complaint redressal mechanisms need to be developed”.

**... and  
macro-economic  
risk is low**

At the other end of the table in Asia was macro-economic risk. Luis Trevino Garza, data policy manager at the Alliance for Financial Inclusion, said: “Rising interest rates in the developed countries in the near future imply some macroeconomic risks, especially related to funding to financial service providers. Nevertheless, innovations and an increasing awareness of market opportunities in developing countries might be able to compensate those trends”.

## Latin America

- |    |                       |
|----|-----------------------|
| 1  | Technology risk       |
| 2  | Regulation            |
| 3  | Governance            |
| 4  | Political risk        |
| 5  | Strategy              |
| 6  | Credit risk           |
| 7  | Client acquisition    |
| 8  | Management            |
| 9  | Reputation            |
| 10 | Competition           |
| 11 | Risk management       |
| 12 | Talent                |
| 13 | Macro-economic risk   |
| 14 | Client relationships  |
| 15 | Funding               |
| 16 | Service delivery risk |
| 17 | Product risk          |
| 18 | Crime                 |

There were pronounced concerns about the public environment in Latin America's response, particularly poorly thought out regulation that risks stymying the sector's growth.

Todd Farrington, director at Symbiotics in Mexico, said: "Regulatory overreach in the form of confiscatory rent-seeking and misguided borrower protection in the context of an increasingly populist political mood presents a risk in a number of Latin American markets". Sebastián Coral, CEO of Capital 77 in Colombia, commented: "I am concerned that populist politicians do not understand the cost structures that microfinance companies have and that they are generally greater than that of banks".

Service providers' own governance also came under scrutiny. Alex Silva, president of Omtrix in Costa Rica, said: "Many boards, especially when NGOs are involved, are still weak and prone to avoid strategic thinking".

## Fear of technological obsolescence

But the highest scored Banana Skin in this region, by some distance, was technology risk. Respondents said that: "technological obsolescence is definitely a risk... financial institutions need to adapt and those that are not yet adapted will face severe problems" and "the landscape of IT use and implementation is very uneven".

While traditional players struggle to keep up with new technologies, the proliferation of new entrants in these markets is raising concerns about competition, especially from non-regulated service providers. A widely-echoed respondent in Peru warned of "over-indebtedness due to an increasing number of entities catering to the same market". David Dewez, regional director Latam at Incofin Investment Management, said: "Increasing competition from different type of providers with – sometimes – doubtful underwriting techniques or different risk appetites may affect the overall portfolio quality".

## Middle East and North Africa (MENA)

**Governance  
beats out  
regulation,  
with technology  
risk lower  
down...**

- |    |                       |
|----|-----------------------|
| 1  | Governance            |
| 2  | Regulation            |
| 3  | Risk management       |
| 4  | Client acquisition    |
| 5  | Management            |
| 6  | Technology risk       |
| 7  | Strategy              |
| 8  | Credit risk           |
| 9  | Talent                |
| 10 | Funding               |
| 11 | Competition           |
| 12 | Client relationships  |
| 13 | Product risk          |
| 14 | Macro-economic        |
| 15 | Political risk        |
| 16 | Reputation            |
| 17 | Crime                 |
| 18 | Service delivery risk |

MENA respondents focused heavily on oversight of service providers in these markets, both internal and external. On the region's top risk, governance, an MFI specialist in Saudi Arabia said: "Several boards which I have seen from field visits do not have the required management or financial know-how to provide proper oversight and strategic direction". On management risk, Ihab Amin, CEO of the Regional Enterprises Development Center in Egypt, noted a "lack of specialized staff, sufficient knowledge and appropriate qualifications to implement the professional aspects of management operations in MFIs in Egypt".

Regulation also ranked higher as a risk than in any other region we surveyed, a concern exacerbated by growing competition. Alaa Abbassi, managing partner at Abbassi Law Office in Jordan, said: "For the majority of countries, the main risk is not having a level playing field for all service providers and regulating entities instead of services. By not

allowing new players in the market, this keeps the traditional service providers, mainly banks, from seriously shifting to serve everyone and not only the elite, because they are kept in a comfortable position protected from any real competition".

This fed into wider fears about mission drift: the feeling that the industry is losing its focus on the quality of service it provides to low income people as it reaches for scale. "Small MFIs will be pushed out and we'll have the 'Amazons' of fintech taking over", said a respondent in Lebanon. On funding risk, Khaled Al-Gazawi, chief executive of Ebdaa Bank for Microfinance, said: "Under pressure from regulators, for example in Bahrain, MFIs are forced to attract profit-oriented investors and are gradually neglecting social business methodologies".

Though political risk ranked relatively low a number of respondents referred to it, particularly conflict in Palestine impeding the sector's development. A consultant in Afghanistan said: "In this region of the world (MENA and Afghanistan) plagued by terrorism, political and security upheaval, attaining a secure environment to conduct business remains the foremost challenge. In this type of environment, MFIs cannot expand operations, have to absorb extra operating costs for security of branches and staff, and growth is slower due to lack of confidence in the economy by the clients".

## Sub-Saharan Africa

**The quality of personnel is important...**

- 1 Technology risk
- 2 Credit risk
- 3 Talent
- 4 Risk management
- 5 Management
- 6 Governance
- 7 Strategy
- 8 Political risk
- 9 Product risk
- 10 Crime
- 11 Macro-economic
- 12 Funding
- 13 Competition
- 14 Client relationships
- 15 Regulation
- 16 Client acquisition
- 17 Service delivery risk
- 18 Reputation

Respondents in SSA – who came from 19 countries – ranked credit risk higher than in any region, stressing the threat that easily available credit from multiple lenders could exacerbate overindebtedness. A respondent in Zimbabwe said: “Most markets are increasingly becoming competitive and pressure to grow often leads to compromises in credit risk tolerance. Debtors will find ingenious means to get undeserved credit from competing parties”. The director of an MFI in Tanzania considered this risk to be high “due to informality of clients' businesses [and] high illiteracy levels – difficulties in maintaining records, lack of awareness of financial services, poor techniques in loan assessment and delinquency management”.

Three of the top six risks in this region were related to the quality of personnel at service providers: talent, management and governance. Respondents warned about nepotism and a lack of professionalism and accountability in boardrooms, and of managers poorly equipped to adapt to a rapidly changing environment. John

Lwande, Program Director at Accion’s Africa Board Fellowship Program in Kenya, said: “Many MFIs are not able to afford and retain employees particularly in this digital age. Larger institutions with deeper pockets or banks are able to attract and retain such talent”.

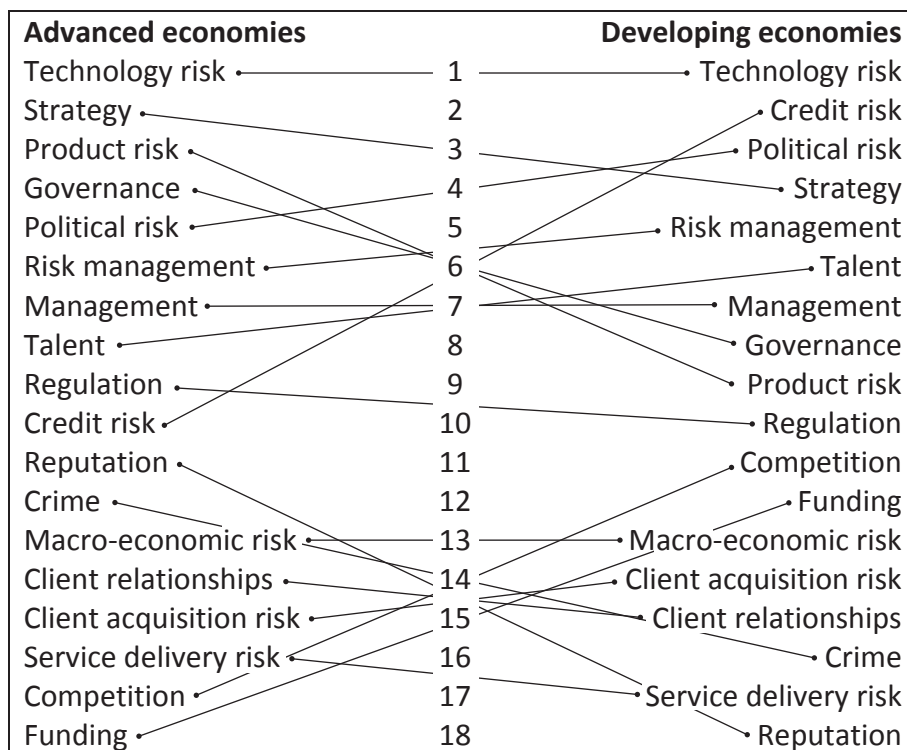
A persistent concern in SSA was that a focus of the number of people that can be reached in these markets is leading to neglect of vital areas such as consumer protection and capacity building. Henry Oketch, chief operating officer of Medina Islamic Digital Finance in Kenya, said: “There are too many vested commercial interests in the industry; not enough focus on the needs of the end-user. Not enough funding going into building real institutions and resolving real problems that could lead to improved financial inclusion... The focus on inclusive finance does not go far enough to examine closely-related challenges of poverty, low-incomes, and high unemployment incidence in countries where financial exclusion remains a big issue”.

