Microfinance Banana Skins 2011

The CSFI survey of microfinance risk

Losing its fairy dust

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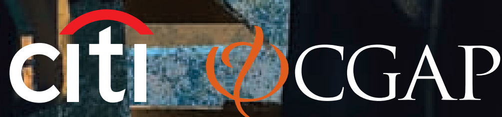

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Published by
Centre for the Study of Financial Innovation (CSFI)

Email: info@csfi.org.uk
Web: www.csfi.org.uk

ISBN: 978-0-9563888-6-5

Printed in the United Kingdom by Heron, Dawson & Sawyer

C S F I / New York CSFI

NUMBER NINETY NINE FEBRUARY 2011

Preface

THIS is the third "Banana Skins" survey of the global microfinance industry that the CSFI – primarily in the form of its Senior Fellow, David Lascelles with the assistance of Sam Mendelson – has prepared. Like its predecessors, it is funded by Citi and the Consultative Group to Assist the Poor (CGAP); we are very grateful to all of them.

In my opinion, this is by far the most interesting – and important – of the series. The reason is simple: Until very recently, scarcely a voice was raised against microfinance. It was regarded by governments, by academics and, increasingly, by the wider public as an unalloyed public good – and its most public face, Grameen's Mohammed Yunus, received a well-deserved Nobel for his efforts. The only problem was one of scale. How could the 'bottom-up' approach of microfinance (which depends on tiny loans to poor people in small communities) be replicated widely enough to make a significant dent in the global problem of poverty?

I still believe in microfinance – not least, because it seems to me unequivocally true that the conventional top-down aid model is broken. But things have certainly changed in the last couple of years.

As this report makes clear, a lot of people – well-meaning, thoughtful people, who are in or close to the microfinance industry – are now worried that microfinance has taken a wrong turn, that it has drifted away from its original mission, that it has been co-opted (or even corrupted) by the pursuit of size and profitability, that it has become a political plaything etc etc. This is new and, as David's report makes clear, it leaves microfinance and individual microfinance institutions at a 'tipping point'. Will the industry continue to evolve - to grow, to offer new products, to move up-market – until it is essentially indistinguishable from conventional financial institutions (banks, consumer finance companies etc)? Or will it rediscover its roots as a more modest source of small-scale credit to a relatively limited market amongst lower-income groups in generally poor countries?

Inevitably, some institutions will go one way, and others another – but it is clear that the sector as a whole is coming under much harsher scrutiny. After years in which, essentially, it got a 'free pass' from most donor governments and agencies (as well as from the authorities in the countries in which microfinance institutions operate), the climate has become very different – and a lot less forgiving. As our survey results show, concerns about reputation, competitiveness, governance, management competence and politicisation abound, and there is a high degree of cynicism about what motivates at least a sizeable chunk of the industry.

But don't throw the baby out with the bathwater. Many of the problems that the industry faces are just the products of its success; it is no longer beneath the radar, either domestically or internationally, and it must expect to be held to higher standards than it was in its earlier days. It remains one of the most promising vehicles for getting money to those people who need it most and who can use it most productively.

So let's hope that its current problems can be overcome, and that the next survey paints a much more optimistic picture. In the meantime let me restate my thanks to our friends at Citi and CGAP for their sponsorship, to Deborah Drake of the Council of Microfinance Equity Funds (CMEF) for advice and support, to the MIX for the data and to Zach Grafe whose management of the online questionnaire helped immeasurably with what has become far and away the biggest survey of its kind.

Andrew Hilton
Director, CSFI

This report was written by David Lascelles and Sam Mendelson
Cover by Joe Cummings

Sponsors' foreword

The Microfinance Banana Skins report, now in its third year, reflects changing perceptions of risk in a dynamic and fast-moving industry. This year's report shows that microfinance has come of age, and with that, new issues have arisen. In an increasing number of markets, the rapid rate of growth and outreach means that microfinance is confronting the same forces of competition, credit cycles, and consolidation seen in other sectors.

