

Microfinance Banana Skins 2008

Risk in a
booming industry



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Preface

The fact that the CSFI was asked to stretch its well-established *'Banana Skins'* brand from banking to insurance and now to microfinance illustrates just how seriously microfinance is being taken these days. It has moved out of the fringes (which is where it was when we published our last report on the subject, in February 1998¹) into the mainstream – at least into the developmental mainstream. When he came to talk to us ten years ago, Grameen's Mohammed Yunus was viewed by many in the financial sector as a marginal figure, preaching to the sceptical; now, he is a Nobel prize-winner and global celebrity, right up there with Bono and Bob Geldof.

But (slightly to my surprise) it seems that the fundamental questions about microfinance remain unanswered. Is it (actually or potentially) an investible asset class into which rich country investors can put their savings with a reasonable hope of a decent return? Or is its real role as a 'bottom-up' alternative to the 'top-down' development model that has long dominated conventional development thinking?

When the Centre first looked at microfinance, we were hoping we could make the case that it would quickly become a self-sustaining asset class in which rich-country pensioners could invest their savings, thereby driving a virtuous cycle in which Western investors could 'do well by doing good'. Unfortunately, with a fairly small number of exceptions, that proved to be too ambitious – it probably still is, though the number of exceptions has certainly grown. In many circumstances, microfinance still needs a helping hand – cheap money, free money, technical assistance, some degree of regulatory forbearance etc. That doesn't deny that some, perhaps many, microfinance institutions are now investible; it does mean that one ought to look also at the developmental rationale for supporting microfinance.

A major appeal of microfinance is that it is a 'bottom up' approach to development, very different to the traditional 'top down' approach that dominated academic thinking for many years. The advantages of this approach are real: whatever its shortcomings, microfinance does ensure that more of the 'development dollar' gets spent at the local or village level than has historically been the case. However, there is a price for that – not least the problem of scalability. How can one build a microfinance infrastructure that can deliver anything like the same amount of aid as does the conventional approach?

This report doesn't address the scalability issue directly, but it does make a number of salutary points that promoters of microfinance need to bear in mind. In particular:

- With the notable exception of Africa, the perception is that a shortage of funding is not a problem for the microfinance industry at the present time. Indeed, too much capital is probably a bigger problem than too little in that it may drive standards down.
- The two biggest problems identified by respondents appear to be growing competition as new players enter the industry, and management quality/corporate governance. Complaints about competition may just be special pleading by incumbents; management skills are obviously in short supply in most of the countries where microfinance can play a role.
- Government often does not help. It is widely felt that regulation is frequently inappropriate, and incentives can be perverse. There can also be (surprise) political interference.
- There appears to be a temptation towards 'mission drift'. We noticed this a decade ago, when it seemed that half the microfinanciers in the world really wanted to be full-service bankers. Now, many of them seem to be shifting from serving the poor to flogging high interest rate consumer finance products. The profits may be more attractive, but the mission has changed – with a potentially adverse reputational impact.

¹ Peter Montagnon: *'Credit where Credit is Due: Bringing Microfinance into the mainstream.'* CSFI, February 1998.

I believe that this report – written by my colleague, David Lascelles, who has made the ‘*Banana Skins*’ patch his own over the last dozen years – is genuinely important. It looks at microfinance from the inside, at what those who are most directly involved feel. It differentiates responses and respondents by their role within the industry and by geography. And it raises a number of warning flags that (to our knowledge) have not been raised before.

We are very grateful to all those institutions who made this report possible. In particular, our thanks go to our two main sponsors – Citi and CGAP (the Consultative Group to Assist the Poor). In addition, the Council of Microfinance Equity Funds (CMEF) and the Microfinance Information eXchange (MIX) provided important support. The report could not have been completed without the help of several individuals from our sponsors, notably Deborah Drake, Philip Brown and Xavier Reille. Finally, a word of thanks to Zach Grafe, who ran the Survey Monkey programme that enabled so many respondents from around the world to join in electronically.

Andrew Hilton
Director
CSFI

Sponsors' foreword

In 1998 when the CSFI issued its first Banking Banana Skins report, microfinance was still largely unknown and obscure, a niche-interest for government-sponsored donors. Today, a decade later, with a Nobel Prize under its belt, and with foreign capital investment at US\$1.5 billion a year, it's a dynamic field, with a slew of new and serious investors. Microfinance is exploding.

No longer the provenance only of NGOs offering microcredit to a limited number of entrepreneurs, the word 'microfinance' has entered the general lexicon. It no longer denotes just small loans for productive purposes. Today, it actually means, for many, retail banking for millions – potentially billions – of poor people.

This is the context in which the Citigroup Foundation and CGAP, a leading microfinance group housed at the World Bank, sponsored CSFI to write the inaugural Microfinance Banana Skins Report.

This report presents the findings of the first global industry survey on the risks affecting the growth and viability of commercial microfinance institutions. Our ambition is to raise awareness and engage investors, policy makers and microfinance institution managers on the perceived risks facing this new sector. While by no means exhaustive, the twenty-nine risks identified provide a faithful snapshot of the microfinance industry today.

None of the risks highlighted here are that surprising for a young, emerging industry that is expanding at breakneck speed. Nonetheless, we hope that by highlighting the perceived risks affecting the global growth of commercial microfinance the report will inject a dose of realism into the debate about the investment boom – and the (mis)perception that microfinance, which has enjoyed limited default history, therefore carries little or no risk.

The report is intended to distinguish areas where development is needed, particularly at an industry level, to keep things on track. It is notable that the report highlights the importance of qualitative variables, with Management Quality, and Governance topping the list of risks, and points to an old microfinance mantra: the need for increased focus on retail institution capacity building.

As sponsors of the report, we are grateful for the 305 industry participants from 74 countries who contributed to the survey and whose comments form the basis of the report. We would like to thank the CSFI and David Lascelles in particular, for producing such a coherent and engaging report. The Council of Microfinance Equity Funds was also an important project partner in this endeavour, and we are grateful to them for co-ordinating the Steering Committee's work. We would also like to thank the Microfinance Information eXchange (MIX) for their support in the survey design and outreach.

We hope that the Microfinance Banana Skins Report will be a valuable tool in charting the progress of commercial microfinance, highlighting the biggest and rising risk areas on the road ahead.

Bob Annibale
Global Director
Citi Microfinance

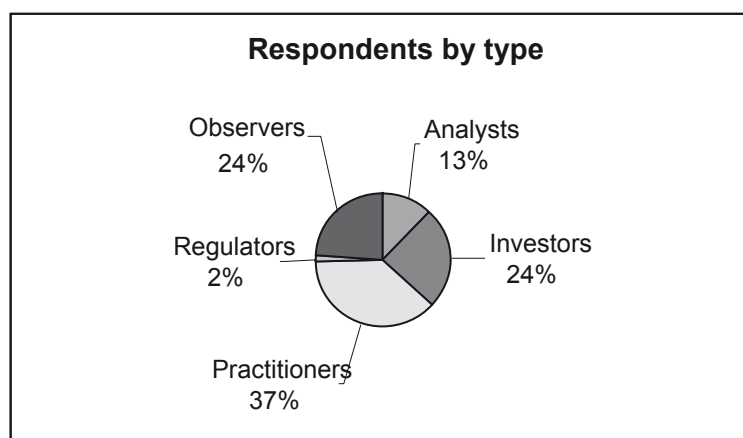
Elizabeth Littlefield
CEO
CGAP

About this survey

This survey was conducted in October and November 2007, and is based on 305 responses from 74 countries and multinational institutions. The questionnaire (reproduced in Appendix 1) 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.

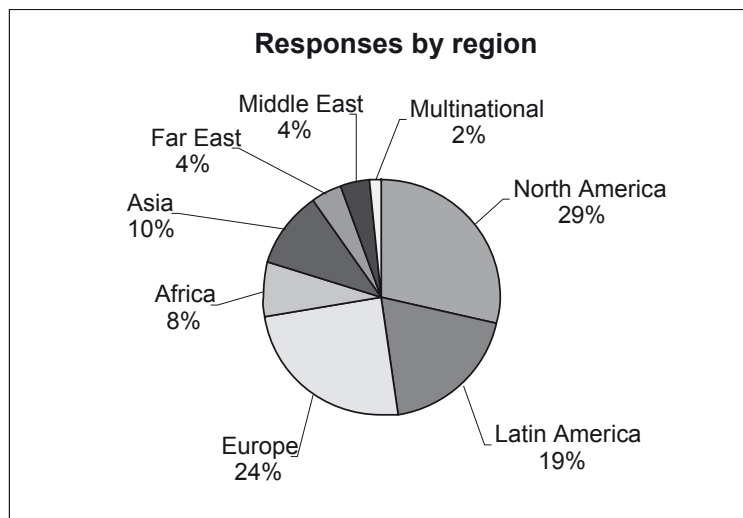
The views expressed in this survey are those of the respondents and do not necessarily reflect those of the publishers or sponsors.

The breakdown by type of respondent was as follows:



The “observers” category included aid officials, academics, accountants, lawyers, consultants etc. The “analyst” category included rating agencies, investment analysts, and those who compile statistical information on microfinance.

The chart shows the distribution of responses by region.



CSFI / New York CSFI

The breakdown by countries was as follows

Afghanistan	3	Ethiopia	2	Nicaragua	4
Africa	1	Finland	1	Nigeria	3
Albania	3	France	9	Norway	2
Angola	1	Germany	7	Pakistan	2
Argentina	1	Guatemala	4	Palestine	1
Aruba	1	Guinea-Conakry	1	Paraguay	2
Australia	1	Haiti	2	Peru	12
Azerbaijan	2	Honduras	1	Philippines	2
Bangladesh	5	Hong Kong	1	Romania	1
Belgium	2	India	13	Russia	3
Benin	1	Italy	2	Rwanda	1
Bolivia	5	Jordan	3	Slovakia	1
Bosnia & Herzegovina	7	Kenya	4	South Africa	4
Brazil	1	Kosovo	1	Sri Lanka	2
Cambodia	7	Kyrgyzstan	1	Sudan	1
Cameroon	1	Lebanon	3	Sweden	1
Canada	3	Luxembourg	3	Switzerland	8
China	1	Mexico	9	Syria	1
Colombia	5	Mongolia	1	Tajikistan	2
Costa Rica	2	Montenegro	1	Uganda	2
Denmark	1	Morocco	2	UK	11
Dominican Republic	2	Multinational	5	United Arab Emirates	1
Ecuador	5	Nepal	2	US	84
Egypt	1	Netherlands	10	Venezuela	2
El Salvador	1			Zimbabwe	1

A breakdown of countries by region is given in Appendix 3.