This was linked to the region’s number one Banana Skin, technology. Mia Thom, technical director at Cenfri in South Africa, worried that: “Tech platforms become substantial new gatekeepers to consumers and abuse this role or do not create adequate value to the consumer”.

A board member of an MFI in Ghana said: “I believe the largest risk we face in Africa is a lack of a population policy that keeps governments unable to know the numbers or locations of our people. Income status in and of itself is not a risk. The risk is in our inability to know how to locate people. When people cannot be found, it breeds a culture that perpetuates such risky behaviours as theft and corruption. The flip side of that is that customers do not receive good service because staff, who are themselves a part of the community, do not treat customers with dignity and respect”.

## Advanced versus developing economies

A third of respondents to this survey came from countries classified by the IMF as “advanced economies” – in this survey, North America, Western Europe, Japan and Australia – and they generally had a global rather than regional focus.



They shared many of the concerns that developing economy respondents had about the potential of new technologies to do harm as well as good, but with even more emphasis on strategic and product risks. Paul DiLeo, president of Grassroots Capital Management in the US, said: “Institutions will generally move towards products (and clients and geographies) that can scale and deliver high profitability. These are appropriate from the standpoint of investors, but not necessarily from the point of view of the client”.

There was higher than average concern in advanced economies about crime – especially the likelihood of cyber-attacks and digital fraud causing serious damage to unprepared service providers – and the industry’s reputation, which was seen as increasingly fragile in the social media era. On the other hand, credit risk was down at No. 10 in the rankings, compared to No. 2 in developing economies. A banker in Austria warned about “mobile money operators snatching away clients from bricks & mortar entities without having sufficient understanding of client repayment capacities”, but others suggested that data-driven improvements in credit scoring would help mitigate this threat.

Some respondents to this survey expressed unease at what they felt was the remoteness of decision makers from the markets they affect – in the words of one support provider to the industry, “the western elite have captured the thinking, the funding, the regulation”. Jenifer Shapiro, manager at Microsave in the US, said: “We need to let clients drive our work more rather than the strategic decisions made by donors who are out of touch with what is really happening on the ground”.

## The Banana Skins



### 1. Technology (2016 position: 4) Score: 7.20 (2016 score: 6.66)

*The risk that service providers fail to capitalise on new developments in IT, cannot effectively manage data, or suffer losses from IT mismanagement.*

The wave of new technologies sweeping through the financial inclusion business poses the greatest threat to service providers over the next two to three years, according to respondents to this survey. Innovations in IT promise to bring financial services to vast underserved markets – expanding institutions’ reach, helping them better understand client needs, and improving operational efficiency. Yet there is a great deal of anxiety about the costs of investing in these technologies and their vulnerability to failure, mismanagement and hype.

This was rated the most urgent Banana Skin in this survey by a considerable distance: the difference in its score out of ten and No. 2 (strategy) was greater than between No. 2 and No. 10 (regulation). A major concern is that the *pace* of technological innovation is foisting change upon service providers more rapidly than they can adapt to it. Petronella Dhitima, managing director of Mustard Seed Advisory in Zimbabwe, said: “Service providers have not been sufficiently utilising IT systems properly and yet that domain is changing rapidly. If they were doing badly with the basics, how much more with complex, inter-operable systems that are connected to other digital platforms?”

Institutions which move too slowly risk being shut out of new markets and, in the face of rising competition and changing customer expectations, increasingly marginalized in their existing ones. The concern is that many of these institutions lack the expertise to understand which technologies they should be investing in and the resources to follow through. Respondents worried that “clearing out legacy infrastructure and systems is a massive impediment to innovation” and “competition for tech talent is fierce and expensive”. Lauren Burnhill, managing director of One Planet Ventures in the US, said: “Many options that are hard to evaluate + limited human capital + increased regulatory requirements = lots of room for chaos”.

“Embracing the fast technological developments in the fintech space is a great opportunity - while ignoring them, or remaining slow in identifying where and how this can revolutionize financial service provision, is a key risk for the next years”.

**Michael Fiebig, head financial institutions equity, ResponsAbility Investments, Switzerland**

But rushing to capitalise on new IT developments could be just as risky. One reason is that as service providers become more dependent on technology, they expose themselves to higher losses and reputational damage that come with systems outages and hacking – particularly if client data is mismanaged (see box) “We cannot do away with a probable increase in the inherent risk of failure of systems or infrastructure, data breaches and leakage of information”, said a regulator in the Philippines.

Another is the hype factor: the risk that new technologies could be seized upon for the sake of innovation even if they serve the needs of clients poorly. Todd Farrington, Director at Symbiotics S.A. in Mexico, said: “The proliferation of fintech solutions is promising, but many algorithms remain insufficiently back-tested, many companies young and overly ambitious. We may see a negative short-term effect of

**Much the biggest risk...**



credit misallocation that could damage both borrowers (individuals and firms) as well as overall deterioration of asset quality in some markets”. An investor in the US warned of “many ‘cowboys’ in the market selling inappropriate technology”.

As the risks posed by technology grow, there are also concerns that any one institution’s ability to deal with these risks may increasingly be outside its control. John Owens, senior advisor at Digital Financial Advisory Services, said: “As new clients join the financial sector increasingly through a variety of digitally-enabled means, whether through a mobile device, an agent or an electronic kiosk, the risks multiply as digital financial value chains get extended. These come from both new players and new products and services, so the entire system is literally as strong as its weakest link”.

## **The growing threat of data abuse**

At the heart of the industry’s technological revolution is an effort to collect and store massive amounts of customer data, from personal details to information about users’ daily habits, spend and cash flows. A striking emergent theme in this year’s survey is the potential for such data to be mismanaged or abused. Shankar Arora, senior vice president at Citi, said: “A significant risk is regulation and protection of sensitive client information. Low income clients should have the same rights and protection of data as anyone else.”

These clients are seen as especially vulnerable to exploitation because of low technological literacy. Joyce Murithi, senior manager at MicroSave in Kenya, said: “As DFS usage grows, customers will now face more customer identity risks emanating from the possible irresponsible use of customer data or inadequate security standards by DFS providers. Providers may also cause these risks by their non-disclosure of the terms and conditions of the services signed up for”.

Because this is a relatively new issue in these markets, much of the legal and regulatory framework around it is still being established. Respondents made the point that institutions should proactively address the risks before they face a backlash from their clients and stiff penalties from regulators. Jayshree Venkatesan, a consultant in India, said: “FSPs have to begin thinking of how data is anonymised to protect individual interests, and think of redressal mechanisms. They will also need to think of how this data is stored, shared with third parties and establish standards for data governance, especially with cross border partnerships and data sharing protocols”.

On the other hand, Matthew Gamser, chief executive of the SME Finance Forum in the US, warned of “the unintended consequences of privacy legislation retarding innovation in data-driven financial services”.

Though the use of data is widely seen as a way to expand financial inclusion, some respondents worried it might do just the opposite. Mia Thom, technical director at Cenfri in South Africa, said one of the main risks to the industry is: “Data collection, analysis and sharing of data in a manner that increases exclusion (e.g. risk data on certain groups inhibits risk pooling), reduces value to the consumer or even exploits the consumer”.



## 2. Strategy (1) Score: 6.73 (7.19)

*The risk that service providers will fail to stay relevant and competitive in a changing marketplace.*

### How to plan for rapid change?

The top ranked Banana Skin in the last edition of this survey is once again a pressing concern. The reason is that new technologies are driving tumultuous change in every area of the marketplace – competition, customer expectations, public policy, etc. – and undermining traditional business models. In this very challenging environment, respondents felt that many service providers are not developing a strategic plan to stay relevant with enough urgency, if at all.

Several explanations were put forward for this perceived inaction: that institutions lack understanding of changing market structures, have become complacent or stuck in their ways, or are overwhelmed by the pace of change and clinging on to survival in the short term. An industry observer in Kenya said: “Institutions are more concerned about their survival than meeting client needs – but if client needs are not met they will cease to exist”.