The survey mirrors this evolution, highlighting the need for increased focus on clients' needs and related credit risk, as opposed to institutional risks such as funding and liquidity. Responses also reflect an industry that is at different stages of development in different regions of the world. Microfinance is only reaching 150m borrowers worldwide - a fraction of the global need. More than 2.7bn people still have no access to formal financial services that are cheaper and more reliable than the informal alternatives.

In a few markets, particularly where many microfinance institutions serve the same communities, some respondents to the survey expressed concern about an oversupply of credit and over-indebtedness. In other markets, we see the emergence of deposit-taking institutions, credit bureaus, comprehensive regulatory oversight, and credit expansion accompanied by savings, insurance, and other services.

Reputation risk and political risk are both placed more highly in the ratings this year. Notwithstanding recent questioning of the ability of microfinance, and particularly microcredit, to lift millions out of poverty, microfinance remains central to achieving financial inclusion, by enabling families to manage their household finances more effectively - allowing them to build assets, smooth consumption, and insure against risk.

This year's survey also reflects an evolving microfinance industry. The volume of concern may be amplified by recent events in a few markets, notably in the Indian state of Andhra Pradesh. But the questioning is undoubtedly healthy, and should lead microfinance practitioners to reassess the business models, and the practices and products that will most effectively serve the needs of low income people.

In many markets, MFIs and investors have already taken notice of the changing risks. MFI growth has slowed, lending standards have been strengthened, and more attention is being given to social performance. In several countries, the rate of increase in non-performing loans at MFIs is easing and more sustainable growth models are emerging. Most regulators now acknowledge the valuable contribution that the microfinance sector is making to financial inclusion, and see it as part of their country's financial infrastructure.

But more needs to be done. The industry needs to accelerate reform to shore up support in the face of growing reputation risk. MFIs need to further strengthen their lending standards, particularly with regard to over-indebtedness among borrowers. And in many countries, improved regulation will be essential to achieve financial inclusion.

A vision of financial inclusion that encompasses the majority of the world's population goes well beyond what is captured in this report. But it is clear from the survey that the landscape of access to finance will look significantly different five years from now. As the microfinance industry continues to evolve, new players and new business models are emerging. The opportunity - and the need - is immense.

We are grateful to the 533 participants from 86 countries who contributed to the survey. We would like to thank David Lascelles and Sam Mendelson for distilling participants' feedback and presenting it in such a cogent manner. We thank Deborah Drake at the Council of Microfinance Equity Funds, Philip Brown at Citi Microfinance, and Xavier Reille at CGAP for their contributions to the success of this survey.

Robert Annibale
Global Director of Citi Microfinance

Tilman Ehrbeck
CGAP CEO

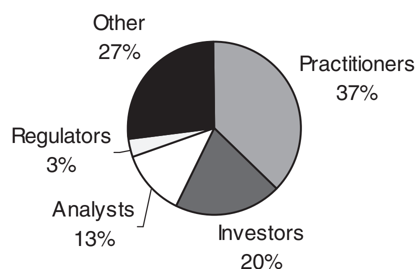
About this survey

Microfinance Banana Skins 2011 describes the risks facing the microfinance industry as seen by an international sample of practitioners, investors, regulators and observers. It updates previous surveys carried out in 2008 and 2009. This survey was conducted in November and December 2010 and is based on 533 responses from 86 countries and multinational institutions.

The questionnaire (reproduced in the Appendix) was in three parts. In the first, respondents were asked to describe, in their own words, their main concerns about the microfinance sector over the next 2-3 years. In the second, they were asked to rate a list of potential risks – or Banana Skins – both by severity and whether they were rising, steady or falling. In the third, they were asked to rate the preparedness of microfinance institutions to handle the risks they identified. Replies were confidential, but respondents could choose to be named.

