

RISK MANAGEMENT COACHING IN A MICROFINANCE INSTITUTION

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Editor's Note: This article summarises the experience of Yves Deceuninck in providing coaching on risk management to a microfinance institution within the context of a programme that has been developed by the **ATTF, ADA and PRiM**. The objective of the programme is to support microfinance institutions in managing the risks that they must face in their daily operations.

Once watched an interview with Muhammad Yunus, the founder of Grameen Bank in Bangladesh and a visionary of microfinance services to the poor. He said that when he wanted to start microfinance, he tried to convince his bank manager to lend to poor people. The banker was amazed and strongly rejected the idea. Yunus told him that he loaned money to one village and it worked. The banker said "with 2 villages it will not work", but it worked and again with 5 villages it worked. But the banker did not change his mind because "we do not lend to the poor". Yunus asked the banker how he knew that. The banker replied "everybody knows it". Yunus added that even if he succeeded in the entire world, the banker would not believe in him and ideas. But Yunus did not give up and knocked on other doors with the success that we now know.

The banker had a preconceived perception of the risks and a preconceived perception of the poor. For him, lending to the poor was considered to be numerous high probability/low impact events. In addition, the bank resources would be used to fix numerous small loss events for non value-added clients, so a waste of time, resource and money.

The banker had an approach of classifying risks that was based on perception only without any analysis, without any empathy for the poor. "The poor" was a concept for the branch manager. "The poor" have no human face... no value...no market value!! So what is the point of taking a risk on them, because there will be no return, he thought - ah, the famous risk/return concept of traditional finance.

It may sound stupid to write that poor people are more than sad masks and that they have a potential of hope, dreams and energy for them and their families, as well as

a desire to succeed or improve like anybody else.

Microfinance practitioners performed a parallel shift in Maslow's pyramid, while helping less fortunate people to step up in the pyramid's hierarchy. One day, one said to me "to believe is to see".

Yunus saw, the banker no, Yunus went to poor villages to see the reality, the banker stayed in his nice office; Yunus won the Nobel Peace Prize, the banker did not. Microfinance services 150 millions clients; the banker is still a banker. A balance has to be found between strict financial risk and reputational risk or reputational opportunity to be more correct.

I define microfinance as a tool to minimise under constraints the poverty equation which can be translated in mathematical terms into an exponential growth problem, due to the world crisis: $Y = A (1+r)^{\exp t}$, where A is the initial population of poor, (1+r) the growth factor of poor people and t the time or period.

The (1+r) term includes not only the "traditional poor", but also ex-middle-class people who lost their jobs, the homeless and small and middle size entrepreneurs who lost everything after a war or a natural disaster. Although charity is essential, it leaves people in a dependent state while microfinance moves them to an independent or interdependent state in the society.

Microfinance is now focused on risk management and has developed the concept of risk versus financial and social return. Microfinance is not "another" financial product. Microfinance is preparing potential clients...for the banker. How strange this cycle is!! Different layers, the primary risk taker and the next one.

We briefly described here the circular approach of Yunus versus the linear approach of the banker. The linear approach has limited feedback loops and learning opportunities, the circular approach is a win/win domino game. It is also the opposite of the "cake" model (i.e., the cake has a limited number of slices and I am envious of the others' slices). The circular approach emphasises the power and the feasibility of the "Universe" model (i.e., in reference to the infinite size of the universe). It is all about extrinsic versus intrinsic (money above all) motivation factors.

When **PRiM/ATTF/ADA** offered to participate in a coaching exercise in risk management for a microfinance institution, I jumped on the opportunity. With little time to prepare, I embarked on a journey with Partner Microcredit in Tuzla (Bosnia Herzegovina). The challenge was to combine the three aspects of the mission: microfinance, coaching and risk management. It was a combination of technical challenges (microfinance and risk management) and soft skills challenges (coaching).

The different stakeholders in the microfinance process are: the clients, which are the microfinance institutions (MFIs) and the microfinance professional associations, the funders (e.g., banks, cooperatives, NGOs, the EBRD, individuals), the microfinance support services, which comprise the banking sector, the rating agencies, Lux Flag, specialised consultants and the different national governments. The coaching was focused on MFIs.

Risk management aspects

The credit default rate for microfinance loans is around 3% (variable) for the top tier MFIs with interest rates to clients between 18% and 45%. The rural sector is targeted by MFIs in some, but not in all countries,

although the majority of MFIs are conscious that they have to increase their presence among the rural population, which is generally the poorest. Only by doing so can they fulfil their social mission. This requires MFIs to invest in infrastructure (branches), travel costs, time and human resources.