The bulk of comments we received focused on the risks facing traditional financial institutions and MFIs as specialised fintechs eat into their markets. Dana Lunberry, a teacher at the London School of Economics, said: “The current trend of business platformization in the digital economy will continue to shape financial services. If financial institutions do not align their strategies accordingly – which may mean further specialization or becoming more of a marketplace – they will lose their relevancy”.

Many respondents took the view that service providers can only remain relevant beyond the short run if they embrace digitisation. Emma Morse, senior specialist at the Center for Financial Inclusion at Accion, said: “I foresee a tectonic shift in the marketplace, where digital transformation of financial service providers no longer is seen as a competitive advantage, but rather becomes a necessary condition for survival. The biggest challenge facing traditional service providers is not whether they should adopt digital solutions but rather if the transformation will occur at a pace that is fast enough to curb the market gains made by fintech providers”.

On the other hand, institutions which rush to adopt a digital strategy at all costs are in danger of compromising what they do already well. “The risk is that all MFIs want to become digital and abandon a functioning relationship and high-touch human business while entering a winner-takes-all competitive market”, said the head of the financial inclusion division of a Swiss bank. A respondent from an MFI warned: “There is always a danger that a service provider will divert from their vision and follow the path of least resistance. I feel this is particularly risky for those trying to provide to those on low income”.

Yet in spite of its high position in the table, the average score this risk received out of ten has fallen from its high point in 2016. Some respondents observed institutions being more forward thinking and flexible to the changing needs of their market. For example, a consultant in the MENA region said: “I think MFIs have learned a lesson from previous years and lack of strategy in Afghanistan. Most of them are moving forward despite challenges because of having a strategy”.



### 3. Political risk (12) Score: 6.63 (6.28)

*The risk that intervention by politicians will harm the sector and distort the market, for example through taxation, subsidy, rate capping etc.*

Concern about political risk is rising fast because of the growing instances of government intervention in the banking markets. This is the highest position political risk has occupied in the rankings in the ten years we have been conducting these surveys. Jerome Savelli, head of market and credit risk at Symbiotics in Switzerland, said: “We view political intervention risk, via regulation, becoming one that can be a brutal game changer in certain markets.”

## Governments are intervening in the markets...

Respondents reported many cases of governments introducing loan waivers or imposing interest rate caps. They see a number of reasons for this. One is that there have been – or soon will be – elections in many countries, and financial services providers are an easy target for populist politicians. Another is that the global tendency is for interest rates to rise, putting pressure on borrowers’ budgets.

Geographically, there was no clear pattern to intervention: cases were cited in Africa, Asia, Latin America and Europe. The trigger was usually related to local lending conditions rather than generalised causes.

The gains from political intervention currently outweigh the damage it causes. But respondents warned that an inevitable consequence would be a shrinkage of the lending market as institutions withdrew and funding dried up. There would also be a decline in credit discipline as bank customers learnt that they would not have to repay loans. A rise in loan sharking was also predicted.

Pakistan is entering election year, like any other unstable democracy this has its own risks. We need to manage any intervention from government that affects a market-based pricing policy. Similarly, we need to realise that the last time we had a turbulent election year, government policies affected inflation and the availability of commodities. This led to a reduction of liquidity and an inability of clients to repay their loans.

**CEO, Support network, Pakistan**

However some respondents felt these concerns were overdone. A number said that governments were warier of meddling with financial institutions. Similarly, borrowers were increasingly aware of what one respondent called “this political gimmick”. Catherine Bolinger, senior risk and compliance officer at Accion in the US, said: “This will continue to be a pressing risk. However, there has been some progress made in proactively addressing potential issues before they become full-blown. The PRFI has presented a unified voice to help prevent potential damaging regulation, such as interest rate caps, from becoming law; this type of unified industry engagement could prove useful going forward as the industry faces innovative digital disruption.”



### 4. Credit risk (8) score: 6.61 (6.58)

*The risk that providers will suffer losses from lending to businesses and consumers who do not have the capacity or willingness to repay.*

Credit risk has risen several positions in this year’s rankings, underlining the importance of this most fundamental lending risk. The rise chiefly reflects concern that technological “improvements” in the provision of credit such as algorithmic scoring and electronic delivery will make access to credit easier, leading to

## “Irresponsible borrowing”

irresponsible borrowing, particularly among people unfamiliar with financial services.

One of the most important risks I see is the emergence of multiple providers of highly priced but easily accessible credit mainly geared towards consumption rather than value addition. This credit is provided mostly through the mobile phone. As much as it is an innovation worth applauding, if it is not controlled, it is likely to entrap the low-income earners into unnecessary debt which may make their financial position worse off.

**Jonathan Nkoola, Frankfurt School of Finance & Management, Kenya**

This tendency could be reinforced by other developments. One is the large growth in the amount of credit on offer following the arrival of new entrants driven by the quest for market share. These entrants may lack the capacity – or even the desire – to know their customers on a personal basis, relying on systems to manage credit quality and defaults. The resulting loss of human touch could increase unwillingness to service loans. Many respondents pointed to an apparent link between the amount of personal contact with the customer and the loan repayment rate: the more of the first, the higher the second.

Another is the extension of the market to include more borrowers with low levels of financial literacy – people who believe that loans are “free” or likely to be waived by government intervention. A respondent from Africa said that “many low-income customers, especially in developing countries, see loans from financial institutions as their own portion of the national benefits indirectly from their government. This is because of their very low literacy level.”

“[Credit risk] is increasing with the introduction of digital credit for thin-file customers; 10% of the Kenyan population are now negatively listed on the credit reference bureau”.

**Graham Wright, group managing director, MicroSave, UK.**

Doubts about the quality of management in lending institutions persist. Are lenders – particularly new ones – able to manage credit risk, or will the profit motive override prudence, making their presence in the market potentially destabilising? Although market information is improving thanks to the proliferation of data sharing initiatives and credit bureaux, there is concern that this information may be of poor quality, or that it is simply ignored.

In Egypt, Ihab Amin, CEO of the Regional Enterprises Development Center, said there was “a severe shortage of monitoring and evaluation programs for client projects” as well as “a lack of interest in the analysis of the loan portfolio in various aspects”. This was in addition to “severe shortcomings of risk management systems [...] and an absence of professional trainers in this field.” A number of countries stressed that credit checks were now obligatory. External factors such as the macro-economic environment, monetary policy, climate impact, conflict etc. were raised as threats to credit quality, though again, these were often country specific.

But while anxiety about the credit outlook dominated the responses, there were also more positive views. Respondents stressed that technology – such as credit scoring models and other analytical tools – could do a lot to widen the boundaries of financial inclusion by reaching people who were previously outside the market. Over time, financial literacy would improve, leading to sounder borrowing.

## **Overindebtedness won't go away**

New financial technologies bring benefits, but they could also amplify the problem of overindebtedness – long a feature of the microfinance industry. More than 60 respondents, spread across every region of this survey, named overindebtedness as one of the main risks they saw to financial inclusion.

The combination of easier access to credit and financial illiteracy makes a fertile breeding ground for overborrowing. With more lenders competing for market share, lending standards are going down, and multiple borrowing is becoming more widespread. Jose Manuel Gonzalez, COO of Te Creemos in Mexico, said: “Loan write-off rates have grown in the last 36 months, mainly due to the increase of credit on offer, sometimes granted under very weak risk policies by newly arrived under-regulated institutions. There is no real punishment as an industry when someone does not pay a loan; they will always have finance alternatives, ranging from other MFIs to pawn shops”.

As more borrowers use their loans for consumption rather than business or investment, the capacity to repay is also declining. A further aggravation is the rise in political interference in the form of waivers which have encouraged irresponsible borrowing.

In Bahrain, Khaled Al-Gazawi, chief executive officer of Ebdaa Bank for Microfinance, said that “MFIs are under the pressure of sustainability; more and more are ignoring the risks involved in credit. They are competing to disburse more loans regardless of whether the client is creditworthy or not.” Another respondent in the Middle East said: “Conventional microfinance products and services are loading low income clients with debt (capital + high fees + high interest rates). This is likely to lead to overindebtedness and ultimately to systemic and reputational risks”.

The problem is aggravated by the fact that information on borrowers is often poor – and liable to be ignored under pressure of competition. Lending is based on algorithms rather than on capacity to repay, removing elements of credit discipline such as human contact. Winnie Terry, executive secretary of the Tanzania Association of Microfinance Institutions, said that “unregulated microfinance institutions are not using credit bureaus and therefore loans are given without credit information. Borrowers are burdened with multiple loans - and non-performing loans have escalated to an astonishing level.”