Summary

Microfinance Banana Skins 2008

Biggest risks		Fastest risers	
1	Management quality	1	Competition
2	Corporate governance	2	Staffing
3	Inappropriate regulation	3	Political interference
4	Cost control	4	Too much funding
5	Staffing	5	Credit risk
6	Interest rates	6	Strategy
7	Competition	7	Mission drift
8	Managing technology	8	Ownership
9	Political interference	9	Interest rates
10	Credit risk	10	Unrealisable expectations
11	Transparency	11	Reputation
12	Foreign exchange	12	Corporate governance
13	Unrealisable expectations	13	Managing technology
14	Mission drift	14	Fraud
15	Fraud	15	Natural catastrophes
16	Strategy	16	Cost control
17	Ownership	17	Management quality
18	Back office operations	18	Foreign exchange
19	Reputation	19	Product development
20	Liquidity	20	Profitability
21	Too much funding	21	Inappropriate regulation
22	Profitability	22	Distribution channels
23	Macro-economic trends	23	Liquidity
24	Product development	24	Macro-economic trends
25	Capital availability	25	Back office operations
26	Distribution channels	26	Transparency
27	Natural catastrophes	27	Refinancing
28	Refinancing	28	Capital availability
29	Too little funding	29	Too little funding

This survey explores the risks and challenges facing microfinance as a business and a social service at a time when the sector is undergoing profound changes.

Originally a small-scale, philanthropic movement to provide credit to the neediest, microfinance has grown enormously in recent years and is now firmly established as a major supplier of a wide range of financial services to millions of people around the world. The 1,200 microfinance institutions (MFIs) who report to the Microfinance Information eXchange (MIX) have 53m borrowers and 64m savers,

and numbers are growing by 25 per cent a year, more in some countries. Total assets of these MFIs amount to \$33bn.

However the sector is also undergoing great structural changes. Its success is attracting large volumes of outside investment, both official and commercial. According to research by the Consultative Group to Assist the Poor, the stock of foreign capital investment in the sector more than tripled to \$4bn between 2004 and 2006, much of it held by specialised microfinance investment vehicles, and much of it coming from the private sector.

Big structural changes...

Convergence is occurring between microfinance and mainstream banking as MFIs grow in size and sophistication, and commercial banks enter the market. These trends have boosted the size and quality of the microfinance sector, but also created new pressures of competition and sharper expectations.

How will these pressures affect the sector? What are the risks posed by rapid growth and change? What are the lessons to be learned by practitioners and those who invest in the business? This survey was conducted to seek answers to these questions, with a special focus on MFIs with more than \$5m in assets which are profitable and capable of commercial growth. These number about 350, according to estimates from MIX, and account for the bulk of microfinance assets globally.

The survey asked respondents to identify and comment on the major risks, or “Banana Skins”, which they saw facing the microfinance sector over the next two to three years. More than 300 people responded from 74 countries. The table shows the ranking of the 29 Banana Skins identified by the survey.

The greatest risk facing microfinance is the **uneven quality of management** at MFIs at a time of rapid change. The survey reveals strong doubts about the ability of many MFIs to adapt to new demands while still retaining their social objectives. The industry is seen, particularly by investors, to be lacking in professionalism and management skills, though these deficiencies are not generalised and are being addressed in many parts of the world.

Closely linked to management is concern about the quality of **corporate governance** (No 2) and **staffing** (No 5) in MFIs, both of which are seen to be weak and a drag on development. High among management concerns are **poor cost control** (No 4) due to lack of commercial awareness, and **managing new technology** (No 8), often the key to raising business efficiency.

...are throwing up new risks

A further obstacle to progress is the existence in many countries of **inappropriate regulation** (No 3) which prevents MFIs from adopting a more commercial form, or forces them to change against their will. A related concern is the unwelcome growth of **political interference** (No 9) by governments who want to control interest rates and influence lending. Respondents reported cases of populist governments encouraging borrowers not to repay their loans.

The rapid growth in **competition** (No 7) in the microfinance market, both from new entrants and among MFIs themselves, is a high level concern among practitioners, though it is viewed by investors and analysts as a necessary, if painful, force for good. Although competition is stimulating greater efficiency and innovation, it may also lead to an erosion of business standards, in particular to higher **credit risk** (No 10) as MFIs cut corners to sustain loan volumes. Both these risks are seen as fast risers.

The problem is too much funding rather than too little

Market risks such as **interest rates** (No 6), **foreign exchange** (No 12) and **macro-economic trends** (No 23) are moderate though, in the case of interest rates, rising as more MFIs become integrated with mainstream banking.

The survey revealed strong concerns about the hype surrounding the industry, and the risk that it may fall foul of **unrealisable expectations** (No 13) both as to social goals such as poverty alleviation, and commercial ones of investment returns. Many MFIs face what they see as conflicting pressures to deliver equally on both, but since commercial demands tend to win out, this leads to **mission drift** (No 14) as they get pushed off their social course. This in turn heightens **reputation risk** (No 19) with accusations that microfinance is failing in its social objectives.

The survey showed that the availability of **funding** (No 29) and **capital** (No 25) is not seen as a major problem for the industry as a whole, though regional breakdowns revealed shortages in Africa particularly, and in Asia. In fact, the problem is the opposite one of **too much funding** (No 21) because microfinance is very much in vogue among investors. Respondents said that this flood of investment is adding to the problems of rising competition, falling standards and mission drift, and could heighten **refinancing risk** (No 28) if microfinance falls out of fashion.

How well prepared are MFIs to handle these risks? Just over a quarter of the respondents thought they were well prepared with good management and sound strategies. Only five per cent thought they were poorly prepared, usually because they lacked management skills or sound funding. Over two thirds gave a mixed response, mainly because they differentiated between large MFIs which were on the whole better prepared than small ones, or because they saw some countries offering a better operating environment than others.

Many respondents felt that present trends of competition, commercialisation and growing dependence on management and technological skills would widen the gap between MFIs that were well prepared and those that were not.

Who said what

Practitioners

Biggest	Fastest risers
1 Competition	1 Competition
2 Cost control	2 Mission drift
3 Inappropriate regulation	3 Credit risk
4 Interest rates	4 Political interference
5 Credit risk	5 Staffing
6 Mission drift	6 Strategy
7 Management quality	7 Managing technology
8 Managing technology	8 Ownership
9 Staffing	9 Interest rates
10 Corporate governance	10 Management quality

The biggest concern for microfinance practitioners is the rise of competition from new entrants, which they see putting downward pressure on standards and squeezing margins. Key management challenges of cost control, credit risk and technology are also high on the list, as are people issues such as management quality and staffing. Inappropriate regulation is a widespread concern. A fast-rising risk for this group is mission drift: the danger that MFIs will be driven away from their original social purposes by commercial interests.

Analysts

Biggest	Fastest risers
1 Corporate governance	1 Competition
2 Management quality	2 Too much funding
3 Interest rates	3 Interest rates
4 Managing technology	4 Unrealisable expectations
5 Unrealisable expectations	5 Natural catastrophes
6 Mission drift	6 Strategy
7 Inappropriate regulation	7 Staffing
8 Ownership	8 Managing technology
9 Strategy	9 Mission drift
10 Transparency	10 Foreign exchange

Analysts of the microfinance sector focused on the control aspects of MFIs: the quality of management, corporate governance, strategy and transparency. They see the biggest risks in the rise of competition - both among MFIs and investors - and a greater exposure to interest rate pressure. Generally, their interest lies with the longer term issues of MFI development such as regulation and ownership rather than with short term issues of credit risk and profitability. They were particularly concerned that microfinance might not be able to meet high investor expectations.

Investors

Biggest risks	Fastest risers
1 Management quality	1 Too much funding
2 Corporate governance	2 Competition
3 Foreign exchange	3 Political interference
4 Inappropriate regulation	4 Reputation
5 Staffing	5 Staffing
6 Too much funding	6 Credit risk
7 Political interference	7 Unrealisable expectations
8 Managing technology	8 Strategy
9 Interest rates	9 Ownership
10 Unrealisable expectations	10 Interest rates

Investors were interested in the control aspects of MFIs – governance, management, staffing - and in broader issues of competition and political interference. As dollar investors, mostly, they are also sensitive to foreign exchange risk. One of their sharpest concerns is with competition from other investors: they see excessive funding as both a high and a rising risk. Their relative lack of concern with issues such as profitability suggests that they are taking a longer term view of the challenges facing the industry.

Observers

Biggest risks	Fastest risers
1 Corporate governance	1 Competition
2 Staffing	2 Staffing
3 Management quality	3 Ownership
4 Transparency	4 Corporate governance
5 Inappropriate regulation	5 Political interference
6 Interest rates	6 Strategy
7 Competition	7 Interest rates
8 Cost control	8 Reputation
9 Managing technology	9 Too much funding
10 Strategy	10 Unrealisable expectations

Observers of the microfinance scene (consultants, academics, regulators, lawyers etc) see the main risks lying with internal control issues: corporate governance, staffing, management, transparency, cost control and strategy. They see external risks in inappropriate regulation, pressure on interest rates and rising competition. A growing concern is the rise of political interference and reputational risk, particularly if MFIs fail to deliver on public expectations. They are less concerned than other groups with the problems posed by excessive funding.

North America

Biggest risks		Fastest risers	
1	Corporate governance	1	Competition
2	Management quality	2	Too much funding
3	Inappropriate regulation	3	Unrealisable expectations
4	Staffing	4	Reputation
5	Transparency	5	Political interference
6	Interest rates	6	Staffing
7	Unrealisable expectations	7	Ownership
8	Foreign exchange	8	Interest rates
9	Back office operations	9	Strategy
10	Managing technology	10	Mission drift

Respondents from the US and Canada, who included a large proportion of investors, saw the greatest risks lying in the areas of management of MFIs: corporate governance, management quality, staffing and transparency. They saw external risks in inappropriate regulation and market pressures such as interest rates and foreign exchange. They also focused strongly on the risks to MFI reputations from excessive public expectations and the danger of mission drift, both of which raised the danger of greater political interference.

Latin America

Biggest risks		Fastest risers	
1	Competition	1	Competition
2	Interest rates	2	Political interference
3	Political interference	3	Strategy
4	Inappropriate regulation	4	Credit risk
5	Cost control	5	Interest rates
6	Credit risk	6	Natural catastrophes
7	Capital availability	7	Foreign exchange
8	Profitability	8	Staffing
9	Product development	9	Ownership
10	Managing technology	10	Fraud

Latin American respondents, who were mostly practitioners, focused closely on external factors bearing on their business: competition, regulatory and political pressures. Their high concern with interest rates reflected the growing commercial pressures to which they feel exposed. Their internal concerns were with improving the quality of the business through better management of costs and credit, by raising profitability, and by expanding the range of products they offer. This group also showed concern with the rising risk of fraud.

Europe

Biggest risks		Fastest risers	
1	Management quality	1	Competition
2	Corporate governance	2	Too much funding
3	Inappropriate regulation	3	Credit risk
4	Staffing	4	Unrealisable expectations
5	Cost control	5	Staffing
6	Fraud	6	Interest rates
7	Managing technology	7	Political interference
8	Too much funding	8	Mission drift
9	Transparency	9	Reputation
10	Strategy	10	Corporate governance

European respondents, who consisted mostly of investors in West Europe and practitioners in East Europe, saw the greatest risks in internal management issues including corporate governance, staffing, cost control and strategy, though these were not necessarily seen to be the fastest rising risks. Concerns about inappropriate regulation were particularly strong in East Europe. The areas of rising risk are the growth of competition, both in business and funding. They also see rising risks in the areas of reputation and mission drift. This group showed a strong concern with fraud.