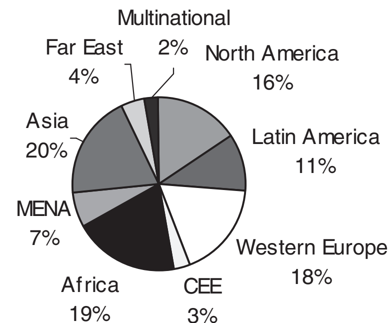
The views expressed in this survey are those of the respondents and do not necessarily reflect those of the CSFI or its sponsors.

The breakdown by type of respondent was as follows:



Just over half (55 per cent) of the practitioners represented deposit-taking institutions. The “other” category included aid officials, academics, accountants, lawyers, consultants etc..

The distribution of responses by region was as follows:



The responses by country were as follows

North America

Country	Responses
Canada	4
US	89

Latin America

Country	Responses
Bolivia	1
Brazil	2
Colombia	10
Costa Rica	3
Dominican Rep.	1
Ecuador	2
El Salvador	2
Guatemala	1
Haiti	3
Mexico	14
Nicaragua	2
Paraguay	5
Peru	7
Uruguay	1
Venezuela	2

Western Europe

Country	Responses
Austria	1
Belgium	4
Finland	1
France	16
Germany	10
Italy	3
Luxembourg	4
Netherlands	21
Spain	2
Sweden	1
Switzerland	7
UK	17

Central & Eastern Europe

Country	Responses
Azerbaijan	1
Bosnia & Herzegov.	5
Kazakhstan	1
Poland	1
Romania	2
Russia	3
Tajikistan	2

Africa

Country	Responses
Benin	5
Burkina Faso	4
Burundi	1
Cameroon	13
Congo Brazzaville	1
Côte d'Ivoire	7
Ethiopia	2
Gabon	2
Ghana	7
Guinea	1
Kenya	5
Madagascar	3
Mali	6
Mauritania	2
Niger	2
Nigeria	5
RD Congo	11
Rwanda	2
Senegal	7
South Africa	1
Tanzania	1
The Gambia	1
Togo	10
Uganda	6

Middle East & North Africa

Country	Responses
Egypt	8
Iraq	2
Jordan	3
Lebanon	4
Morocco	6
Palestine	2
Syria	1
Tunisia	1
UAR	2
Yemen	5

Asia

Country	Responses
Afghanistan	1
Bangladesh	6
India	82
Nepal	4
Pakistan	13
Sri Lanka	1

Far East

Country	Responses
Australia	3
Cambodia	2
China	4
Fiji	1
Hong Kong	1
Laos	1
New Zealand	2
Philippines	8
Vietnam	1

Country	Responses
Multinational	13

Summary

This survey explores the risks facing the microfinance industry at a time when hard questions are being asked about its future, prompted by growing doubts about its effectiveness as a source of small scale finance for the poor. One of our respondents summed up the significance of these doubts, saying they could "dissipate the fairy dust that has historically coated everything related to microfinance". Many of the risks explored in this report reach the heart of the debate about where microfinance goes next.

Originally created as a grass-roots movement to provide credit to the neediest, microfinance has grown enormously over the last 20 years and is now firmly established as a major supplier of a wide range of financial services to millions of people in the emerging world. The one thousand-plus microfinance institutions (MFIs) that report to the Microfinance Information eXchange (MIX) have 88m borrowers and 76m savers, and numbers are growing by 20 per cent a year, more in some countries. Total assets of these MFIs amount to $60bn.

Many of the risks go to the heart of the microfinance debate

However in the last two years, microfinance has found its enviable reputation under attack for a number of perceived reasons: its growing commercialism, as evidenced by an increasing focus on size and profitability, a decline in standards, particularly in the area of lending, and a sense that the industry may be drifting away from its original "double bottom line" purpose. All have combined to cast microfinance in a new and unflattering light, and have raised doubts about the continued willingness of donors and investors to provide the support it crucially needs.