Juan Carlos Zamalloa, founder and CEO of Ayllu Fintech in Peru, said: “Although [the new financial institutions'] loans are cheaper and more flexible than those of regular financial institutions, they have the potential to over-indebt people because they don't report to any credit bureau. Therefore, initially they can bring more financial inclusion, but in the end people will be more excluded than before.”



## 5. Risk management (2) Score: 6.57 (6.90)

*The risk that service providers will fail to identify and manage the risks in their business.*

The ability of financial institutions to stay on top of the risks in their business continues to be a high level concern, though there are signs of improvement.

The responses focused on two areas: the quality of risk management in financial institutions, and their ability to keep up with a changing risk landscape that will contain new threats.

Quality depends on local conditions, particularly on the strength of the risk culture and regulatory oversight. Many respondents commented critically on attitudes towards risk management in their regions. “Risk functions have been nominally strengthened in many companies in Latin America but often remain box-ticking/regulatory exercises in fact”, was a comment from Mexico; another from Ghana was that: “Many providers treat risk and its management in silos”.

“Risk management is an important consideration. The key is for businesses to be able to identify their risks so they can measure them and set appropriate controls. The use of technology in providing financial services to the unbanked and underserved sector holds promise as well as new risks that should be well understood and managed. Relevant regulations for BSP-supervised financial institutions include guidelines on credit, market, operational and IT risk, among others.”

**Pia Bernadette Roman Tayag, director, Bangko Sentral ng Pilipinas**

Further complications include the shortage of skills and training resources, and poor grasp of the market. A growing factor is performance pressure from shareholders and competitors which increases the temptation to bypass risk controls. Vinita Godinho, general manager of Good Shepherd Microfinance in Australia, said: “I believe providers do understand the risks. The question is whether the risk appetites of key stakeholders e.g. institutional investors, shareholders etc. are aligned to meet needs of low income clients.”

Risk management is still widely seen in terms of credit risk when new forms of risk have begun to emerge: regulatory risk, environmental risk, technology, cyber and business model risk which can be just as damaging. Deborah Drake of the Center for Financial Inclusion at Accion, said: “The landscape of financial inclusion is changing so rapidly that it makes identification of risk and risk mitigation very challenging. Whereas financial institutions traditionally delivered products and services directly to clients, we now have new players such as technology companies, telephone and communications companies providing services through indirect means. The risks to reaching the client are spread throughout various different actors resulting in dependency risk which is difficult to manage.”

However, in the bigger picture, risk awareness is growing, and more institutions are putting effective risk management systems in place. Sibusisiwe Mashoko, Channels and Operations Manager at Homelink Finance in Zimbabwe, said: “Risk management frameworks have been generally developed and observed throughout the industry through regulation. Failure of some companies has also driven existing companies to seek an improvement in risk management policies”.

**Risk  
management  
still too  
narrowly  
defined...**



## 6. Product risk (7) Score: 6.51 (6.60)

*The risk that service providers will fail to offer appropriate products to clients, for example because they fail to understand their needs.*

**Is there real demand - or is it supply-driven?**

The risk that institutions fail to offer clients products that are appropriate to their needs again ranks high up the table this year: it was No. 3 for industry observers and No. 6 for regulators. However, service and support providers had it much lower, which may suggest some complacency in the industry.

Two main themes emerged in the responses. One is the observation that many institutions are pushing products onto clients with little evidence of demand for them, such as fintech firms with innovative technologies searching for real world applications in these markets. Comments in this area included: “Very few providers start from the viewpoint of the user with a low income and offer what they need and want” and “We seem to think everyone needs the products we are developing, but low usage suggests that everyone doesn't need them.”

“There is a certain 'Steve Jobs mentality' prevalent in the fintech world, sometimes exacerbated by well-intentioned foundation funders, that supply-side solutions can be imposed on clients who just don't know what is good for them. This is an old problem dressed up in new, fintech fashions, but which may very well have the same predictable negative outcomes.”

**Jesse Fripp, general manager, Aga Khan Agency for Microfinance, Switzerland**

Traditional players also come under scrutiny for not rigorously researching and understanding client needs, partly because of a lack of resources. Stephen Wanjala, executive director at Housing and Development Finance Consultants in Kenya, said: “You can't be innovative with products if you don't know the tastes, preferences and capacities of your target group. It is always assumed that MFIs know their clients which is not the case – if you look at how products are developed it leaves a lot to be desired”. Another respondent commented: “Our interactions with providers show products that have no bearing on capacity and cash flow patterns of the clients.”

A second major theme is that much of the industry's product offering is homogenous. Respondents worried about “lazy bankers treating financial services like simple utility products” and that “the tendency to copy what others are doing is still very much alive”. Joel Anthony Muhumuza, partner support specialist at Financial Sector Deepening Uganda, said: “Risk-averse financial service providers rarely take a chance on new products tailored to meet needs of low income clients but rather want to have low income clients use already established products and services”.

“Low income people need products that perfectly meet their needs and cash flow amount and timing. This risk is a key source of loan defaults where the product features mismatch [the] client situation.”

**Patrick Wameyo, director of Financial Academy & Technologies, Kenya,**

But there was also optimism that this risk may become less of an issue in the future, as digital business models provide instantaneous market feedback on products and institutions take advantage of “near endless data crunching possibilities to gain insights.” A respondent at an MFI said: “It is a medium risk for me given that with proper metrics, bad products can be averted early on”. Susan Olsen, senior investment specialist at ADB in the Philippines, said this Banana Skin “should be mitigated by good healthy competition between lenders. Those that serve well grow better and faster”.

## **Mission drift and the base of the pyramid**

A widespread concern in this survey was that the industry is losing its social focus; respondents observed a growing number of service providers primarily motivated by maximising profits or market share in the short run. This 'mission drift' is damaging to financial inclusion for two reasons.

One is that short term thinking increases the likelihood that clients are laden with inappropriate products or worse, exploited, potentially damaging trust in all the players in this space. Timothy Ogden, managing director of the Financial Access Initiative in the US, worried that "the growth of digital financial services provided by telecoms or other firms who do not have a mandate to serve poor customers or care about their well-being lowers the quality of available products, hurts margins of traditional MFIs and sparks a backlash against service providers in general."

The other is that markets which are difficult to make commercially viable, especially clients at the base of the pyramid, are neglected in favour of easier targets. "What we have seen in the financial service space is a 'one product fits all' approach which does not consider the diversities of profiles of the underbanked and unbanked segments of the population", said an industry observer in Nigeria. "Until these diversities are considered in the design and delivery of financial services, the vulnerable segments of the population will continue to be excluded. This will, in turn, relegate them to informal mechanisms which are high-risk products/services especially for those at the bottom of the pyramid."

Some respondents ascribed this mission drift to institutions exploiting vulnerabilities such as low levels of financial literacy and weak regulation in order to turn a quick profit. "New informal financial institutions are not doing responsible finance, they just aim at making money rather than poverty alleviation. Thus they charge very high interest rates and blind clients on pricing by deceiving them, due to a lack of financial knowledge," said Liang Sun, head of SME Risk at Grassland Finance in China.

But many others thought that bad outcomes can come from good intentions, such as fintech providers that genuinely believe their technologies can change the world but are attempting to scale them much too quickly in a highly competitive climate. The point was also made that service providers often have no choice but to focus on medium-income clients that can turn them a profit relatively quickly, because of the focus of impact investors on the bottom line. Gerhard Coetzee, lead financial sector specialist at CGAP in the US, said a risk is that: "Regulators fail to make the connection between positive customer outcomes and incentive-based regulations that will keep at-scale FSPs interested in the poor and vulnerable market. Non-conventional FSPs get disillusioned with the uphill battle to get a business model to work at the BoP and walk away."





## 7. Governance (9) Score: 6.50 (6.53)

*The risk that the boards of service providers will fail to provide necessary oversight and strategic direction.*

Poor corporate governance remains a persistent risk, though the nature of the risk is changing. In past surveys, the concern was about the quality and effectiveness of company boards. Now, people worry about the ability of boards to stay on top of fast-changing markets and whether they possess the understanding to handle an increasingly complicated business.

Along with the growth of fintech, respondents saw a more short-term, profit-oriented business style eroding governance standards and tilting the balance of power towards management. A typical comment came from Danielle Piskadlo of the Center for Financial Inclusion at Accion: “Many boards seem unprepared to lead the digital strategies needed at their institutions to stay relevant.”

“Governance remains a huge challenge, and in my view this is the mother of all risks. This is not about to change anytime soon. Owner/shareholder directors who do not understand microfinance are on the boards; directors are largely family and friends; directors do not participate in training sessions and no one holds directors accountable when MFIs fail.”