Africa

Biggest risks		Fastest risers	
1	Too little funding	1	Competition
2	Management quality	2	Corporate governance
3	Credit risk	3	Management quality
4	Managing technology	4	Managing technology
5	Inappropriate regulation	5	Staffing
6	Corporate governance	6	Distribution channels
7	Staffing	7	Product development
8	Cost control	8	Profitability
9	Profitability	9	Strategy
10	Strategy	10	Back office operations

African respondents consisted mainly of practitioners and members of aid organisations and NGOs. They were the most concerned of any group about the scarcity of funding for microfinance – in contrast to other regions which saw the risk lying in an overabundance. Management issues ranked high on their list, particularly staffing. Credit risk was also seen as a high level problem. African MFIs put profitability and cost control among their strongest concerns, and saw growing challenges in the areas of distribution channels and product development.

Asia

Biggest risks		Fastest risers	
1	Managing technology	1	Competition
2	Management quality	2	Staffing
3	Corporate governance	3	Credit risk
4	Staffing	4	Mission drift
5	Competition	5	Strategy
6	Mission drift	6	Interest rates
7	Fraud	7	Fraud
8	Reputation	8	Product development
9	Strategy	9	Managing technology
10	Credit risk	10	Corporate governance

The Asian response was strongly tilted towards practitioners who saw the biggest challenges lying in the area of management, particularly technology, and also staffing and corporate governance. The rise of competition is a top level concern. This group saw credit risk as a growing problem, as well as fraud. Reputation risk and mission drift were also among their worries. This group was less concerned than others with the problems of inappropriate regulation.

Far East

Biggest risks		Fastest risers	
1	Foreign exchange	1	Competition
2	Unrealisable expectations	2	Ownership
3	Cost control	3	Credit risk
4	Competition	4	Distribution channels
5	Inappropriate regulation	5	Mission drift
6	Management quality	6	Political interference
7	Political interference	7	Staffing
8	Credit risk	8	Too little funding
9	Natural catastrophes	9	Management quality
10	Mission drift	10	Managing technology

Respondents from the Far East included microfinance practitioners, investors and NGOs. Their response was very different from other regions. It showed a stronger concern with operational issues such as foreign exchange risk than with the management themes highlighted by other groups. Many MFI respondents felt they faced growing political pressure because of the excessive expectations that were placed upon them. This group also showed a high concern with the impact of natural catastrophes, not surprising given the number of recent disasters.

Middle East

Biggest risks	Fastest risers
1 Staffing	1 Competition
2 Capital availability	2 Mission drift
3 Competition	3 Staffing
4 Inappropriate regulation	4 Capital availability
5 Interest rates	5 Interest rates
6 Mission drift	6 Unrealisable expectations
7 Managing technology	7 Inappropriate regulation
8 Corporate governance	8 Political interference
9 Macro-economic trends	9 Strategy
10 Political interference	10 Credit risk

Middle East respondents, who were mostly practitioners, showed less concern than other groups with high level management issues, apart from staffing shortages which are a problem the world over. Instead they focused on the growing competition in their region for business and capital, and the risk that MFIs will be diverted from their missions by mounting commercial pressures. MFIs in this group feel vulnerable to growing political interference. They also felt the most exposed of any group to economic trends at the macro level.

A full breakdown of the responses by type and region is given in Appendix 2 on p 38.



1. Management quality

The uneven quality of management in microfinance institutions (MFIs) is the greatest risk facing the industry, according to respondents to this survey. In all the regions in which they operate, MFIs are being stretched by hectic rates of growth, by the growing complexity of their business, and by pressures to become more commercially-motivated. One respondent warned: “MFIs which lack management breadth and depth will remain higher risk institutions and are not likely to emerge as winners in an increasingly competitive environment.”

Concerns about management quality were strongest among investors and analysts of the microfinance sector (who placed this Banana Skin at No.1 and No.2 respectively) as opposed to practitioners who ranked it No 7. Julie Earne, an investment officer with the International Finance Corporation in South Africa, said there were “not enough good managers and a growing market.” Geographically, concerns were highest in Europe, North America, Africa and Asia. South America was least concerned, placing it No 16.

Managing change

The principal risk is overheating: high and unrealistic expectations for long term returns, excess investor liquidity and appetite, and a lack of clarity about the difference between mainstream investors and those with a social motivation.

Elizabeth Littlefield

Chief executive officer
Consultative Group to Assist the Poor

Much of the worry about management quality focused on the fact that MFIs tend to be dominated by “visionaries” who are strong on charisma but less so on management skills and strategic flexibility. Many respondents felt that MFIs risked getting trapped between their social and commercial objectives and succeeding at neither as the industry changed around them. A US practitioner saw MFIs having “difficulty in balancing

business and social missions, leading to tension, unclear focus, and inefficiencies in operations.” Several respondents felt that MFIs were not investing enough in MF management skills because the philanthropic culture of the industry emphasised dedication rather than professionalism.

This risk was closely linked to concerns about weak corporate governance (see No 2) and staffing (No 5).

However the risks of poor management are not seen as rising: this Banana Skin came only No 17 on the risers list. Indeed, many respondents saw it falling as the problem was increasingly recognised and tackled. Leonor Melo de Velasco, executive president of the Fundacion Mundo Mujer in Colombia, said: “It is being strengthened by training.” Another respondent said he had observed “a strong performance among MF managers who have ‘grown with their institutions’.”

MFIs with poor management could be the losers



2. Corporate governance

Poor corporate governance is seen an area of high risk, though more by investors, analysts and regulators than by MFI practitioners themselves. A Canadian development expert said that “lack of governance has been a major risk factor in

many MFIs and will continue to be an area of concern for the coming years”. The perceived trend in this risk is moderately upwards.

Investors were particularly concerned. “Too often, basic concepts of corporate governance are little known or neglected,” said Geert Peetermans, chief investment officer of Incofin in Belgium. At the end of the day, the risk is that MFIs will forego funding if they lose the confidence of their investors.

Shortcomings typically take the form of low calibre personnel, lack of experience, cronyism and poor transparency. Khirod Chandra Malick, chairman of the Bharat Integrated Social Welfare Agency in India, said this whole area “needs more professionalism.”

Many of these weaknesses have been shown up by the demands of commercial investors. But this discipline has also had the beneficial effect of forcing MFIs to raise their game. Hanns Martin Hagen, senior financial sector economist at the KfW Entwicklungsbank in Germany, said: “Many MFIs have opened up to outside private investors and now have a much more transparent corporate governance structure.”



3. Inappropriate regulation

Poor regulatory structures are blocking change in many countries

The lack of appropriate regulatory structures for MFIs in many parts of the world is a threat to their healthy development. Alejandro Soriano, deputy director of the Corporación Andina de Fomento in Venezuela, said: “Many countries do not progress due to the lack of prudential regulation”, a view which was widely echoed in Latin America, Africa, the Middle East and the Far East. A Cambodian respondent said the central bank was “too slow in regulating new areas that need urgent attention (savings, insurance, etc)”. Asia was the only region in which this Banana Skin did not feature in the top ten.

According to comments from respondents, inadequate regulatory structures are restricting MFIs’ operating freedoms and creating legal uncertainty, particularly by blocking their efforts to transform themselves from NGO status to fully-fledged banks, or alternatively by forcing them to make the change against their will (see box). A respondent from Angola said: “I believe that MFIs must be clearly defined within the legal framework to obtain the clear identity which is necessary in dealing with banks and other investors”.

At another level, respondents complained about the “hassle factor” of petty rules which looked like political interference in disguise. Money laundering regulations were a particular annoyance. Corruption, delays, and unnecessary cost were extra hazards. A US investor said that “the relative lack of sophistication and inconsistency of many regulators in sub-Saharan Africa is going to stifle growth”.

Poor regulation was attributed variously to incompetence, bureaucratic heavy-handedness, or simple failure to keep up with a fast-moving industry. In India, an investor said that it was clear that regulators “can afford to ignore MFIs – as they have done for years”, though this could not continue as MFIs became more important players on the financial landscape.

Despite the gloom, though, this was not seen to be a rising risk (No. 22), and several respondents saw improvements on the way with new legislation and stronger skills in the regulator.

The transformation challenge

One of the biggest challenges facing MFIs is to transform themselves from NGOs into commercial institutions, a task which is greatly complicated in many countries by unhelpful regulation.

The problem is particularly acute in Bosnia & Herzegovina where MFIs are being forced by a new microcredit law to transform themselves into institutions with profit objectives, regulated by the central bank. One practitioner from that country said: "The transformation risk will be very high for those MFIs which decide to transform themselves into for-profit companies because a company is a very different 'animal' from an NGO. There are associated risks such as management, governance, regulation and supervision, etc."

In Kenya, Phyllis Mbungu, CEO of the Small and Micro-Enterprise Programme, faced a reverse though not uncommon problem. Regulation of banks has been tightened up, and many smaller banking institutions are opting to become MFIs instead, adding to competition in the sector.



4. Cost control

"Most MFIs have never been good at controlling costs..."

This risk was particularly stressed by microfinance practitioners who put it No 2 on their list, with comments that stressed the need to keep a tight grip on spending. "Obligatory... more important than ever before... a matter of survival...the number one operational challenge for microfinance today." Geographically, concern was strongest in Latin America and the Far East.

But respondents recognised that it wasn't easy. A Scandinavian government advisor said: "Most MFIs have never been very good at controlling cost," because so much MFI work is labour intensive and requires strong management to stay within budget. Some respondents felt that MFIs lacked the discipline to keep costs down because they could easily pass them on to their customers through higher loan charges. The superabundance of capital also made life too comfortable. A practitioner in Albania said that the MFI business model "will need to change to lower the delivery cost of services."

Some MFIs operate in high inflation countries where cost control is specially difficult. Nkosilathi Moyo, a bank supervisor at the Reserve Bank of Zimbabwe, said that this was "a challenge in a hyperinflationary environment and also due to the fact that granting small loans is expensive".

This was not, however, seen as a strongly rising risk (No 16) because it was widely recognised and being acted upon.



5. Staffing

Staffing is a perennial and worsening risk for most MFIs. The growth in competition, poaching, the lack of training and rising salaries make this one of the most intractable problems in the sector.

Responses from all major regions told a similar tale of staff shortages holding back growth and service improvement. “A critical issue...a huge problem...human capacity is a key constraint” were among the comments made. The lack of locally trained staff to fill management positions is widespread. “MFIs are headed by amazing visionaries and leaders but lack the mid-management resources to scale up,” said one respondent.