How serious are these developments? What are the new risks that the industry faces? Is microfinance coming to a crossroads in its evolution, and if so, what should be its new direction?

The survey results

This survey, the third in the series, was conducted to seek answers to these questions and put the risks into perspective. Its focus is on MFIs with more than $5m in assets which are profitable and capable of commercial growth. These number about 600, according to estimates from MIX, and account for the bulk of microfinance assets globally.

The survey asked a series of experts on microfinance (practitioners, analysts, regulators, investors etc.) to identify and comment on the biggest risks, or "Banana Skins", which they saw facing the microfinance sector over the next two to three years. Over 500 of them from 86 countries took part, the largest response to any Microfinance Banana Skins survey so far. The table on p.6 shows how they responded: it ranks the 24 Banana Skins they identified both as to severity and how strongly they are seen to be rising.

The overall message from the survey is that the immediate risks posed by the global economic crisis have receded – but have been replaced by larger concerns about the future direction of the industry.

Microfinance Banana Skins 2011

(2009 position in brackets)

	Biggest risks		Fastest risers
1	Credit risk (1)	1	Competition (3)
2	Reputation (17)	2	Credit risk (1)
3	Competition (9)	3	Reputation (11)
4	Corporate governance (7)	4	Political interference (7)
5	Political interference (10)	5	Mission drift (13)
6	Inappropriate regulation (13)	6	Strategy (-)
7	Management quality (4)	7	Staffing (20)
8	Staffing (14)	8	Unrealisable expectations (17)
9	Mission drift (19)	9	Profitability (9)
10	Unrealisable expectations (18)	10	Inappropriate regulation (22)
11	Managing technology (15)	11	Corporate governance (12)
12	Profitability (12)	12	Management quality (18)
13	Back office (22)	13	Ownership (16)
14	Transparency (16)	14	Liquidity (5)
15	Strategy (-)	15	Product development (24)
16	Liquidity (2)	16	Macro-economic trends (2)
17	Macro-economic trends (3)	17	Managing technology (23)
18	Fraud (20)	18	Interest rates (10)
19	Product development (24)	19	Fraud (14)
20	Ownership (17)	20	Transparency (21)
21	Interest rates (11)	21	Back office (19)
22	Too much funding (25)	22	Too much funding (25)
23	Too little funding (6)	23	Too little funding (6)
24	Foreign exchange (8)	24	Foreign exchange (8)

The key finding of the survey is that **credit risk** constitutes the biggest threat to the industry over this turbulent period. Although this result is unchanged from the previous survey in 2009, the reasons behind it have shifted sharply.

Credit risk is still top of the list

The earlier result was largely explained by the difficulties facing borrowers during the economic crisis. This time, the reasons have multiplied. There is still economic stress, but also growing evidence of competitive pressures in the microfinance market, of poor credit management by MFIs, of greater cynicism among borrowers, and of increasing interference in the credit process by political forces. Above all, credit risk is seen to reflect the fast-growing problem of **overindebtedness** among millions of microfinance customers: poor people who have accumulated larger debts than they will ever be able to repay, often as a result of pressure from business-hungry MFIs. The potential for large microfinance loan losses is seen to be high in some markets, bringing a dramatic change to an industry which has always prided itself on its “99 per cent” repayment record.

Many of the top Banana Skins are linked to this finding. The surge in concern about **reputation risk** (up from No. 17 to No. 2) directly reflects view that MFIs have brought credit risk upon themselves through their aggressive lending and their desire for growth. This also accounts for the rise in the risk of **mission drift** (up from No. 19 to No. 9) because of the perception that MFIs are abandoning their commitment to poverty alleviation in favour of financial profit.

Another link is with the rise of **political interference** (from No. 10 to No. 5) as governments in some countries respond to the growing unpopularity of MFIs by imposing interest rate caps and encouraging repayment strikes. Although the current focus is on the Indian state of Andhra Pradesh where there have been severe political tensions over the behaviour of MFIs, the concern is that political risk is spreading.