**Ernest Dzandu, consultant, Ghana**

These emerging difficulties seem to lie less with seasoned financial institutions than with non-profit volunteer-run organisations that may lack the means to build strong governance, and with high-tech start-ups more interested in business opportunity than in how they run themselves. Mohammed Khaled, senior operations officer at IFC in Egypt, said that “in MENA this is a serious risk as most of the main providers on the microcredit side are still NGOs and not for profit companies. The bigger these providers get the more corporate governance becomes a concern, knowing that board members are volunteers.”

Several respondents said that regulators in their country were focusing more closely on governance issues, and this was producing improvements, though at the risk of placing greater burdens on company boards and discouraging would-be directors. A US investor said: “Corporate governance is still under pressure in developing countries and there are not enough qualified independent directors who are willing to serve and take responsibility and liability risk for little compensation.” The lack of training was mentioned as an issue in several countries, though initiatives such as the Africa Board Fellowship (ABF) programme for directors of financial companies are proliferating.

However there was also a note of optimism. The combination of tougher regulation and better training seems to be having an effect. A banker in Kenya said the country “has had her fair share of bank failures over the past four years but the stringent controls that have been put in place have led to a stable banking environment.”



## 8. Talent (15) Score: 6.49 (6.08)

*The risk that service providers will fail to attract and retain suitably qualified staff.*

There has been a big jump in this Banana Skin’s ranking because of the difficulty that many institutions are having in retaining staff, and ensuing skill shortages in key areas. It was a particular concern in sub-Saharan Africa, where it came No. 3.

**The drive for profit may hit governance...**

## Staff don't stay...

A major concern is that as the nature of the financial inclusion business changes, traditional institutions such as MFIs are not offering ambitious employees a compelling reason to stay with them, in terms of salary, challenging work, or career advancement opportunities. Edet Daniel Andem, regional manager at Microcred in Zimbabwe, said: “There will be increased mobility of skilled staff to more challenging and rewarding institutions, as well as more technologically mobile institutions”. An industry observer in the UK commented: “As regulatory and market pressures grow, the calibre of people will need to follow. It’s not clear if the sector has the ability to attract these skills either for money or culture”.

The risk is sharpened by high turnover in the industry. Several respondents complained about the prevalence of poaching – a disincentive to provide training to staff “who depart in less than a year or two to join the banking sector”, as one respondent put it. The managing director of an MFI in Tanzania said: “As commercial banks start looking for business at the low end market of the financial sector, they are most likely going to recruit staff from MFIs. We have already this happening in our market. This is likely to result into high staff turnover”.

“FSPs for poor populations face more and more competition in the labour market to hire and retain qualified and skilled staff. It is a worrying trend that the competition for staff is not with peers but more with banks and other institutions like MNOs.”

**Director of MFI network, Ghana**

A consequence is that certain skills are in short supply, especially in technical areas. For example, one respondent warned that “the talent pool on the fintech side will remain limited and that will hinder rollout of tech-based product and service enhancements.” Nqe Dlamini, director at SaveAct in South Africa, said: “Professional staff prefer to work for established financial institutions. The country is very slow in rolling out skills development initiatives that will provide a pool of professional staff for microfinance institutions”.

Respondents who downplayed this Banana Skin pointed to local factors, such as a growing emphasis on training in some countries or high unemployment rates increasing the supply of available talent. In India, where it ranked No.16 among the country’s 30 respondents, a banker said: “Talent is available, skill development is on the increase”. A respondent in Zimbabwe said that the country “is characterized by a high unemployment rate which makes it an employers’ market. Talent is adequate.”



## 9. Management (10) Score: 6.49 (6.51)

*The risk that poor management in service providers will damage the business.*

Concern about management risk – a regular feature of these surveys – touches on several points, including the quality of management, the availability of talent, the incentives offered to management, and the ability of management to handle this period of rapid change.

On quality, many respondents blamed poor management on inappropriate qualification, inexperience or sheer incompetence. In Saudi Arabia, a microfinance specialist said: “I have visited several MFIs which are not really aware of how to calculate operational costs! They seem to not look at key performance indicators of the business.” A banker in India commented: “The management teams at [finance]

institutions need improvement. More professional, seasoned management with overall banking/lending experience would be more suitable.”

The availability of talent and the difficulty of building management capacity were issues for many respondents. The problem lies at both ends of the process. Finding good managers is hard enough, but many then leave for better paid jobs in the mainstream sector or, as a respondent from Venezuela said, “flee the country”.

## Incentives?

This touches on the question of incentives. Are management paid enough, and are the incentives put before them appropriate to building lasting businesses? There is a concern that the more competitive direction in which this business is moving causes managers to focus increasingly on short term results, neglecting longer term strategic considerations. Dr. Suhasini Verma, of the Manipal University in Jaipur, commented: “In this era of cut-throat oligopolistic competition, there is a chance that in order to gain profit or win market share, management will take hurried decisions.”

But new sources of concern are offset by the view that, on the whole, management quality is improving. The director of a London-based credit union said that “new attention to quality and qualifications make me feel more confident that a decent level of local management will return to service providers”. Rene Azokly, chief operating officer of PAMIGA in the Ivory Coast, said: “This risk is medium because there are more and more qualified people in the labour market to ensure proper management of MFIs”.

“One cannot underestimate how many good ideas die on the vine because of poor technology platforms and poor execution in technology projects.”

**Senior director, credit card company**



## 10. Regulation (16) Score: 6.38 (6.04)

*The risk that the sector will be hampered by a lack of appropriate supervision and regulatory coordination.*

Regulation is becoming a more pressing risk because of the fear that it is not keeping up with market developments. Respondents’ concerns centred particularly on the ability of regulation to create an environment where different types of provider could compete on equal terms and where the right balance was struck between innovation and safety.

## Is regulation lagging the market?

“Regulators are unable to understand the dynamics of the sector, resulting in policy approaches that do not accommodate or are disconnected from ground realities. The consequences of inadequate or inappropriate regulation could be a decline in the quality of service provision, or even its withdrawal altogether if it imposes impossible costs and restrictions.”

**Faeyza Khan, investment officer with the IFC in Pakistan**

At the moment, few countries offer such an environment and the prospects for improvement look mixed. A widely made point was that regulation is lagging the growth of fintechs and other entrants into the financial inclusion industry, as well as non-financial institutions such as telcos. The risk of regulators responding too lightly is that it creates a vacuum which can lead to an uneven playing field among FSPs and greater risk; but heavy-handedness could damage the growth of innovative new players.

Some respondents said that regulation was increasingly biased towards large commercial players, making life difficult for smaller players and MFIs who were targeting the low income end of the market. A regional director of a financial services NGO said that regulatory changes and inappropriate taxation were pushing financial service providers “to move away from rural areas and needy people and concentrate on top market segments.”

“For the majority of countries, the main risk is not having a level playing field for all service providers and regulating entities instead of services. By not allowing new players in the market, this keeps the traditional service providers, mainly banks, from seriously shifting to serve everyone and not only the elite...”

**Alaa Abbassi, managing partner, Abbassi Law Office, Jordan**

## Too much? or too little?

If inadequate regulation is a problem, so is the risk of too much of it. Some respondents feared that excessive regulation was damaging the market, for example by piling on capital requirements. A risk manager at a microfinance network in Germany said: “Regulators are increasingly passing new standards that are intended for systemically important global banks. These are not practical to deal with and create enormous compliance costs without clearly reducing actual risk exposures (and also likely distract from real risks).”

But a number of respondents felt that while regulation had its failings, it was addressing the issues facing the market and bringing about improvements. The value of financial inclusion was understood at a political level, and encouragement to regulatory improvement was given. Luis Trevino Garza, data policy manager at the Alliance for Financial Inclusion, said: “Policymakers, regulators and even standard setting bodies are more aware than before of the risks in financial market innovation and there is a trend to enable regulations and legislation to mitigate those risks considering an appropriate proportionality approach in the implementation”.

### Consumer protection at risk

Digital finance may be the vehicle which delivers financial services to the financially excluded, but it also carries risks. Many respondents were concerned that the excitement over new technology would cause people to lose sight of the need for consumer protection. This was especially important in a market that included the financially unsophisticated. The chief auditor of a large US NGO said: “Our reach to clients can be greatly enhanced [though the digital transformation], but the customer protection risks are great.”

Concerns included unscrupulous suppliers eager for market share, lack of transparency (hidden terms and fees), product mis-selling (particularly loans), ineffective redress systems, lack of accountability and poor regulatory oversight. Laurence Julius of the Campaign for Fair Finance in the UK said that “the financial service industry has a terrible track record of greed and exploitation. Unfortunately lessons are still to be learnt”.