Even when they are available, staff are hard to retain. Poaching is rife, particularly by well-heeled new entrants who can outbid the locals. Yousef Mousa Kandah, deputy general manager of the Ahli Microfinancing Company in Jordan, said that competition “will put us at risk due to the resignation of field loan officers who are attracted by banks entering the MFI business”.

Inadequate training is a serious bottleneck. An Indian investor saw a “lack of focus on quality and training of human resources, particularly at the field level, and on building a strong second/third line of management”. In Venezuela, Juan Uslar-Gathmann, president of BanGente microfinance institution, said that his bank had set up a training institute and opened it to the competition in order to address the staffing risk.

The staff requirements at MFIs are also specialised: they need people who are “dedicated” but also able to handle the new pressures on microfinance. A practitioner in Angola said “I strongly believe that the sustainability of MFIs greatly depends on the competence and efficiency of its personnel”. Practitioners saw all these pressures steadily driving up operating costs without delivering any improvements.

A perennial and worsening risk...



6. Interest rates

Two types of risk are identified here: market and political.

On the market side, many MFIs are protected from interest rate movements by the insensitivity of their borrowers to loan pricing, which can also encourage bad management practice. But as competition grows and clients become financially more literate this protection disappears, exposing MFIs to stronger interest rate pressures. Can they meet this challenge?

Respondents had their doubts. An Egyptian practitioner said that high interest rates “are covering inefficiency” and many other respondents thought that rates should be more market-driven to instil cost-awareness into MFIs. Bill Harrington, an advisor to the Mennonite Economic Development Associates in the US, said: “Competitive pressure to lower interest rates will hurt, but will benefit clients.” Another respondent pointed out that high interest rates merely attract “new profit maximizing players to a field that was never meant to be for ‘high profits’”. Several agreed that high loan rates bring in “the wrong type of competition”.

On the political side, high interest rates are catching the attention of politicians and provoking potentially damaging measures such as interest rate caps (see No 9). Greater competition among MFIs could avert this risk by forcing them to reduce their costs. Several respondents noted that interest rates on loans are already falling in some countries, for example in Latin America.

This was seen as a moderately rising risk (No 9).

The urge to merge

Over the next 2-3 year horizon, I believe the microfinance sector will undergo some consolidation, increased competition and deepen its market penetration. MFIs will need to do this not only to stay on the path towards profitable growth but, in many cases, to stay competitive.

Romi Bhatia

Vice president, International operations
Microfinance International Corp., US



7. Competition

Competition is rising strongly and having a big impact on the microfinance sector, though whether this is good or bad is an open question. Practitioners are the most worried about it: they put competition risk at the top of their list, notably in Latin America. But other respondents ranked it much lower, investors at No. 17 and analysts at No. 18. All groups, however, saw it strongly on the up.

The facts are that commercial banks, money lenders and consumer finance companies are taking advantage of low entry barriers to move into MFI territory with aggressive, well-funded campaigns, bringing market forces to bear on hitherto sacrosanct lending margins. MFIs are also competing more strongly among themselves.

The downside is that competition could undermine operating standards and erode profitability. A practitioner from Colombia saw “bad practices and greater risk” emerging in the sector. Many respondents felt that competition was destroying the social purpose of microfinance by choking off the supply of finance to the most neediest and encouraging overindebtedness in the creditworthy. A frequent complaint from Latin American practitioners was that new entrants were “prostituting” the market. One respondent from India blamed “unethical competition”. Ganhuyag Ch. Hutagt, CEO of XacBank in Mongolia, said that competitive pressures were “pushing MFIs out of their traditional market [with] abandonment of the poor as a result”. An African regulator described competition as “destructive”.

But many respondents saw competition as a good thing because it brought down loan costs and encouraged innovation. An investor in India saw it delivering “benefits to customers through lower interest rates and availability of loans”. And while competition might squeeze individual MFIs, it was good for the industry as a whole. An analyst in the Netherlands said: “The industry should start to see this as normal.”

Practitioners see competition as the greatest risk

Some respondents were more sanguine about the impact of competition, feeling that its harmful effects had been exaggerated by anxious MFI practitioners. A European aid official said: “Competition is not a risk - there are enough opportunities for all institutions.”



8. Managing technology

Although many MFIs do not have sophisticated technology, this is seen as a key area because of the industry’s need for good systems and cost control as it becomes more complex and profit-conscious. A US aid official said that “managing technology is a critical factor in separating the winners from the losers in an increasingly competitive environment.” An Indian investor said that the industry “needs to focus more on building in robust technology to meet the growing operational complexity with volumes and multiple products”. In Colombia, a practitioner said that the “viability of the low cost business model depends on technology”.

Cost was often cited as a barrier to getting the most out of technology, as well as a shortage of the right skills. A US analyst said: “There will be a temptation to invest in new technologies, though some may not be ready to recover the substantial costs of such an investment”.

Nonetheless this risk was not seen as a fast riser; indeed, many respondents were quite optimistic about it. An MFI consultant in Mexico said: “Technology is becoming increasingly attainable and more user friendly (cheaper ATMs, cell phone transfers, finger print signatures, etc)”.



9. Political interference

“The dark side of Nobel prizes...”

Governments are meddling more in microfinance markets, and putting new pressures on the business. One respondent said “This may be one the most significant areas of risk on the rise in the next 2-3 years”. Another described it as “the dark side of Nobel prizes...”.

F. Bakx, a programme manager at the Rabobank Foundation in the Netherlands, singled out “populist governments that wish to (mis)use microfinance institutions for their policies.” In Nicaragua, Armando Gutiérrez Navarro, general manager of the Prestanic MFI, said interference was on the rise with the recent change in government. Some respondents highlighted recent incidents in Andhra Pradesh where reports of hard-pressed MFI borrowers committing suicide prompted the state government to shut a number of MFIs down and regulate interest rates.

Political interference takes many forms: caps on interest rates, subsidies for government-sponsored institutions, directed lending, pressure to take on a social role such as job creation. It also corrupts the market. A respondent from the Dominican Republic said that populist attacks on MFIs had given borrowers the idea that they did not need to repay their loans. “There is no greater disincentive to the operation of an MFI than people understanding that they do not have to pay their debts.” A US respondent said that “if populists, demagogues and self-serving hypocrites impose interest rate regulation and other anti-competitive measures, the growth of the field will be stymied”.

However, the responses showed that this risk, while rising, is specific to particular countries. A respondent in Colombia said: “There is no interference here”. Some respondents even welcomed political interference, provided it was supportive and led to better regulation. A bank regulator said that without political interest in microfinance there would be no “conducive and enabling environment to allow growth in the sector.”

Borrowers hit back

What would happen if a campaign developed to support the cancellation of microfinance debt? Shortly after his arrival as the new and democratically elected head of state, the new president of Benin, and former president of the West African Development Bank, declared that microfinance loans were too expensive and incited borrowers to not pay them back. This declaration contributed to sending the local microfinance sector, which had been the best performing in West Africa, into a severe crisis.

Cyrille Arnould

Senior operations officer
European Investment Bank
Luxembourg



10. Credit risk

Credit risk is not traditionally seen as a major threat to the microfinance sector because the social sanctions against default in typical MFI markets are strong. In this survey, it appears only as a moderately high risk though, ominously perhaps, as one of the fastest risers, ranking fifth.

Our respondents identified many reasons for the rising trend. One is the growth in lending capacity which is leading to greater competition and through that to lower credit standards and tighter margins. A Mexican analyst warned: “As markets become increasingly saturated, the risk of default is rising.” A bank regulator from Central Africa noted “the high rate of non-performing loans to several MFIs” in her territory. Banks are also taking on greater risk by extending their reach into unfamiliar markets and new product areas.

A consequence of growing commercial pressure is the spread of overindebtedness as MFIs push more loans on to their customers. A respondent from a women’s bank in Colombia warned of “the high level of indebtedness in the microfinance sector.” Elizabeth Marinelli of Norfund in Norway said the greatest risk in the coming years was “potentially a lack of proper portfolio monitoring and provisioning”.

Some respondents noted that borrowers were getting the message about lower standards and had become more delinquent, running up debts to several banks at once. Group guarantees, traditionally the underpinning of individual creditworthiness, were also weakening. Philip Biswas, executive director of the Rural Reconstruction Foundation in Bangladesh, said “the main risk we are currently facing - and it’ll be critical in future - is the duplication of different MFIs in the same area with the same borrowers.”

Loan default is seen as a fast-rising risk

All this is taking place against a background in which credit assessment and portfolio management skills may be inadequate, where credit bureaux are lacking, and where legal systems may not aid the recovery of bad debts.

But improvement may be on the way. Eduardo Carlos Ferreira, executive manager of Microinvest in Brazil, said that “international best practices, microcredit tools and techniques have only been very recently and partially applied, and could improve and stabilize loan quality.”

Leaders and Luddites

The adoption of change is one of the biggest risks for any industry, and microfinance cannot be insulated from that. Will the current senior management react positively or negatively to the change required to manage a business, and one that is ten times its current size? There will be those who react brilliantly, and those who adopt Luddite attitudes. Either way there will be stresses, successes and failures.

Colin Howard

MFDAQ, The microfinance capital market, UK



11. Transparency

MFIs need to “dispel suspicion”

The risks associated with poor transparency in MFIs are high because it drives away investors and customers, and attracts unwelcome political attention. A practitioner in Colombia described this as “the great challenge” and an Indian investor said MFIs should act to dispel “suspicion about the sector”.

Several respondents from the investor side singled out transparency as a key risk, particularly the lack of standardised reporting structures and measurement tools. A director of a rating agency said “The sector needs more transparency and instruments to help investors assess risk”. Tracey Pettengill Turner, general manager of MicroPlace in the US, felt that transparency should be more widely cast to include financial performance, social metrics and mission statements to aid borrowers as well as investors. An African bank regulator said transparency should be extended to the pricing of products and services.

However, the risks of poor transparency are widely recognized, and many respondents said there had been a marked improvement in recent years, even if it had been uneven. Credit for this was given to investor pressure as well as to international accounting and governance initiatives, and to the growing role of rating agencies. An investor in India said that “the involvement of various stakeholders is leading to an improvement in transparency”, and an analyst in Mexico said that “accountability is rising as more international funds are used by various MFIs”.



12. Foreign exchange

An increasing number of MFIs face foreign exchange risk because they fund themselves in a non-domestic currency. Many of them do not have the means to protect themselves against currency volatility, notably against the US dollar in which most foreign funding comes.

Paul Hamlin, an advisor at ACDI/VOCA in Azerbaijan said: “Given increased volatility in almost all capital market components, foreign exchange risk will only increase as well.” A practitioner in Egypt said that MFIs “are lending in foreign currency assuming that they have no currency risk on the balance sheet, but their clients are exposed to this risk, which could affect their repayment capabilities.”

Some respondents blamed foreign exchange exposure on the shortage of local funding sources. A practitioner in Cambodia said that it was easier for banks there to lend in dollars than in local currency, and because of this the supply of small loans in riel or bhat was restricted. In Nicaragua, Gabriel Solorzano, president of Findesa, said there was “a need for more local currency funding.”