A surge in concern about reputation risk

One of the major reasons behind MFIs' more aggressive approach to business is widely seen to be the intensity of **competition** in the microloan market (up from No. 9 to No. 3) caused by the ready availability of capital for MFI expansion and the entry of well-heeled commercial banks armed with mass marketing skills and new banking technology. At the same time, MFIs are seen to be institutionally weak in the areas of **corporate governance** (No. 4), **management quality** (no. 7) and **staffing** (No. 8), meaning that they may lack the resource and know-how to handle competitive pressures. A further contributor is **inappropriate regulation** (up from No. 13 to No. 6) which is failing to provide the right framework to keep MFIs on track.

The big movers

UP

Reputation: the good name of microfinance increasingly under attack
Competition: undermining business and ethical standards
Corporate governance: showing weakness under stress
Political interference: backlash against MFI lending practices
Inappropriate regulation: failing to provide a healthy environment

DOWN

Macro-economy: ebbing concern about the global crisis
Liquidity: cash shortages easing
Too little funding: investors returning to the market
Foreign exchange: "currency wars" not a major concern
Interest rates: lower and less volatile

Other areas of institutional weakness are seen to lie in the **back office** (up from No. 22 to No. 13) and the **management of technology** (up from No. 15 to No. 11), both of which may be contributing to the problem of imprudent lending through poor controls.

But a number of risks – mainly those thrust to the top of the rankings in the last survey by the global crisis – have fallen away quite sharply. **Liquidity** risk, which came No. 2 last time because of fears that MFIs would lose their access to working funds, has slumped to No. 16. In general MFIs, particularly the larger and healthier ones, are back in funds again. Similarly, concern about **too little funding** has subsided, down from No. 6 to No. 23. In fact, the only riser in this set of risks is **too much funding,** marking a return of concern that an over-supply of cash may fuel the risks of competition and overlending. Similarly, concerns about the state of the **macro-economy**, **interest rates** and the **foreign exchange** markets remain very low.

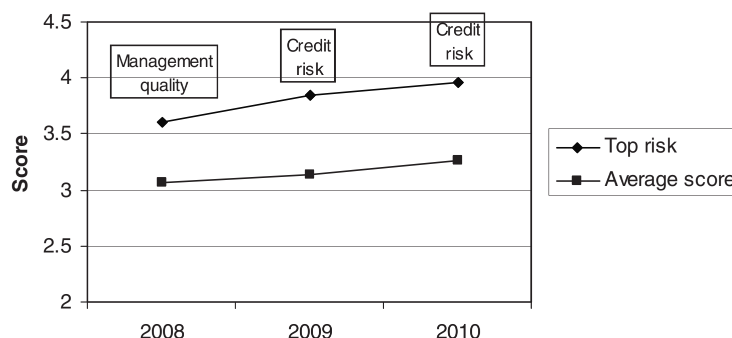
A breakdown of responses by type shows microfinance **practitioners** deeply concerned about the growth of credit and reputation risk which they see mainly caused by "unfair" competition and poor regulation. **Investors** in the microfinance industry have similar concerns, though they are also worried about political interference in the industry, and weakness in corporate governance. The main concerns of **regulators** lie in the areas of transparency, internal controls and the availability of funding. **Geographically**, credit risk, competition and reputation topped the concerns of most regions with the exception of Asia where the focus was on political risk. As in previous surveys, management issues ranked high in Africa.