The answer had to be an ethical approach by suppliers reinforced by regulation. Godwin Nwabunka, CEO of Grooming People for Better Livelihood Centre in Nigeria, said that a priority was “the regulation of alternative delivery channels ... to ensure client protection and best value for clients are enhanced.”



## 11. Macro-economic risk (6) Score: 6.13 (6.60)

*The risk that service providers and their clients will be damaged by trends in the wider economy such as inflation and recession.*

**Interest rate risk is a real issue...**

Confidence in the economic outlook is improving. Macro-economic risk is no longer in the top ten mainly because growth is occurring in many parts of the world, and financial institutions seem better able to manage economic shocks. However, the responses did contain a note of concern about potential instability due to high levels of public and private sector debt.

The main concern is interest rate risk. As the industrial countries move out of quantitative easing, interest rates will rise putting pressure on financial service providers as well as their customers.

Other concerns included inflation, currency risk and commodity price volatility. Cody Ling, vice-president at Citigroup, said: "Foreign exchange continues to be a challenge for the sector. Access to local currency may be limited and lending in foreign or pegged currencies creates unique challenges and risks for both borrowers and lenders. Moreover, even if the risks are known, hedging instruments may be limited or cost prohibitive".

In individual regions such as the Middle East and Africa, economic growth was seen to be vulnerable to political instability and military conflict.

"I feel this is a lower risk to those on low income as their lives seem less volatile than their wealthy counterparts. Low income individuals do not do as well in the good times but they suffer no worse in bad times."

**Director, credit union, UK**

A respondent from a development bank in Kenya gave the following graphic account: "The economic situation right now is still fluid after having gone through a gruelling and prolonged electioneering period. The country is also experiencing the aftermath of a severe drought and inflation levels are high. These effects hit low income clients first, thereby increasing the risks they face. The past year has seen the non-performing loan ratio for micro and SME customers at an all-time high due to these factors. The political climate has yet to settle down which means that the economy will take time to stabilise. Lending in this climate will continue to be difficult."

Financial institutions have a mixed exposure to global economic currents. Some local ones are well insulated, others are heavily exposed, particularly those that rely on external funding. On an upbeat note, Guillermo Salcedo of Oikocredit in the Netherlands said: "In spite of increased volatility, microfinance service providers and their clients have over and over shown a high resilience to negative macro-economic trends."

### **The plight of Venezuela**

"...The destruction of the sector due to hyperinflation and the lack of adequate public policies allowing the sustainable delivery of inclusive finances for the poor... Micro entrepreneurs are sinking back into poverty and financial institutions have retreated into serving only (what is left of) the formal economy..."

**Juan Uslar Gathmann, board member, Bancaribe, Venezuela**



## 12. Crime (20) Score: 6.10 (5.08)

*The risk that service providers will be damaged by threats such as cyber attack, fraud, money laundering and tax evasion*

This Banana Skin ranked a distant bottom the last time we ran this survey; this year its score out of ten has jumped by twice that of the next biggest climber. The tone of responses we received suggests that it will only get more urgent.

The principle reason is that the digitisation and automation of the industry are creating vulnerabilities for criminals to exploit much faster than service providers can upgrade their defensive weaponry. These include “cyber threats, fraud, hacking and illegal access of electronic accounts and transaction data”, said a regulator in Malawi. A microfinance specialist in the Middle East warned that crime is “very likely to damage service providers due to issues with lack of standards, supervision and regulation in many countries”.

## Crime - picking up

“This risk increases with the use of new distribution channels and non-regulated providers. This risk also applies to countries with weak institutions and drug related crime.”

**Investor, Peru**

A number of respondents flagged the growing risk of fraud, both external and from within companies. A specialist in electronic payments at an NGO in Nigeria said the main risk to the industry is: “The risk of fraud with the deepening of digital financial services. The use of DFS products like mobile money and agent banking has gone a long way in providing access to basic financial services to un(der) banked adults, especially at the bottom of the pyramid [but] many of these people are not literate and usually rely on the agent to provide assistance in carrying out their basic transactions. This act is prone to the customers being exposed to different fraud risks”. An academic in Cameroon warned about “the risk of embezzlement (fraud) by employees, in organizations with weak controls arising from inadequate procedural documentation”.

Some respondents believed that because of the low profile of many of the service providers in this sector, the risk of cyber-attacks is less than at top-tier banks and insurance companies. But the general feeling is that this risk is increasing fast, especially as these institutions store huge amounts of potentially valuable client data. “Institutions must make the issue of securing their systems a matter of top priority”, said a respondent in Zimbabwe. However, the head of an MFI in Ethiopia warned: “Cyber-attacks cannot be tackled by individual MFIs. They call for security at a country level”.

Money laundering was generally seen as a less urgent threat, but still flagged by some. One reason is “the pressure and cost for providers to have robust AML and KYC procedures, and report suspicious transactions to regulators”, said a respondent in the US. The entry of new types of actors in the sector can also makes it more difficult to perform KYCs checks, potentially increasing the risk of money laundering.



## 13. Client relationships (14) Score: 6.06 (6.16)

*The risk that growing remoteness between client and provider caused, for example, by automation, will lead to a deterioration in client relationships.*

Little change in the score assigned to this risk, which divided respondents into two opposing camps of about equal size. One view is that the relationship between service providers and their clients is likely to be damaged as automation limits human interactions. The counter argument is that physical proximity has become much less important than it once was, and institutions that use technology adeptly can not only preserve but improve the quality of relationships.

Remoteness is seen as a threat mainly to demographic groups with low financial and technology literacy – particularly older generations and people at the bottom of the pyramid. Alexis Beggs Olsen, a consultant in the US, said: “The move towards low-touch digital financial services has many benefits... [but] many people who are new to the formal financial system (particularly women and rural dwellers) want to talk to another human being to verify the legitimacy of the financial service provider, fully understand the product, and resolve problems or complaints”. Respondents pointed to research showing that a decade after the launch of M-Pesa in Kenya, half the population still visited agents for assistance with transactions.

**High-touch/  
Low-touch?**

“Many of the major risks I see facing the sector over the next 2-3 years stem from the lack of direct customer-connect. MFIs that we work with tell us that their main communication with customers is through a vast network of loan officers. Because microfinance customers are semi-literate, speak vernacular languages, and don’t use smart phones; apps and even SMS struggle to reach them. This dependence on loan officers causes irregularities and fraud when sourcing customers and collecting cash and hurts borrower discipline in both normal and stressed scenarios like demonetisation.”

**Sonali Mehta-Rao, co-founder & chief growth officer of Awaaz.De, India**

Respondents that downplayed this risk argued that younger generations in particular not only tolerate, but welcome, a lower-touch approach to managing their finances. “Younger generations appreciate technologies that avoid time consuming procedures and red tape”, said an investor in Peru, while Sebastián Coral, CEO of Capital 77 in Colombia, said: “Customers are more interested in the efficiency of the service and in obtaining their product than in seeking personal proximity”. Others suggested that loyalty to effective tech-based products might strengthen clients’ ties to an institution.

It was also noted that remoteness is not an inevitable consequence of automation. “With technology financial service providers will see their clients less often but know them much better”, said a respondent in Switzerland, and several others took the view that automation could strengthen relationships by leading to more frequent and smoother communication. “The appropriate model is a high-tech high touch model, where tech is focused on making internal processes efficient and time is focused on customer relationships”, said an investor in Norway.



## 14. Competition (13) Score: 6.04 (6.23)

*The risk that excessive or insufficient competition will prevent healthy growth of the market.*

The question of whether competition is good or bad for the financial inclusion business comes up with the answer: generally good. As a threat to prudence and good practice, competition has declined steadily in importance over the years in these surveys (it once ranked No. 3), and it has fallen again this year. However the responses raised a number of issues.

Changes in the market are pitting different types of institution against each other – fintech companies, commercial banks, MFIs – with different strengths and weaknesses. Many respondents felt the playing field on which they operated was not level. Banks had greater liquidity, fintechs possessed the technical know-how, commercial groups were after profits, microfinance lenders saw themselves playing a social role.

This led to concerns about “unfair competition” – powerful institutions using their advantages to take market share away from smaller and possibly “worthier” players. Especially singled out were new entrants who seemed to be interested mainly in volume and profit, who did not “understand” the market, and did not aim for a sustainable presence.

Excessive competition could encourage imprudent behaviour as players compete for market share, resulting in lenders abandoning the financially excluded in favour of easier pickings in the urban consumer markets. Fatou Deen Touray, deputy director of the Central Bank of The Gambia, commented that “microfinance growth will lead to abandonment of its core mission of serving the poor”.