However a number of respondents saw local funding on the rise, and therefore reducing the risk of foreign exposure. One respondent noted that funding was increasingly available in Mexican pesos, Peruvian soles and Russian roubles. Technology and training are also strengthening MFI capability in this area. Heather Henyon, general manager of Grameen-Jameel Pan-Arab Microfinance in the United Arab Emirates said that MFIs in the Middle East and North African regions “have grown increasingly aware of their inability to manage forex risk, and have therefore decreased taking on funding in hard currency.”



13. Unrealisable expectations

So much is expected of microfinance that it could be riding for a fall. Gil Lacson, relationship manager with Women’s World Banking in the US, said: “With the amount of attention given to microfinance, it is easy for expectations to dramatically exceed delivery, possibly leading to negative consequences like ‘microfinance fatigue’”.

The risk lies on two fronts. One is that public expectations will be disappointed, leading to political and regulatory backlash. The other is that investors, drawn to microfinance by philanthropic or commercial motives, will become cynical and go elsewhere. Brigit Helms, a project manager with the IFC in Cambodia, said that “once many of the new players seduced into the sector (the Gates and the JP Morgans of this world, especially) realise that microfinance may not be able to resolve all the world’s problems as advertised, the disillusionment may cause them to withdraw their capital and support, to the detriment to the sector as a whole”.

The denouement could be even more dramatic: a few negative newspaper articles exposing mismanagement and corruption, or researchers producing evidence that microfinance is having minimal impact on poverty could severely damage the standing of the industry. Anne Hastings, director of Fonkoze in Haiti, said microfinance’s biggest risk was that it will “not be able to produce credible evidence that it does indeed reduce poverty.”

Many respondents said it was up to the industry to respond to these risks by stressing that microfinance was “not a panacea”, and by launching robust studies to measure the investment and social performance of MFIs.

Can MFIs match up to what is expected of them?



14. Mission drift

Mounting commercial pressures are pushing MFIs away from their original missions of poverty alleviation and financial inclusion. This is seen as a strongly rising risk in many parts of the world.

A respondent from Mexico said that “as microfinance becomes more lucrative, the initial objective of sustained socio-economic development is being brushed aside.” A practitioner in Haiti said that pressures from profit-seeking investors “will lead, little

Loans for jewellery and cosmetics

Microfinance is now seen as a highly profitable area in which to invest, forgetting/ignoring that the clients behind the "profits" are people from very low income sectors, living at the margin and using microloans as a way to improve their small incomes. This is attracting many new profit-seeking players with access to funding and technological advances that genuine microcredit players will find very hard to compete with.

These new players are inducing "the poor" to take out loans that carry very high interest rates for short term consumer purposes, rather than for productive activities which require serious loan repayment capacity and lower interest rates. Consumer loans are going to purchase luxury items such as jewellery, ornaments, perfumes and cosmetics, even "wellness" products that "poor women" sell to other "poor women".

In countries with large populations living below the poverty line (Mexico, Brazil, Argentina to name a few in this region) this consumer lending mentality will seriously threaten the performance of the microcredit sector and, more importantly, will produce clients who are unable to repay their loans, who end up in credit risk bureaux, and will never again have access to a loan. In the meantime, the new players will make enough profits so that, when the going gets tough, they will get out of the market and no one will care about the many who are left in "civic death" on the way.

Pilar Ramirez
General manager
Locfund
Bolivia

“The initial objective is being brushed aside”

by little, to MFIs putting profitability ahead of social development objectives”. In Syria, Namaan Adra, country manager of the Aga Khan Agency for Microfinance, feared that “due to pressure to be sustainable, MFIs will change their focus from poverty reduction to profit-making. This is compounded by the increase in competition from the commercial sector”. Prakash Raj Sharma, general manager of Nirdhan Utthan Bank in Nepal, said that “in the name of sustainability, some institutions are trying to make themselves more commercial...I think the challenge is to create a balance between a pro-poor system and commercialisation”.

This Banana Skin provoked dozens of passionate responses, most of which blamed return-hungry investors for turning up the commercial heat on MFIs. A respondent from India said investors were pushing MFIs to deliver “faster growth at the cost of sacrificing their reach to the underprivileged community.” Jerome Aba, a microfinance expert at PlaNet Finance in France, said that “too many financiers are imposing their *diktats* supposedly on the basis of ‘sustainability’”. Malcolm Harper, an independent researcher, said that microfinance was in danger of becoming “just another exploitative business which will continue the trend towards growing inequity, worldwide.”

The consequence is not just that MFIs are deserting their original social missions, but that they are being pushed into business areas where they may not have the right skills and management tools. This increases the risk of business failure. It also raises the microfinance sector's vulnerability to a change investment fashions. As many respondents pointed out, the flood of investment could just as quickly flow out again as investors pursue a new fad.



15. Fraud

MFIs are reluctant to share fraud experience

Responses to this Banana Skin had a resigned tone to them: “always with us, a natural business risk, manageable etc...” But a number of respondents felt there were worrying trends. Some commented on the growth of fraud by staff and white collar workers, others on the new possibilities for fraud opened up by MFI moves into unfamiliar markets or by the introduction of new but unreliable technologies.

Geographically, concerns about fraud were strongest in Asia. It was also a leading concern among investors in North America and Europe. One US investor felt the fraud problem was underplayed because MFIs were frightened of “airing their dirty laundry”. Their reluctance to share fraud experience meant that other MFIs were condemned to repeat their mistakes.

But many felt these concerns were overdone, and that the fraud experience of MFIs was not exceptional in the financial field. Better controls and a stronger anti-fraud culture were being introduced. A South African respondent said that fraud was being mitigated by “licensing, better governance and best practice organisations.”

The trust factor

The present situation looks 'too good to be true'. I sense that every day we are coming closer to a failing institution (too high portfolio at risk, or more likely, fraud). How will the market react to this? At the same time, every day without such an event confirms the trust people have in this sector, and the likelihood increases that they will stay on.

Els Boerhof
Manager
Micro and Small Enterprise Fund
FMO
Netherlands



16. Strategy

Weaknesses in MFIs' strategic planning are perceived to be only a middle level risk, but nonetheless a rising one (No 6) as the microfinance sector becomes more complex and competitive. Many respondents felt that strategy could soon become a survival issue.

Philippe Serres, network director of PlaNet Rating, said this was a major risk “given that many institutions simply do not know how to plan or are too ambitious”. Xavier Reille, manager with CGAP in France, saw MFIs suffering from a “lack of

awareness of competition and market developments”. A bank regulator said that MFIs “lack strategic imperatives”.

Some respondents felt that MFIs were too hooked on ideology when it came to strategic planning, and should be more open-minded. Elissa McCarter, director of development finance at CHF International in the US, said that microfinance had accumulated a very solid base of experience and had much to applaud, but “there is likely ‘more than one truth’...as it develops further!” A Swiss investor said that “those MFIs which position themselves in a mature market will be able to handle the challenges successfully”.



17. Ownership

As more MFIs make the transition from NGO-type organisations to commercial companies, potentially destabilising tensions are arising among the different types of owner. These surround key issues such as the nature of the MFI’s mission, the role of profit, whether to remain local or broaden out etc... Some respondents saw the problem in terms of founding owners trying to cling to their original missions, others in terms of new realities forcing MFIs to move with the times. This was seen as a rising problem in all regions.

Ira Lieberman, president of Lipam International and an advisor to microfinance funds, said that “new investors push the market too fast”. Yet Deborah Drake, vice-president of ACCION International, said that “‘founder syndrome’ continues to plague the NGOs transforming into regulated MFIs”. Another respondent said that “multi-stakeholder MFIs are still difficult”.

Some respondents saw the ownership issue in terms of a regulatory bias which forces new ownership structures on MFIs or makes it difficult for them to transform themselves into regulated entities. Bob Annibale, global director of Citi Microfinance, took issue with the view that MFIs needed to transform themselves into for-profit banks in order to succeed. In Bangladesh it was BRAC the NGO, not BRAC Bank, that completed an AAA rated securitisation “because of the quality of its management”.



18. Back office operations

Many MFIs lack the strong management and accounting systems which are necessary to control risk and keep costs down, particularly as they expand in size and complexity. In general, this was seen to be a middle level risk, but not on the rise owing to the amount of work that is being put into it.

Concerns focused particularly on larger MFIs which might be overwhelmed by rapid growth or which put back office upgrading too low on their list of priorities, though many smaller MFIs were also seen to be dangerously under-equipped. Howard Brady, president and CEO of MFI Resources in the US, said that “system providers are not doing a very good job of training and implementing systems, and MFIs are not willing to pay the costs of a good MIS. The result is systems that are inferior and are held together with frequent patches that create more problems”.

Maria Nerissa Cochingco, an MF consultant in the Philippines, said that “as the volume of transaction increases, systems fail to adapt most of the time”. C.O. Joby,

“Neglecting the back end...is not a healthy trend”

a manager with ICICI Bank in India, said: “The whole concentration right now is on expanding at any cost and being everywhere possible. This is not a healthy trend... neglecting the back end.”

Weaknesses were specially marked in India and Africa where respondents said that unregulated MFIs tended to put their faith in social networks rather than IT systems; this held back modernisation.



19. Reputation

Potential for backlash

The reputation of the microfinance sector looks vulnerable. Large profits, high interest rates and unfulfilled promises have attracted public interest and adverse publicity.

Gloomy responses on this issue tended to come from investors in the developed world rather than practitioners in the developing. An investor in the US said that microfinance’s image was threatened by “profits off high interest rates, misguided expectations and a lack of studies demonstrating the effectiveness of microfinance in

Reputation at risk

The unwillingness of larger MFIs (over \$10m in assets) to keep serving the poorer populations [would make] this industry solely a very profitable emerging market business.

Stephanie Cohn, Senior investment officer, PlaNet Finance, US

The extreme profits that many MFIs are generating through deceptive marketing of high-priced products will generate a backlash against the image of microfinance as a means to alleviate poverty. Microfinance could become synonymous with money lending if we don't fight for consumer protection.

Chuck Waterfield, CEO, MFI Solutions, US

Too much fragmentation leads to more opportunity for a small failure to taint the whole field of microfinance.

Michael Mainelli, Executive chairman, Z/Yen Group, UK

poverty alleviation”. A Dutch investor said that there was “potential for backlash”. Jeremy Leach, executive director of FinMark Trust in South Africa, saw the risk of “consumer and regulatory backlash against (a) compulsory financial products (eg credit life insurance) (b) high interest rates (c) sub-standard products (especially contractual savings products)”.

Reports from practitioners tended to be more upbeat. A Latin American respondent said that the reputation of MFIs was safe “so long as management was transparent and profitable”.



20. Liquidity

Liquidity risk comes relatively low on the risk scale because money was – at least until recently – plentiful and there were few cases of difficulty in the commercialised sector of microfinance. MFIs have also become, as one respondent put it, “more savvy” in the management of liquidity. Those MFIs making the transition to

banking status have gained access to wider funding options, while the emergence of liquidity facilities such as the Costa Rica-based Emergency Liquidity Facility has set an example that others might follow.