Some risks are local, some global

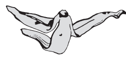
Global versus local. This survey also points up a distinction between risks that apply to the industry in general, and those that are more localised. The anecdotal responses show that credit risk is very widespread, gaining a mention in 75 per cent of respondent countries. The impact of competition is more localised, though it can usually be traced to similar causes: excessive funding and pressure from commercial banks. The risk of political interference is also local, but its impact is wide because of negative media coverage. Regulatory risk is local, though the industry suffers from the generalised perception that microfinance regulation still needs to be "fixed". Institutional issues such as management and staffing are local. Risks in the area of funding also depend on MFI type and location, though there is a new concern that global reputation risk could damage the microfinance "asset class" more widely.

How well prepared are MFIs to handle these risks? On a scale of 1 (poorly) to 5 (well), respondents gave a score of 2.7, which is slightly better than middling, with Latin America seen to be the best prepared and Asia the worst. Among respondent types, practitioners were the most optimistic and regulators the least.

The Microfinance Banana Skins Index provides a picture of changing "anxiety levels" in the microfinance business. The top line shows the average score given to the top risk over the last three years, and the bottom line the average of all the risks. Both lines show a clear worsening in sentiment over that time, and suggest that anxiety over the present ructions in microfinance is higher than it was over the global economic crisis.



Health warning. A number of points should be borne in mind when taking messages 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 sort, to focus on the negative and overlook the positive, of which there is still a lot in microfinance. Linked to this is the risk of generalisation: microfinance is an enormously varied business, and its condition differs greatly from one market to another. Nonetheless, the broad trends this report describes suggest that microfinance faces a very testing period.



1. Credit risk (1)

A STARK indication of the tests facing microfinance is the top position occupied by credit risk in this survey. For an industry which once prided itself on its enviable loan repayment record, the strength and persistence of this Banana Skin is a worrying trend.

Credit risk was top of the list in our last survey conducted in the depths of the 2009 economic crisis when, to some extent, it could be explained by the difficulties facing borrowers in a period of economic stress. But this time, the reasons for its high position have multiplied. There is still economic stress, but also growing evidence of competitive pressures, of recklessness among MFIs and their borrowers, and of interference in the credit process by political forces.

The breadth of concern about credit risk revealed by this survey is very striking. It was the No. 1 Banana Skin for all types of respondents except regulators who ranked it No. 2. Geographically it was a high level risk in all regions, suggesting that similar forces are endangering microfinance loan portfolios in many different markets.

Overindebtedness is becoming a bigger problem

Of these, much the most prominent is the problem of **overindebtedness**: large numbers of poor people who have accumulated bigger debts than they will ever be able to repay, with the prospect that MFIs will have to write them off and suffer heavy loan losses. This problem is now so broad that it has the makings of a worldwide social/economic phenomenon. Moses Ochieng, regional representative for CGAP/DFID in East and Southern Africa, warned of a possible "implosion of some of the key players" unless measures were taken to deal with it. A respondent from one of the large European funding banks said: "Increased delinquencies, program deterioration, damage to clients' well-being…We're seeing this issue crop up into too many markets."

Respondents identified many causes of overindebtedness. On the lending side, there is the intensity of **competition** in a business where growth is now a key objective for many MFIs. Elissa McCarter, director of development finance at CHF International in the US, said that "the tendency to focus on growth alone to generate the profits that shareholders anticipate has led to a weakening of microloan underwriting standards and greater risk of delinquency, fraud, and undercapitalised institutions that become exposed during crises".

This is leading to the problem of **multiple lending** (or, more strictly, multiple borrowing) when microfinance customers take advantage of competition among lenders and the lack of centralised credit information to tap many lenders at once. In Colombia, the managing director of an MFI reported that the number of micro-lenders to the average MFI customer had grown from 1.5 to 4, and that 75 per cent of MFI customers were borrowing from other institutions, mostly commercial banks which had entered the field.

Another reason is the **weakness of internal controls** at MFIs, poor incentive structures for loan officers, and misdirected management objectives. Edmond Atangana Evina of the ministry of finance in Cameroon said that in many cases "the failure of MFIs can be traced to enormous loans granted to clients, in breach of the checks and balances necessary to those institutions' survival". The need to **know your client** is an associated issue. Many respondents reported that loans were being made without proper credit checks or client information – and deliberately in order

to meet business targets. A UK-based consultant said that "many MFIs do not have a good understanding of the borrowers' financial position and repayment capacity."