In addition to the points mentioned above, monoculture and extensive use of pesticides may be seen as a risk that affects the long-term development of an MFI's clients and can create liquidity issues. It may severely impact the credit quality of the MFIs. Another fundamental risk point is timely access to markets, which for us may be obvious, since we have real-time access to stock markets. If, however, a fisherman cannot access the local market in town on time due to a lack of infrastructure, the production will be lost and he will not be able to pay his loan instalments.

The main risk issue of Partner was credit risk management due to internal but also due to external factors. The main internal weaknesses were related to the credit analysis and monitoring and a lack of a systematic corporate credit policy. Each business region was free to manage its client base, credit risk and follow-up on bad debtors, but legal actions were centralised at the head office.

The Bosnian microfinance market developed after the war in 1990s and progressively many competing microfinance institutions were created. The absence of a central national credit database did not allow anticipation of debt burden/positions among micro-entrepreneurs.

Although Partner is a risk-averse institution, it was not possible for them to identify with a reasonable assurance the debt burden of a new client before the creation of this credit database. A fundamental point is the

close monitoring of clients by credit agents as the client assessment is not based on structured and audited financial statements but on verbal feedback from clients.

A professional credit agent has an in-depth understanding of the business cycle, seasonality, internal and external risk factors related to the client's business. Diversification within business, agricultural sectors and geographical sectors is a key point to reduce the impact of natural disasters (floods in a region can affect the harvest of all farmers and render the community guarantees inoperable, leading to systemic risk).

Coaching

"Coaching is unlocking a person's potential to maximise their performance. It is helping them to learn rather than teaching them" (John Whitmore).

Armed with the trust of PRiM and the ATTF, the advice of a coach, a training on microfinance delivered by ADA, the openness of my management and my white page, I started to learn the business environment of Partner Microcredit and to meet clients as a way of better understanding the reality of the situation in Bosnia Herzegovina.

It was agreed with Partner Microcredit's top management that we would focus on four aspects:

Risk Awareness: At the management level, a one-week workshop focused on global processes rather than departmental ones. The workshop covered risk self-assessment, impact-likelihood analysis, risk classification, risk measure and solutions (mitigate, transfer, hedge, accept, etc.), loss distribution.

Execution: Regarding roles related to the risk management functions and not only to the risk manager.

Extension of risk management responsibilities to the entire organisation and creation of a risk committee.

Corporate governance responsibilities and board reporting.

For the coaching and following the feedback received by Partner related to their risk issues and knowing the influence of external factors in the international market, I opted for the "Aymé Jacquet style" (in reference to the French coach who won the football World Cup in 1998) for the first phase of the coaching. Aymé Jacquet created a bubble around his team to keep the momentum and ignoring external noise (coming from journalists or other stakeholders). By creating this bubble we were able to focus on risk management discussions only and avoid blaming God and nature or moaning time. The only things you can change rapidly are your attitude and actions in the market.

Coaching is about looking at the future, not analysing the past. We had to create a new era, a new vision and a new business model driven by people, in which the essence was positive energy, enthusiasm and desire to change. Change management with the same people and this in a short period. Although the three components of projects are scope, time and resources, with the Director of Partner we decided to emphasise scope and resources and manage time as a secondary component. The reason for this strategy was to avoid the negative impact of stress and to deal with the absence of benchmarking about this exercise with other microfinance institutions.

Time is money, but for us it was an investment to put in place a strong enterprise-wide risk management framework.

Conclusion

To end this article, I would like to give you a personal definition of risk and return perception.

Once upon a time a superb top model said to an ugly old risk manager, "I would like to have a baby with you". Surprised, the old man said "Why?" The model replied emotionally "Can you imagine the baby will have my beauty and your intelligence". Perplexed the old risk manager responded "But what will happen if the baby has my body and your intelligence?!?!?" So it is with managing risk – you do what you can, but you have to wait and see what the reality will be.

In addition to the coaching in risk management they received, Partner Microcredit is making important efforts in terms of reorganisation, compliance with regulations and other areas, which led them in 2010 to become the number one in the region in terms of asset quality (PAR ratio). Partner Microcredit is ready to play a fundamental role in reducing the systemic risk in the microcredit market in Bosnia by sharing best practices with its competitors.

In 2011, Partner's management decided to go for ISO 31000 and 31010 implementation. Both standards talk about risk management.

For me personally, it was a great experience - so good that we will continue the collaboration with Partner Microcredit in 2011 and we are strongly convinced that they will conform with the standards mentioned above.

The world is changing locally for a better society by using the universe model.