Some respondents thought the risk lay in MFIs failing to understand – as the world’s biggest banks also do – that liquidity has a nasty habit of drying up when most needed. Peter Wall, executive director of the Microfinance Information eXchange, said there was a risk “to the extent that domestic MFIs are linking in to today’s extraordinary international liquidity levels, and get used to these.” Liquidity risk could also rise as MFIs expand into more complex liability side products. One US investor warned that it would only take one default for MFI liquidity to be more widely affected.

Smaller MFIs face greater liquidity risks because of a lack of skills and restricted access to money markets, though their dependence on outside funding tends to be lower. There was little geographical variation in this risk.



21. Too much funding

An excess of funding can create as much risk as a shortage. The flood of money pouring into the MFI sector is stirring up irrational exuberance and undermining discipline. Though ranked low, this was seen as a strongly rising risk.

The profit imperative

The risk is that we fall short of the goal of mainstreaming microfinance into the banking sectors of poor countries, and create instead a social entrepreneurial space that produces programs that operate with minimal profits and no real market-making returns...This would retard the supply of the largest number of financial services to the broadest array of clients around the world.

US investor

Respondents feared that easy money would encourage uncontrolled growth and bad investment decisions. An investment officer with a G7 aid agency said: “This is increasingly becoming a critical issue. MFIs need the capacity to effectively deploy funds on a commercially sustainable

basis. If funders focus their attention on a small group of MFIs, there is a risk that these MFIs will lack the systems, technology, management capability and other resources to prudently deploy this capital.” Several respondents said this showed that the need was not for more money, but for a greater number of commercial MFIs.

Respondents were also concerned about the hype. Peter Platan of Finnfund in Finland warned that “a bubble might be growing.” John Wilson of Christian Brothers Investment Services in the US feared that imprudent lending would bump up defaults and “lead to a decline in confidence of the industry”. An analyst in India saw the boom leading to a bust which “could turn off the capital markets tap for some time, similar to what happened during the Asian crisis in the mid-90s”.

Excessive funding is also widening the tiers between the haves and the have-nots. Rakhat Uraimova, training and consulting manager at the Microfinance Center for Central and Eastern Europe and the NIC in Kyrgyzstan, said that the sector in her part of the world “will see a growing gap between very few large MFIs created and supported by international networks, donors and financial organizations, and emerging MFIs often created by new donor funding”.

Overfunding is a strongly rising risk

The risk also lies in the type of investor getting into microfinance. Matthew Gamser, principal operations officer at the International Finance Corporation in Hong Kong, said: “The quantity is not the problem, it's who is bringing the new money to the table, with too little understanding of the situation.”

But some respondents took issue with the fact that there was too much funding. A Colombian practitioner said: “No scenario exists with that type of funding supply.”



22. Profitability

“Profitable growth is only possible for the top 50-75 MFIs”

The profitability of MFIs is being squeezed by greater competition, though this is not seen as a risk everywhere. The picture painted by respondents was patchy with MFIs in some regions doing well, in others less so. Concerns were strongest in Latin America and Africa, followed by Asia.

One respondent said the sector was rich in “success stories” but Jan Lamboo, CEO of MFDAQ, the microfinance capital market, in Aruba, said that profitable growth was only possible for the top 50-75 MFIs. “Many of the other 3,000 MFIs need to upgrade in all managerial aspects in order to join the top.” A respondent from India said that “increasing competition leading to falling interest rates, compounded by rising costs, is leading to a drop in margins.” This sense of imminent profitability decline was widely shared.

The need for MFIs to focus more on profitability was a strong message. Andrew Pospelovsky, general manager of Microfinance Bank of Azerbaijan, said that “in order to ensure their long-term sustainability, MFIs have to ensure that they are profitable and commercially viable without any technical assistance or other

The Compartamos affair

Compartamos, the hugely successful Mexican MFI, is a living example that microfinance can be commercially viable. But has it done more harm than good?

Founded in the 1990s, Compartamos grew at breathtaking speed, achieving annual growth rates of 50 per cent and profits of \$50m a year. By the time it was floated on the public markets in April 2007, it had over 600,000 borrowers. The flotation valued the bank at over \$400m and made many of its shareholders millionaires.

But Compartamos also acquired a reputation for aggressive business tactics, charging its borrowers over 100 per cent a year, all of which made it highly controversial among our respondents.

Although many argued that MFIs must become more commercial, they feared that Compartamos had damaged the industry's image and stoked investor expectations up to unrealistic levels. A backlash might be in the offing. A US investor saw the danger of greater political interference “due to deals like the Compartamos IPO where super high profits are made on the back of very high interest rates.” Richard Rosenberg, a senior adviser with CGAP, said that the “disastrous publicity” generated by Compartamos showed that the industry needed to strike a better balance in its “double bottom line”.

But others drew encouragement from the strong commercial message in Compartamos. A South African analyst said that successful MFI flotations would attract private capital to the sector. “This is a good thing as long as it does not mean exploitation of the end client through very high interest rates. What the sector needs is more competition to keep services appropriate and affordable, but also profitable.”

subsidies”. A risk analyst in Peru said: “Whenever possible, and without affecting the soundness of the business, profitability should be as high as possible.”

But some respondents alluded to the Compartamos affair to warn against excessive profitability (see box). A respondent from Bolivia said: “The vision of quick profitability is the highest risk for this field.” The strength of feeling about the dangers of mission drift (see No 14) suggests that profitability needs to know its place.



23. Macro-economic trends

The localised nature of microfinance tends to insulate it from wider economic trends, and the evidence is that MFIs have weathered recent storms quite well. The growth of local funding sources has helped, and the low correlation with developments at the macro level has appealed to outside investors. But this could change as more MFIs move into the mainstream and expose themselves to forces beyond their control, such as the current global credit crunch.

Furthermore, MFI vulnerability to macro trends may not have been fully tested because many emerging economies are still strong and provide good conditions for profitable growth. This too could change. Chikako Kuno of the EBRD in London, said: “Countries are booming...[but there is a] need to manage for the eventual downturn.”

Marcelino San Miguel, president of Fundacion San Miguel Arcangel in the Dominican Republic, said that MFIs were only vulnerable to macro trends in the short term. “In the medium and long terms, MFIs operate in a market that depends more on microeconomic conditions than macro fluctuations, though macro trends affect everything ... But I do not believe that this determines the survival and operational management of a successful MFI.”

“There is a need to manage for the eventual downturn”

What about the global credit crunch?

Although MFIs are traditionally seen to be insulated from trends in global markets, that could change as they become more integrated with mainstream banking and therefore more vulnerable to “contagion”. Several respondents raised the risk that liquidity and investment might become harder for MFIs if global markets continue to deteriorate. A Canadian economist said that this “could have a direct impact on the cost of capital for microfinance institutions leading to a slow down in the growth of the sector.”

If MFIs suffer, they will also lose one of their investment appeals: lack of correlation with global markets. In this case they would have to find “other elements of attractiveness” to compensate, according to one MFI investor. Such a “dose of reality” might be healthy for an overfed industry, said another.



24. Product development

Competition is spurring new products

Despite all the calls for microfinanciers to expand their services, the responses to this Banana Skin suggested that MFIs are doing OK on the product development front. The great majority of our respondents felt that MFIs appreciated the need to widen their product range, and were able to deliver, whether it be more sophisticated loans, insurance, savings accounts or products targeted at particular groups. Competition was the spur.

A practitioner at a Latin American women's bank said: "MFIs understand the importance of having attractive products for niche markets." An investor in India said a lot of innovation was occurring "at various levels on introducing new types of products". An investor in the Netherlands said that "the trend away from 'credit only' is firmly underway".

But some respondents felt that MFIs were risking losing customers by failing to be more innovative. Perlat Sula, chief financial officer of Partneri Shqiptar ne Mikrokredu in Albania, said this was particularly the case in East Europe. Vanya Pasheva, a student of microfinance at MIT, said that MFIs would have to provide a more diverse product offering but "without losing efficiency and increasing transactions costs".

Those respondents who felt less positively about this topic stressed the high cost of product development and wondered whether MFIs had the necessary resources to fund it or were willing to spend money on market research. An Indian investor said that "serious investment has to be made in this area..."

One straw in the wind blew in from Russia where a respondent said that MFIs were experiencing a decline in demand for their services as the self-employed segment of the workforce advanced to become business owners with larger and more sophisticated needs.

Wrong money, wrong place

Although capital for microfinance is abundant, it does not reach everywhere.

Respondents' comments suggested that Latin America and the Far East enjoy more of it than Africa and Asia where a number of practitioners complained of sourcing difficulties. Teshome Dayesso, general manager of Buusaa Gonofaa MFI in Ethiopia, said that capital was scarce in countries like his "where the financial sector is not liberalized (no foreign participation) and banks are not yet convinced that MFIs are 'investment- or credit-worthy'". A bank inspector in Central Africa commented that "many MFIs don't have enough means to obtain the required minimum capital." Generally, access to capital was linked to size: smaller MFIs had greater difficulty than large ones.

The type of capital was also an issue. Debt financing tends to be plentiful, long-term equity financing less so. But equity financing comes with strings: it is expensive and carries high investor expectations. An Egyptian practitioner said commercial capital was available, but with it came "a push for commercialisation and higher profit margins." Lulzim Sadrija, CEO of Kreditimi Rural i Kosoves in Kosovo, complained of "the high interest rate of financial sources (9-12%)".



25. Capital availability

The availability of capital is not a widespread problem for MFIs. An analyst in Mexico said: “As microfinance becomes increasingly profitable and transparent, capital availability is rising,” a view that was widely reflected by other respondents who saw the problem more in terms of MFI ability to absorb a strong supply of capital. Timothy Lyman, an advisor at CGAP, said that “the flood of international capital, coupled with new domestic sources in many markets, means capital availability isn't the problem. In fact over abundance presents a much bigger risk”. A US investor thought availability would only be difficult if there were “some high profile failures or a public backlash against high interest rates.”



26. Distribution channels

Improvements in distribution channels are being driven by new technology such as cash machines and mobile phone banking, but also by the microfinance sector's mission to reach the financially disadvantaged.

Both of these drivers pose challenges which our respondents thought MFIs might be pressed to meet. One investor said: “Branchless banking and other technologies will hopefully bring delivery costs down, but this is very uncertain.” The difficulties lie in the cost of investment, the speed of change, the regulatory environment (often involving several different regulators, eg finance, electricity and telecoms) and simply getting it right. A Swiss investor agreed; there was “too little MFI retail capacity for the huge amounts of debt funding becoming available.” A particular challenge is getting distribution channels out to remote or poor areas which need the service but lack the infrastructure to support modern branches and technology.

Robert Akode, director of Papme in Benin, observed that a common problem in reaching the markets is that “the educational level of the customers is very low” and after sales service is non-existent. But as many respondents pointed out, those who do get it right should reap cost savings and competitive advantage.