Then there is **political interference** in countries where the lending practices of MFIs have come under public scrutiny, leading to officially inspired borrowing binges and repayment strikes. Although the Indian state of Andhra Pradesh is the specific focus of this concern, respondents identified many countries where this was a problem, including Nicaragua, Azerbaijan, and Bosnia and Herzegovina. In Rwanda, a banking regulator said that borrowers were developing "a culture of non-repayment".

Although some respondents stressed that the severity of credit risk differed greatly among institutions and markets, this Banana Skin looks set to be the dominant issue for the industry over the next few years.

How a borrower thinks...

P.N. Vasudevan, managing director of Equitas Micro Finance in India, described the mindset of many overindebted borrowers: "With more MFIs in operation, clients are getting more options to borrow, and since loans are unsecured, the tendency of most people is to borrow more than their immediate need and to justify it by saying that they will use it for some 'good' purpose, and that they cannot be sure it will be available later when they might really need it. This can destroy the borrower's family peace which is what MFIs are supposed to promote!"

2. Reputation (17)

NO SURPRISE that this Banana Skin has soared after the torrent of bad publicity surrounding microfinance in the world's media, and events in Andhra Pradesh in particular. Reputation risk is up 15 places from the last survey when only a few far-sighted respondents waved a red flag about the dangers of growing commercialism.

Microfinance's reputation 'will never be the same'

Microfinance is becoming a punch bag from all sides – accused of exploiting the poor with burdensome debt, of losing sight of its social mission, of putting profits before poverty reduction, and in AP most notably - though elsewhere too - of driving people to suicide through tough loan terms and strong-arm debt collection practices.

Gil Lacson, relationship manager at Women's World Banking, said that "the industry will face a huge reputational risk with the growing clash between opposing ideology and expectations. Is microfinance primarily about financial inclusion or poverty alleviation? Is microfinance primarily a business opportunity or a development intervention? Does microfinance really meet both financial and social return expectations? Is it an 'either or'? Or has microfinance many faces? Whatever the answers, the industry's reputation will never be the same".

Reputation risk has many angles. For some respondents, it is the **commercialisation of microfinance**, as seen in the growing importance of profit as a goal, and the high-value flotation of MFIs on the stock market. Last year's IPO of SKS, India's largest MFI, was a ready theme for respondents the world over. Some saw it as a watershed, drawing popular attention to the profits now being extracted from microfinance.

For others, it is **unethical practices** as evidenced by the huge growth in **indebtedness** among MFI customers, much of it the result of aggressive marketing of loans whose true cost is obscured. Michaël de Groot, regional director of the

Rabobank Foundation in The Netherlands, said that "top-end, commercially-driven MFIs and banks are becoming the new loan sharks". Raksa Pheng, business development manager at Visionfund in Cambodia, said that defaulters took to "running away from their homes. In some cases, I could see that they reduced their food to save money to repay their debts, or in others, they forced their children to drop out from school to find jobs to earn more income to support the repaying of debts".

Another symptom is the emergence of "consumer lending" as a prime product to replace the business lending for which microfinance was originally devised. Xavier Reille, manager at CGAP in France, said that "previously, microcredit was seen as a good thing and money lending as a bad thing. With the increased focus on short term profit in several markets, the lines are blurring and the reputation of the sector is tarnished. The onus is on MFIs to show that they are following responsible practices".

The industry faces the backlash

For others still it is the exposure of microfinance as "a sham", with its social *bona fides* no longer a given. Joachim Bald, a senior consultant at the Frankfurt School of Finance and Management, said that a backlash was now on the cards. "We tend to celebrate every overpriced small loan to poor people as a life-changing breakthrough in access to finance. But where is the evidence that microfinance borrowers on their tenth cycle are better off than their peers who did not have access to microcredit?"