A particular concern is that competition will aggravate the perennial problem of overindebtedness as lenders compete for loan business among the financially illiterate or those less able to pay. Lloyd Borerwe, CEO of Microcred Zimbabwe, said that “increased competition stemming from new entrants, traditional and non-traditional players, will remain a cause for concern and will increase over-indebtedness in the short to medium term. Unless the sector develops and maintains high levels of discipline, prudent practice balancing growth and responsible lending, over-indebtedness will not be avoided.” One respondent suggested a code of conduct for digital banking.

“Established financial inclusion organizations are losing ground to new market entrants. New players often work with more cost efficient, digital business models and can rapidly reach a large number of clients. Due to their constantly evolving business model based on data generated through digital interaction, they can tailor their offering to clients and prospects quickly and efficiently. Incumbents often work with only basic IT infrastructure that cannot easily be scaled up or replaced.”

**Banker, Switzerland**

But a very large number of respondents stressed the benefits of competition: innovation, better products, better prices – arguing that the risks were manageable. Becca Spradlin, director of knowledge management at HOPE International in the US, said: “While competition is higher or lower depending on the country and region, it forces us to pursue a better strategy with a more intentional focus on clients, encouraging us to listen well to provide better services and customer care.”

## Competition- good or bad?





## 15. Client acquisition risk (-) Score: 6.04 (-)

*The risk that service providers will fail to acquire clients, for example, by misunderstanding their market, failing to reach customers through digital channels, or because of resistance to the formal economy.*

A new addition to this year's survey, the risk that service providers will have difficulty acquiring clients is on the whole lower order. But there were segments of the market where it was more of a concern: it was No. 4 in MENA and No. 7 in Latin America, as well as a top ten risk for regulators and industry observers.

Respondents made the point was that it is not acquiring clients but *retaining* them which is the bigger risk – for example, because initial sign-ups do not necessarily turn into usage, and encouraging client loyalty and regular use of digital financial services can be difficult. A third party service provider in the US said: “The data shows there is not a problem with more people getting banked. The problem is in the quality of the services on offer”. The managing director of an MFI in Tanzania said: “While technology might block MFIs from catching up with needs of the market, they can still manage to get sufficient numbers of clients”.

However, client acquisition is more of a concern in rural areas (see box) and at the bottom of the pyramid. An academic in Nigeria said: “There seems to be a concentration of providers in urban centres, leaving the rural communities to grapple with ill-suited products or to entirely abandon the system.” A banker in Zambia said: “Many service providers do not spend enough resources – in terms of time, research, and finances – to understand the lower end of the market.”

But while institutions' failures in this area were noted, the point was made that many clients are deeply resistant to formal financial services – and not unjustifiably. Tenie Eric Ouattara, managing director at FDH Bank Malawi, said: “The informal sector is still very important and is not moving easily and smoothly to the formal one”. Natalie Schoon, principal consultant at Formabb in the UK commented: “This is a market segment that has been turned down over and over again, and has a distrust of the financial services industry. The offering needs to be sound, and the provider will need to be patient and invest time in attracting clients.”

### **The “rational decision” to remain outside the formal financial system**

“In some areas of the world, access is no longer the primordial hurdle to financial inclusion. The rational decision to remain outside the financial system by low income populations is what results in low levels in use of already accessible financial products and services.

Financial inclusion should not be interpreted as an opportunity to tax the poor, obliging them to become formalized by opening mandatory accounts or eliminating cash. Financial inclusion is the result of giving low income populations the tools to become more productive so they can grow to the point where being informal is not efficient any longer. Many of the countries embracing digitisation of financial services are listed in the Doing Business index as requiring to pay taxes over 20 times, while some of those taxes apply to returns on savings or financial transactions. It is very risky to assume governments are always right, and poor people simply need to be educated. We should become more aware of the risks of applying digital models over very different tax, legal and regulatory frameworks in diverse countries.”

**Advisor to regulators, Peru**

## Difficulty of covering rural clients

## The rural challenge

Getting financial services out to rural areas poses a special challenge. The markets are remote, largely illiterate, subject to particular risks (such as weather and floods), and unattractive to financial services suppliers with short-term profit goals. As a respondent in Malawi pointed out, many people don't have electricity or even ID documents.

Although digital financial services offer new opportunities to reach and service these markets, the operating costs are high both because of high customer dispersal and the particular financing needs of rural communities. Another respondent said suppliers needed to understand "the rural psyche".

The risk is that the new wave of financial service supply will pass these communities by, leaving them as badly off as before. The fault may not lie with fintech so much as with governments which fail to supply the right environment and infrastructure. One respondent in Zimbabwe suggested that that a rural tax be introduced "to encourage microfinance banks driving the inclusive agenda."



## 16. Reputation (18) Score: 6.03 (5.95)

*The risk that the industry will suffer a poor reputation or lack of public trust.*

In spite of the negative publicity surrounding the microfinance industry in recent years, reputation risk remains low in the table. However, stark regional differences emerged: it was top ten among respondents in Latin America and North America & Western Europe, but bottom in sub-Saharan Africa by a long distance.

Among those who gave it a maximum severity score was Chuck Waterfield, a consultant in the US, who commented: "This is already an historical fact. The industry has already completely lost its positive reputation".

Some respondents worried that the reputation of the entire industry is being tarred by the actions of a few bad actors, especially because of the spotlight of social media. Antony Elliott, founder of the Fairbanking Foundation in the UK, said: "It is very easy to focus on any cases for which [the industry] has not worked and to create a view that exploitation is taking place."

But there was also widespread recognition that exploitative practices are damaging trust in service providers, exacerbated by a perceived lack of supervision, lack of transparency, and overindebtedness. Benoit Destouches, finance director at the Aga Khan Agency for Microfinance in Switzerland, said: "The sector may be facing reputational risks – and clients may be facing consumer risk – with the arrival of new entrants in the sector who may just be interested in short-term financial gains, at the expense of clients. Products may therefore be developed not necessarily for clients' benefits but rather for the service providers' benefits – or rather service providers may only be interested in developing products that benefit their income statement".

Respondents also observed that a poor reputation can have an increasingly material impact on institutions. One reason is that it is becoming easier for clients to switch away from service providers they are unhappy with. "People hate banks but have to use them. The emergence of alternatives is changing that", noted Neil Darke, CEO of The Lifehouse.Co in the UK. Another is that if the industry cannot prove its value, major donors or funders could pull away and lead others to do the same.

## Is trust at risk?

Why, then, is this risk not ranked higher? One reason is that it was very much downplayed by respondents in sub-Saharan Africa. A comment from Mozambique was: “It does not seem to be the case in the country – quite the contrary”, and from Zimbabwe: “Generally there is better appreciation and public positive perception of financial inclusion”.

Some respondents are seeing reputation as improving from its nadir. Gil Lacson, director of strategic partnerships at Women's World Banking, said: “I think the absence of scandals and scams since 2010 has brought the industry back to its 2006 glory days.” The investment director at a Canadian cooperative financial group commented: “We do recognise that some countries have experienced events that have damaged the sector, but we do not see this as the case everywhere”.

“The main problem I see it is how to raise trust/confidence among low income clients/users [of] financial services. Beneficiaries are quite reluctant to use new services as they have had bad finance experiences with moneylenders, microfinance institutions and banks. Due to high competition among microfinance institutions and the lack of knowledge among users about certain financial services, many of them are in a worse situation than they were before starting to use financial services such as credit. There is still a need to understand that a good financial decision is perhaps not a good emotional decision for beneficiaries and therefore when they take a decision that puts them in a worse situation than they were before, it is going to be difficult for them to trust again in financial products.”

**Felix Pindado Garcia, program coordinator, Guatemala**



## **17. Funding (19) Score: 6.02 (5.76)**

*The risk that service providers will fail to attract diversified sources of debt and equity.*

Although funding is not seen as a critical issue, its risk score has increased noticeably. The responses highlighted a number of areas where the risk of shortages or distortions could occur.

Funding is plentiful for service providers who measure up to the requirements of “impact investors”, i.e. who can demonstrate that they are making a profit as well as advancing the cause of financial inclusion. Providers who are moving into digital services also have appeal. And, as previously, size and local political/regulatory conditions play a role.

The more difficult areas are the traditional microfinance institutions, particularly those which rely on uncertain public sector funding and donations and hold little appeal for mainstream investors, as well as the smaller or new-style providers who have yet to prove that they can “scale up”. A project officer at an NGO in Luxembourg, said that “currently the availability of traditional donors is decreasing, which poses a risk for NGOs, especially those that depend greatly on donations. I think MFIs need to think more about impact investors and less about donors.”