27. Natural catastrophes

Many MFIs operate in risk-prone regions, and have been affected by climate change, earthquake and tsunami. Stephen Nnawuba, chief accountant of Centenary Bank in Uganda, commented on the difficulty of working in “the drought-stricken countries of Africa”.

The impact of catastrophe is not always direct physical damage. In the Philippines, Joy Cadangen, manager of Cadangen Lending, said that government and private sector lenders were imposing tougher terms on borrowers living in areas affected by natural calamities. Daniel Kalbassou, general manager of Credit du Sahel in Cameroon, said that “the draught in the Sahelien area is resulting in the non-repayment of loans.”

But can MFIs do more to protect themselves against these risks? A respondent from Colombia said that MFIs there were “not prepared or covered for such afflictions”. From Peru a respondent said MFIs should spread out more to avoid the risk of

Too little retail capacity to handle rapid growth

concentration. Several respondents pointed out that the risk can be mitigated by insurance or through use of the growing number of emergency funding facilities.

Generally, though, the incidence of natural catastrophes is seen more as a cost of doing business than as a major business challenge.



28. Refinancing

MFIs face the risk that they may be unable to renew financing commitments from their investors when these fall due. But this risk was generally considered to be small. In cases where donors might fall away, private capital was ready to step in, and where private capital was already there, it would renew its commitments for well-run and profitable MFIs. A Peruvian respondent saw difficulties “only in very special circumstances and with due process”.

However some respondents felt that MFIs could encounter problems if they drifted too far from their missions, or took on large amounts of term debt. A US aid official

warned: “It is very important that MFIs develop a funding plan that incorporates sufficient financial flexibility.”

A flight of fashion?

A heightened understanding of the causes and nature of poverty will lead to other development interventions replacing microfinance as fashionable.

Allan Bussard
Managing director
Integra Co-op
Slovakia

Microfinance is currently very much in fashion, which means it could face refinancing problems if investor interest moves elsewhere. A US investor warned: “right now microfinance is the hot new thing so the money is there...[but]...there will be a NEW hot

new thing soon”. A German practitioner agreed: “Microfinance is *en vogue* now - what happens if [international financial institutions’] interests shift to other sectors?”



29. Too little funding

Funding shortages are not a general problem...

If funding problems exist for MFIs, they are very selective. Respondents singled out MFIs which were small, unprofitable, unregulated or located in remote areas, or those with exclusive missions that were unlikely to become commercial. Some funding-starved institutions also operate in countries with inhibiting political or regulatory environments, particularly in Africa where large numbers of MFIs are “very small, non-viable and non-profitable” according to one respondent.

In Bangladesh, Moiz Ahmed Chowdhury, chief financial officer of the Shakti Foundation for Disadvantaged Women, said local MFIs had only “limited financial resources” to meet “unlimited client demand”. Due to this scarcity, he said, “many of our clients are leaving our organization”. A practitioner in Guatemala said that financial resources to take on more customers “will be limited”.

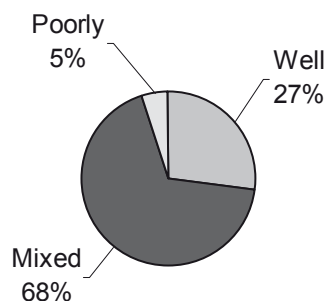
Several respondents also said that the overabundance of funding for top tier MFIs was not trickling down to tiers two and three, though this was often because MFIs were reluctant to come to terms with market forces or obtain credit ratings which might open the door to capital investment.

Gavin Oldham, chairman of The Share Foundation in the UK, said that funding shortages could be due to “too many intermediaries extracting value from investors and recipients.”

Preparedness

We asked respondents how well prepared they thought MFIs were to handle the risks they had identified. Just over a quarter thought they were well prepared with good management and sound strategies. Only five per cent thought they were poorly prepared, usually because they lacked management skills or sound funding. Over

Just over a quarter of respondents say that MFIs are well prepared to handle risks



two thirds gave a mixed response, mainly because they differentiated between large MFIs which were on the whole better prepared than small ones, or because they saw some countries offering a better operating environment than others.

The breakdown by type of respondent shows a quarter of practitioners and analysts thinking that MFIs were well prepared, but only a fifth of investors. Investors also led those who gave a mixed rating. Practitioners led the (small) number of respondents who thought they were poorly prepared.

Response by type of respondent %

	Practitioners	Investors	Analysts	Others
Well	25	20	25	37
Mixed	69	75	71	59
Poorly	6	5	4	4

Many respondents felt that present trends of competition, commercialisation and growing dependence on management and technological skills would widen the gap between MFIs that were well prepared and those that were not.

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Microfinance Banana Skins 2007

This survey seeks to identify the risks facing the microfinance industry (MFI) over the medium term, as seen by practitioners, investors and other close observers. Its focus is the commercial MFI sector, by which we mean institutions which are run for profit and have assets of more than US\$5 million.

Please read the accompanying guide for information on how to complete the questionnaire.

Please complete and return this questionnaire to us by October 31st 2007

Name Position

Institution Country

Replies are in confidence, but if you are willing to be quoted in our report, please tick

What is your perspective on the microfinance industry?

Practitioner Investor

Regulator Analyst

Other (please state)

Question 1. Please describe the main risks you see facing the microfinance industry (both individual institutions and the sector as a whole) over the next two to three years.

Please turn over

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Question 2. Here are some areas of risk which have been attracting attention. How do you rate their severity, and what is their trend: rising, steady or falling? Use the right hand column to add comments. Insert more risks at the bottom if you wish.

	Severity	Trend	
	1=low 5=high	Rising Steady Falling	Comment
1 Back office operations	<input type="text"/>	<input type="text"/>	
2 Capital availability	<input type="text"/>	<input type="text"/>	
3 Competition	<input type="text"/>	<input type="text"/>	
4 Corporate governance	<input type="text"/>	<input type="text"/>	
5 Cost control	<input type="text"/>	<input type="text"/>	
6 Credit risk	<input type="text"/>	<input type="text"/>	
7 Distribution channels	<input type="text"/>	<input type="text"/>	
8 Foreign exchange	<input type="text"/>	<input type="text"/>	
9 Fraud	<input type="text"/>	<input type="text"/>	
10 Funding - too little	<input type="text"/>	<input type="text"/>	
11 Funding - too much	<input type="text"/>	<input type="text"/>	
12 Inappropriate regulation	<input type="text"/>	<input type="text"/>	
13 Interest rates	<input type="text"/>	<input type="text"/>	
14 Liquidity	<input type="text"/>	<input type="text"/>	
15 Macro-economic trends	<input type="text"/>	<input type="text"/>	
16 Management quality	<input type="text"/>	<input type="text"/>	
17 Managing technology	<input type="text"/>	<input type="text"/>	
18 Mission drift	<input type="text"/>	<input type="text"/>	
19 Natural catastrophes	<input type="text"/>	<input type="text"/>	
20 Ownership	<input type="text"/>	<input type="text"/>	
21 Political interference	<input type="text"/>	<input type="text"/>	
22 Product development	<input type="text"/>	<input type="text"/>	
23 Profitability	<input type="text"/>	<input type="text"/>	
24 Refinancing	<input type="text"/>	<input type="text"/>	
25 Reputation	<input type="text"/>	<input type="text"/>	
26 Staffing	<input type="text"/>	<input type="text"/>	
27 Strategy	<input type="text"/>	<input type="text"/>	
28 Transparency	<input type="text"/>	<input type="text"/>	
29 Unrealisable expectations	<input type="text"/>	<input type="text"/>	
30	<input type="text"/>	<input type="text"/>	

Question 3. How well prepared do you think your own and other institutions are to handle the risks you have identified?

Poorly Mixed Well

Appendix 2: Sector breakdowns

	Practitioners	Analysts	Investors	Observers
Biggest risks				
1	Competition	Corporate governance	Management quality	Corporate governance
2	Cost control	Management quality	Corporate governance	Staffing
3	Inappropriate regulation	Interest rates	Foreign exchange	Management quality
4	Interest rates	Managing technology	Inappropriate regulation	Transparency
5	Credit risk	Unrealisable expectations	Staffing	Inappropriate regulation
6	Mission drift	Mission drift	Too much funding	Interest rates
7	Management quality	Inappropriate regulation	Political interference	Competition
8	Managing technology	Ownership	Managing technology	Cost control
9	Staffing	Strategy	Interest rates	Managing technology
10	Corporate governance	Transparency	Unrealisable expectations	Strategy
11	Macro-economic trends	Staffing	Reputation	Back office operations
12	Political interference	Back office operations	Transparency	Reputation
13	Fraud	Product development	Back office operations	Unrealisable expectations
14	Profitability	Credit risk	Cost control	Ownership
15	Foreign exchange	Foreign exchange	Ownership	Too much funding
16	Capital availability	Liquidity	Credit risk	Political interference
17	Strategy	Political interference	Competition	Fraud
18	Product development	Competition	Fraud	Credit risk
19	Liquidity	Cost control	Liquidity	Liquidity
20	Transparency	Fraud	Profitability	Distribution channels
21	Unrealisable expectations	Capital availability	Strategy	Product development
22	Too little funding	Too much funding	Mission drift	Capital availability
23	Ownership	Refinancing	Macro-economic trends	Mission drift
24	Reputation	Too little funding	Distribution channels	Natural catastrophes
25	Back office operations	Reputation	Refinancing	Profitability
26	Distribution channels	Distribution channels	Natural catastrophes	Foreign exchange
27	Natural catastrophes	Natural catastrophes	Product development	Refinancing
28	Refinancing	Profitability	Capital availability	Macro-economic trends
29	Too much funding	Macro-economic trends	Too little funding	Too little funding
Fastest risers				
1	Competition	Competition	Too much funding	Competition
2	Mission drift	Too much funding	Competition	Staffing
3	Credit risk	Interest rates	Political interference	Ownership
4	Political interference	Unrealisable expectations	Reputation	Corporate governance
5	Staffing	Natural catastrophes	Staffing	Political interference
6	Strategy	Strategy	Credit risk	Strategy
7	Managing technology	Staffing	Unrealisable expectations	Interest rates
8	Ownership	Managing technology	Strategy	Reputation
9	Interest rates	Mission drift	Ownership	Too much funding
10	Management quality	Foreign exchange	Interest rates	Unrealisable expectations
11	Cost control	Liquidity	Distribution channels	Credit risk
12	Corporate governance	Inappropriate regulation	Mission drift	Mission drift
13	Profitability	Fraud	Corporate governance	Managing technology
14	Foreign exchange	Political interference	Fraud	Cost control
15	Natural catastrophes	Credit risk	Managing technology	Fraud
16	Unrealisable expectations	Ownership	Natural catastrophes	Product development
17	Product development	Product development	Product development	Back office operations
18	Fraud	Refinancing	Management quality	Inappropriate regulation
19	Liquidity	Reputation	Foreign exchange	Distribution channels
20	Macro-economic trends	Distribution channels	Transparency	Management quality
21	Transparency	Back office operations	Cost control	Profitability
22	Refinancing	Corporate governance	Macro-economic trends	Natural catastrophes
23	Back office operations	Management quality	Inappropriate regulation	Transparency
24	Inappropriate regulation	Cost control	Profitability	Macro-economic trends
25	Distribution channels	Profitability	Back office operations	Foreign exchange
26	Reputation	Macro-economic trends	Liquidity	Capital availability
27	Capital availability	Capital availability	Refinancing	Refinancing
28	Too much funding	Too little funding	Too little funding	Liquidity
29	Too little funding	Transparency	Capital availability	Too little funding