The consequences of reputation risk are potentially severe. A US investor warned that "if studies continue to show that microfinance is 'not working' and if news stories of overindebtedness, client harassment, excessive riches and other bad behaviour continue to make headlines, the industry will lose the moral high ground, and with it donors, investors and talent".

The consumer lending boom

A big concern in the industry is microfinance's shift from tiny, uncollateralised business loans for micro-entrepreneurs - "microenterprise finance" - to general lending to the unbanked for consumption purposes. This is widely seen as evidence of "mission drift", and could harm the industry's reputation for poverty alleviation. It's happening for several reasons: competition from commercial banks, pressure for short-term profitability, and the frequently voiced need for "product development".

Chikako Kuno, director of capital markets at FINCA International, said: "There are reputational risks as new commercial entrants, attracted by the volume and profitability of microfinance, come in without a clear double bottom-line objective and blur the boundary between predatory consumer finance and true microfinance". Daniel Schriber, director of investment analysis at Symbiotics in Switzerland, thought that the move towards consumer lending constituted "a huge reputational risk for the whole industry".

3. Competition (9)

ALTHOUGH competition in the microfinance market can deliver benefits to customers in the form of keener pricing and better service, it is more often seen as something bad, creating instability and encouraging dubious practices. In line with earlier surveys, this Banana Skin is high on the list this year, and is seen as a rising problem because of the proliferation of microfinance providers in most markets.

Geographically, this is a widespread concern: it got a high ranking in most regions, and was also seen as a top level risk by respondent types, practitioners in particular.

Competition is seen as dangerous because it can cause market disruption, squeeze margins, and spur MFIs to take greater risks. Several respondents referred to competition as "unhealthy" and "unfair". In particular, competition is widely seen as the prime cause of irresponsible lending and **overindebtedness**. A respondent from the Philippines said that "the presence of too many competitors encourages some MFI staff to become lax in implementing policies rather than take it as a challenge to improve products and services".

Competition is eroding business and ethical standards

Competition is also squeezing **margins**. A microfinance banker in Ecuador complained that "prices are going down every year and everywhere", driven by new competitors "without knowledge". Jaime Nieto, director of treasury at Camesa in Mexico, said that markets in accessible areas were all "saturated" and suffering a "rate war". Others saw competition driving MFIs to reach into new and riskier markets in search of business. A respondent from Tanzania said that "as more players such as banks enter the industry, the tendency is to move towards untapped market segments about which is little is known".

Respondents also regretted that competition was encouraging MFIs to adopt **unethical practices** such as loan pushing, poaching clients and staff, and deceptive advertising. Vaidyanath Yerraguntla, a consultant at Coromandel Infotech in India, said there was "very high pressures on the field collection teams translating into 'loan-sharking' behaviour with the borrower/s".

A feature of competition is that it pushes MFIs to focus on parts of the market that are already well served and ignore those that are not, usually the neediest and those out in the country. A respondent from Colombia said banks were exhibiting "herd behaviour" and concentrating "on areas with good economic performance with aggressive credit offers".

The reasons for greater competition include the **ready availability of funding** to expand capacity, and the **downscaling by large banks** into the microfinance market, a trend that is visible in most regions. Other competitive threats come from subsidised government lending programmes and, increasingly, from telecoms companies able to access the market through branchless banking. Hans Boon, managing director at Postfinance International Development in The Netherlands, said that "new scenarios of 'branchless' banking with larger banks downscaling via mobile and internet technology and franchise formulas for agents could heavily impact existing MFIs".

But others saw competition as a good thing because it put MFIs on their mettle. A US consultant said that competition "could be a net positive as MFIs are forced to be more innovative and provide higher customer service. Most MFIs know how to handle this but I am sure some markets will be overheated and get carried away".