Philip Brown, managing director, risk, at Citi, said funding risk was “quite low for seasoned names but more difficult for emerging names with non-traditional balance sheets and operating models that may not have access to debt financing.” Other

## **Plentiful?**

respondents felt that the growth of profit-oriented investors would accelerate an undesirable process of mission drift and divert funding away from social goals.

The primacy of scale and, particularly for fintechs, transaction volume will be promoted as more money looks for investments that carry an impact label. But scale, volume and indeed "inclusion" bear no necessary relationship to improving the prospects of low income, vulnerable and marginalized people. While an increasing proportion of the sector will meet investors' financial objectives, its social content will be no more or less on average than any other sector. Some people will think this is good, some people bad, but it is certainly not what motivated the creation of microfinance, financial inclusion and impact investing.

**Paul DiLeo, president, Grassroots Capital Management, USA**

However, the great majority of respondents believed that funding was not a serious problem – if anything there was too much of it. Titos Macie, chairman of Socremo in Mozambique, said: “If the board and the management are running the institution in a sound manner, [funding] should never be a problem, as it appears that there is plenty of it out there waiting to be invested in the microfinance industry.”



## **18. Service delivery risk (-) Score: 5.89 (-)**

*The risk that providers fail to deliver a successful service because of operating problems such as weak performance, poor partners and badly framed contracts.*

This was the only Banana Skin with an average score lower than six out ten. While operating problems were acknowledged, they were typically seen as an inevitable risk of doing business in these markets, and not getting more urgent.

A notable exception is partnership risk. As increasingly specialized players enter the financial inclusion business, the number and complexity of business partnerships is growing. Institutions could choose their partnerships poorly, for reasons such as insufficient due diligence or misaligned expectations. Olive Kabatalya, board member of UGAFODE in Uganda, said: “With digitisation and other forms of cost cutting and efficiency enhancement, partnerships are unavoidable. Once a process involves external partnerships, the risk of one or more partners failing a service provider will always be there. Good selection of partners is key in overcoming such challenges”. A consultant in Canada warned: “more players means more risk; every partner has their own agenda and it isn’t always transparent”.

Respondents also made the point that partnering with third party vendors requires stringent due diligence and the need to dedicate resources for ongoing management of these relationships – a cost which many service providers cannot afford.

But other operating problems such as weak performance and badly framed contracts were typically seen as concerns for individual institutions rather than the industry as a whole. Respondents said they “could cause disturbances, but not a full failure in delivering the necessary services to the clients” and “were just a medium risk where all other risks are foreseen”.

Matthew Sparkes, lead investment and risk counsel at Blue Orchard Finance, said: “Generally speaking, it seems that established traditional institutions, even weaker examples, still manage to deliver products to customers in a reasonably competent way. New technologies will create challenges, but it likely stands to reason that those successful in fintech will survive because they deliver products in an effective way. Whether that product is the right one, or the best one, is a different question”.

## APPENDIX 1: The Top Ten since 2008

2008	2009	2011
1 Management	1 Credit risk	1 Credit risk
2 Governance	2 Reputation	2 Reputation
3 Regulation	3 Competition	3 Competition
4 Cost control	4 Corporate governance	4 Corporate governance
5 Staffing	5 Political interference	5 Political interference
6 Interest rates	6 Inappropriate regulation	6 Inappropriate regulation
7 Competition	7 Management quality	7 Management quality
8 Technology	8 Staffing	8 Staffing
9 Political interference	9 Mission drift	9 Mission drift
10 Credit risk	10 Unrealisable expectations	10 Unrealisable expectations

2012	2014	2016	2018
1 Overindebtedness	1 Overindebtedness	1 Strategy	1 Technology risk
2 Corporate governance	2 Credit risk	2 Risk management	2 Strategy
3 Management quality	3 Competition	3 Change management	3 Political risk
4 Credit risk	4 Risk management	4 Technology	4 Credit risk
5 Political interference	5 Governance	5 Repayment capacity	5 Risk management
6 Quality of risk mgt.	6 Strategy	6 Macro-economic risk	6 Product risk
7 Client management	7 Political interference	7 Product risk	7 Governance
8 Competition	8 Management	8 Credit risk	8 Talent
9 Regulation	9 Regulation	9 Governance	9 Management
10 Liquidity	10 Staffing	10 Management	10 Regulation

Results are for *Microfinance Banana Skins 2009-2014* and *Finance for All 2016-2018*

The history of the top ten risks identified by the *Microfinance/Finance for All* surveys since 2009 shows important shifts in risk perceptions.

The first survey in 2008 was dominated by concerns over the quality of management and corporate governance in MFIs, while credit risk ranked down at No. 10; MFI borrowers paid their loans back. This was to change dramatically over the next two years. Growing concerns about the quality of microfinance lending propelled credit risk to the top of the list, where it stayed until 2011. By then, concern had crystallised around overindebtedness as the chief risk facing the sector. In parallel, concerns about the risk of political interference in the industry and its reputation rose into the top five.

Meanwhile worries about institutional weaknesses in MFIs persisted, with corporate governance and management holding their places in the top ten risks, and the quality of risk management becoming a prominent issue.

The rankings began to shift in 2014 when strategy risk made its first appearance, pointing to the changes that are now visible in the industry as it undergoes transformation into a more technology-driven financial inclusion business with a fresh set of risks.

## APPENDIX 2: The questionnaire

### Finance for All A CSFI 'Banana Skins' survey

Each year we ask practitioners and observers of the finance industry to describe their main concerns about the risks, or "Banana Skins", facing the business as they look ahead 2-3 years.

This survey aims to identify the risks to institutions which offer services to people and businesses who have only marginal access to financial services, or none at all, i.e. low income, self-employed individuals, micro and small enterprises.

#### 1. Who you are:

1. Name;
2. Email;
3. Institution;
4. Position;
5. Country where you are based
6. Whether you are willing to be quoted by name

#### 2. Please select what best describes your role in the industry:

1. I work for a banking institution.
2. I work for a mobile money provider or mobile network operator (MNO).
3. I work for a micro finance institution (MFI).
4. I work for a 3rd party service provider (agent, non-MNO mobile financial product provider etc.).
5. I provide support to service providers as a network/association.
6. I work for an organisation which regulates or supervises institutions which provide financial services.
7. I am an observer, academic or consultant.
8. I invest in service providers.
9. I support the provision of financial services through grants and technical assistance.
10. Other (please state)

#### 3. Please describe, in your own words, the main risks you see facing the sector over the next 2-3 years in the provision of financial services to low income clients

#### 4. Risks

Below is a list of potential risks to institutions. They are grouped into three categories: service provider, client, and business environment. Please rate the severity of each on a scale of 1-10 (1 being negligible, 10 being acute), and provide comments.

##### SERVICE PROVIDER

1. **Credit risk.** The risk that providers will suffer losses from lending to businesses and consumers who do not have the capacity or willingness to repay.
2. **Governance.** The risk that the boards of service providers will fail to provide necessary oversight and strategic direction.
3. **Management.** The risk that poor management in service providers will damage the business.

4. **Product risk.** The risk that service providers will fail to offer appropriate products to clients, for example because they fail to understand their needs.

5. **Risk management.** The risk that service providers will fail to identify and manage the risks in their business.

6. **Service delivery risk.** The risk that providers fail to deliver a successful service because of operating problems such as weak performance, poor partners and badly framed contracts.

7. **Strategy.** The risk that service providers will fail to stay relevant and competitive in a changing marketplace.

8. **Talent.** The risk that service providers will fail to attract and retain suitably qualified staff.

9. **Technology risk.** The risk that service providers fail to capitalise on new developments in IT, cannot effectively manage data, or suffer losses from IT mismanagement.

## CLIENT

10. **Client acquisition risk.** The risk that service providers will fail to acquire clients, for example, by misunderstanding their market, failing to reach customers through digital channels, or because of resistance to the formal economy.

11. **Client relationships.** The risk that growing remoteness between client and provider caused, for example, by automation, will lead to a deterioration in client relationships.

## BUSINESS ENVIRONMENT

12. **Competition.** The risk that excessive or insufficient competition will prevent healthy growth of the market.

13. **Crime.** The risk that service providers will be damaged by threats such as cyber attack, fraud, money laundering and tax evasion

14. **Funding.** The risk that service providers will fail to attract diversified sources of debt and equity.

15. **Macro-economic risk.** The risk that service providers and their clients will be damaged by trends in the wider economy such as inflation and recession.

16. **Political risk.** The risk that intervention by politicians will harm the sector and distort the market, for example through taxation, subsidy, rate capping etc.

17. **Regulation.** The risk that the sector will be hampered by a lack of appropriate supervision and regulatory coordination.

18. **Reputation.** The risk that the industry will suffer a poor reputation or lack of public trust.

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