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	North America	South America	Europe	Africa
Biggest risks				
1	Corporate governance	Competition	Management quality	Too little funding
2	Management quality	Interest rates	Corporate governance	Management quality
3	Inappropriate regulation	Political interference	Inappropriate regulation	Credit risk
4	Staffing	Inappropriate regulation	Staffing	Managing technology
5	Transparency	Cost control	Cost control	Inappropriate regulation
6	Interest rates	Credit risk	Fraud	Corporate governance
7	Unrealisable expectations	Capital availability	Managing technology	Staffing
8	Foreign exchange	Profitability	Too much funding	Cost control
9	Back office operations	Product development	Transparency	Profitability
10	Managing technology	Managing technology	Strategy	Strategy
11	Political interference	Macro-economic trends	Back office operations	Capital availability
12	Reputation	Strategy	Unrealisable expectations	Distribution channels
13	Cost control	Natural catastrophes	Competition	Foreign exchange
14	Too much funding	Transparency	Interest rates	Macro-economic trends
15	Ownership	Staffing	Credit risk	Unrealisable expectations
16	Liquidity	Management quality	Ownership	Competition
17	Competition	Mission drift	Foreign exchange	Interest rates
18	Fraud	Corporate governance	Reputation	Political interference
19	Credit risk	Too little funding	Profitability	Fraud
20	Mission drift	Ownership	Mission drift	Liquidity
21	Strategy	Liquidity	Macro-economic trends	Mission drift
22	Distribution channels	Unrealisable expectations	Political interference	Ownership
23	Profitability	Distribution channels	Liquidity	Product development
24	Refinancing	Foreign exchange	Capital availability	Transparency
25	Product development	Fraud	Product development	Back office operations
26	Natural catastrophes	Reputation	Distribution channels	Reputation
27	Macro-economic trends	Back office operations	Refinancing	Natural catastrophes
28	Capital availability	Refinancing	Natural catastrophes	Refinancing
29	Too little funding	Too much funding	Too little funding	Too much funding
Fastest risers				
1	Competition	Competition	Competition	Competition
2	Too much funding	Political interference	Too much funding	Corporate governance
3	Unrealisable expectations	Strategy	Credit risk	Management quality
4	Reputation	Credit risk	Unrealisable expectations	Managing technology
5	Political interference	Interest rates	Staffing	Staffing
6	Staffing	Natural catastrophes	Interest rates	Distribution channels
7	Ownership	Foreign exchange	Political interference	Product development
8	Interest rates	Staffing	Mission drift	Profitability
9	Strategy	Ownership	Reputation	Strategy
10	Mission drift	Fraud	Corporate governance	Back office operations
11	Corporate governance	Mission drift	Cost control	Cost control
12	Managing technology	Capital availability	Fraud	Inappropriate regulation
13	Credit risk	Managing technology	Strategy	Mission drift
14	Distribution channels	Cost control	Ownership	Ownership
15	Foreign exchange	Product development	Managing technology	Transparency
16	Management quality	Refinancing	Profitability	Credit risk
17	Inappropriate regulation	Macro-economic trends	Natural catastrophes	Natural catastrophes
18	Transparency	Profitability	Management quality	Political interference
19	Fraud	Inappropriate regulation	Product development	Refinancing
20	Natural catastrophes	Distribution channels	Macro-economic trends	Reputation
21	Liquidity	Reputation	Back office operations	Unrealisable expectations
22	Back office operations	Transparency	Liquidity	Foreign exchange
23	Cost control	Too little funding	Distribution channels	Fraud
24	Profitability	Management quality	Foreign exchange	Interest rates
25	Macro-economic trends	Corporate governance	Inappropriate regulation	Liquidity
26	Product development	Liquidity	Transparency	Capital availability
27	Refinancing	Unrealisable expectations	Refinancing	Too little funding
28	Capital availability	Back office operations	Capital availability	Macro-economic trends
29	Too little funding	Too much funding	Too little funding	Too much funding

	Asia	Far East	Middle East
Biggest risks			
1	Managing technology	Foreign exchange	Staffing
2	Management quality	Unrealisable expectations	Capital availability
3	Corporate governance	Cost control	Competition
4	Staffing	Competition	Inappropriate regulation
5	Competition	Inappropriate regulation	Interest rates
6	Mission drift	Management quality	Mission drift
7	Fraud	Political interference	Managing technology
8	Reputation	Credit risk	Corporate governance
9	Strategy	Natural catastrophes	Macro-economic trends
10	Credit risk	Mission drift	Political interference
11	Product development	Distribution channels	Ownership
12	Foreign exchange	Ownership	Credit risk
13	Liquidity	Interest rates	Too little funding
14	Ownership	Liquidity	Foreign exchange
15	Profitability	Macro-economic trends	Fraud
16	Back office operations	Staffing	Liquidity
17	Interest rates	Too little funding	Management quality
18	Political interference	Managing technology	Product development
19	Cost control	Product development	Profitability
20	Inappropriate regulation	Transparency	Refinancing
21	Transparency	Back office operations	Strategy
22	Macro-economic trends	Corporate governance	Transparency
23	Unrealisable expectations	Fraud	Cost control
24	Too little funding	Too much funding	Back office operations
25	Refinancing	Capital availability	Distribution channels
26	Natural catastrophes	Refinancing	Too much funding
27	Capital availability	Reputation	Unrealisable expectations
28	Distribution channels	Profitability	Natural catastrophes
29	Too much funding	Strategy	Reputation
Fastest risers			
1	Competition	Competition	Competition
2	Staffing	Ownership	Mission drift
3	Credit risk	Credit risk	Staffing
4	Mission drift	Distribution channels	Capital availability
5	Strategy	Mission drift	Interest rates
6	Interest rates	Political interference	Unrealisable expectations
7	Fraud	Staffing	Inappropriate regulation
8	Product development	Too little funding	Political interference
9	Managing technology	Management quality	Strategy
10	Corporate governance	Managing technology	Credit risk
11	Foreign exchange	Natural catastrophes	Fraud
12	Ownership	Product development	Liquidity
13	Political interference	Reputation	Management quality
14	Cost control	Unrealisable expectations	Product development
15	Natural catastrophes	Corporate governance	Profitability
16	Liquidity	Liquidity	Back office operations
17	Too much funding	Refinancing	Corporate governance
18	Back office operations	Strategy	Cost control
19	Macro-economic trends	Back office operations	Foreign exchange
20	Profitability	Cost control	Too little funding
21	Refinancing	Foreign exchange	Too much funding
22	Management quality	Too much funding	Macro-economic trends
23	Transparency	Capital availability	Managing technology
24	Unrealisable expectations	Inappropriate regulation	Natural catastrophes
25	Too little funding	Macro-economic trends	Ownership
26	Inappropriate regulation	Transparency	Refinancing
27	Reputation	Interest rates	Reputation
28	Distribution channels	Profitability	Transparency
29	Capital availability	Fraud	Distribution channels

Appendix 3: Respondent countries by region

Africa	Asia	Europe	Far East	Middle East	North America	Latin America
Angola	Afghanistan	Albania	Australia	Egypt	Canada	Argentina
Benin	Azerbaijan	Belgium	Cambodia	Jordan	US	Aruba
Cameroon	Bangladesh	Bosnia & Herzegovina	China	Lebanon		Bolivia
Ethiopia	India	Denmark	Hong Kong	Morocco		Brazil
Guinea-Conakry	Kyrgyzstan	Finland	Philippines	Palestine		Colombia
Rwanda	Mongolia	France		Sudan		Costa Rica
South Africa	Nepal	Germany		Syria		Dominican Republic
Uganda	Pakistan	Italy		United Arab Emirates		Ecuador
Zimbabwe	Sri Lanka	Kosovo				El Salvador
	Tajikistan	Luxembourg				Guatemala
		Montenegro				Haiti
		Netherlands				Honduras
		Norway				Mexico
		Romania				Nicaragua
		Russia				Paraguay
		Slovakia				Peru
		Sweden				Venezuela
		Switzerland				
		UK				

CSFI PUBLICATIONS

1. **“Financing the Russian safety net”**: A proposal for Western funding of social security in Russia, coupled with guarantee fund for Western investors.
By Peter Ackerman/Edward Balls. September 1993 £40/\$65
2. **“Derivatives for the retail client”**: A proposal to permit retail investors access to the risk management aspects of financial derivatives, currently available only at the wholesale level.
By Andrew Dobson. Nov 1993 (Only photostat available) £10/\$15
3. **“Rating environmental risk”**: A proposal for a new rating scheme that would assess a company’s environmental exposure against its financial ability to manage that exposure.
By David Lascelles. December 1993 £25/\$40
4. **“Electronic share dealing for the private investor”**: An examination of new ways to broaden retail share ownership, inter alia, by utilising ATM networks, PCs, etc.
By Paul Laird. January 1994 £25/\$40
5. **“The IBM dollar”**: A proposal for the wider use of “target” currencies, i.e. forms of public or private money that can be used only for specific purposes.
By Edward de Bono. March 1994 £15/\$25
6. **“UK financial supervision”**: A radical proposal for reform of UK financial regulation, (prepared pseudonymously by a senior commercial banker).
May 1994 £25/\$40
7. **“Banking banana skins”**: The first in a periodic series of papers looking at where the next financial crisis is likely to spring from.
June 1994 £25/\$40
8. **“A new approach to capital adequacy for banks”**: A proposal for a market-based alternative, using the concept of ‘value-at-risk’, to the present mechanistic Basle approach to setting bank capital requirements.
By Charles Taylor. July 1994 £25/\$40
9. **“New forms of Euro-Arab cooperation”**: A proposal for a new public/private development finance corporation to promote employment-generating projects in the Arab world.
By Jacques Roger-Machart. October 1994 £25/\$40
10. **“Banking banana skins II”**: Four leading UK bankers and a senior corporate treasurer discuss lessons for the future from the last banking crisis.
November 1994 £25/\$40
11. **“IBM/CSFI essay prize”**: The two winning essays for the 1994 IBM/CSFI Prize.
November 1994 £10/\$15
12. **“Liquidity ratings for bonds”**: A proposed methodology for measuring the liquidity of issues by scoring the most widely accepted components, and aggregating them into a liquidity rating.
By Ian Mackintosh. January 1995 £25/\$40
13. **“Banks as providers of information security services”**: Banks have a privileged position as transmitters of secure data: they should make a business of it.
By Nick Collin. February 1995 £25/\$40
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