Proceed with caution

*The CSFI's latest Banana Skins survey focuses on the risks facing the financial inclusion sector: **Keyur Patel** analyses the findings and reveals that service providers are worried most about the problems posed by new technology*

Nowhere is the transformative potential of financial technology lauded more enthusiastically than in the business of financial inclusion: the provision of banking, savings and insurance services to people with limited or no access to them. There are persuasive reasons for this. Innovations in IT promise to bring financial services to vast under-served markets – expanding institutions' reach, helping them better understand client needs, and improving operational efficiency. The opportunities in serving a market of at least 2bn people worldwide are enticing – both the commercial and those that come from the potential to do much good.

But there is a danger that, in this rush of excitement, the uglier sides of new technologies are overlooked. The financial inclusion industry is now resolutely mainstream: an interconnected ecosystem of traditional microfinance institutions (MFIs) and younger fintech companies, commercial banks and non-financial institutions such as telecoms companies. What happens when these service providers get it wrong? Tech companies have often taken the approach of "move fast and break things", but financial services are heavily regulated for a reason.

The introduction of new technologies to financial services, particularly when the customers involved are far from sophisticated, raises pointed questions about the efficacy and reliability of those technologies, about encouraging too much debt, and about customer protection and data privacy.

These are the concerns that dominate the CSFI's latest Finance for All survey, which ranks 18 risks facing service providers using the tried and tested Banana Skins methodology. The report, supported by the Center for Financial Inclusion at Accion and Citi, surveyed 300 practitioners, investors, regulators and industry observers in 70 countries.

Technology emerged as both the top-ranked Banana Skin and the most pressing theme. It framed the debate for many of the others. Respondents were worried about the cost of investing in new developments in IT and their vulnerability to failure, and about mismanagement and hype – especially given the breakneck speed of technological change in these markets. Some of the most striking concerns were about the protection of sensitive client data – with the widely made point that low-income clients deserve the same rights and protection of their personal information as anyone else.

> "Institutions are concerned more about their survival than meeting client needs

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

At No.2 was strategy risk, which topped the rankings when we last conducted this survey in 2016. In failing to understand and respond to technological changes to the industry, many service providers – especially more traditional ones – risk bringing about their own demise. Developing an effective strategy is no easy task: it requires them to

Finance for All 2018

(2016 position in brackets)*

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

*In the survey *Financial Services for All 2016*

embrace digitisation without compromising what they already do well. A respondent in Kenya warned: "Institutions are more concerned about their survival than meeting client needs – but if client needs are not met, the institutions will cease to exist."

As the numbers of service providers in these markets multiply and competitive pressures mount, a growing concern is that credit made more freely available by algorithmic scoring and electronic delivery will tempt low-income people into taking on too much debt – especially those with low levels of financial literacy.

Credit risk climbed four positions to No.4. In Bahrain, Khaled Al-Gazawi, chief executive officer of Ebdaa Bank for Microfinance, said: "MFIs are under the pressure of sustainability; more and more are ignoring the risks involved in credit. They are competing to disburse more loans regardless of whether the client is creditworthy or not."

This strikes at the heart of what, for many respondents, is the main danger of untrammelled technological development: that financial inclusion will change from an industry motivated largely by social goals to one where short-term commercial gain takes precedence, at the expense of vulnerable people. There were many comments about unscrupulous suppliers eager for market share, a lack of transparency over terms and fees, and product mis-selling.

Less pernicious, but seen as at least as great a risk, is that bad outcomes can come from good intentions – such as fintech providers that genuinely believe their technologies can do much good but are attempting to scale them too quickly in a winner-takes-all environment. On product risk (No.6), Jesse Fripp, general manager at the Aga Khan Agency for Microfinance in Switzerland, said: "There is a certain 'Steve Jobs mentality' prevalent in the fintech world, sometimes exacerbated by well-intentioned foundation funders, that supply-side solutions can be imposed on clients who just don't know what is good for them. This is an old problem dressed up in new fintech fashions, but which may very well have the same predictable negative outcomes."

> *"Staffing has become a worry, particularly the retention of talent, and poaching is rife*

Unintended outcomes also feature heavily in concerns about the public environment around the financial inclusion industry. Most striking is the No.3 position of political risk, up from No.12 in 2016, and described by one respondent as a "brutal game changer in certain markets". The general feeling is that political intervention does more good than harm, but, with elections imminent in many countries and political populism on the rise, policies such as loan waivers and interest rate caps could shrink the regular lending market and increase opportunites for loan sharking.

The perceived risks about regulation also rose sharply, up six positions to No.10. A big challenge is creating an environment in which different types of provider can compete on equal terms, and ensuring that the right balance is struck between innovation and safety. A regional director of a financial services NGO said that regulatory changes and inappropriate taxation were pushing financial service providers "to move away from rural areas and needy people and concentrate on top market segments".

When it comes to their internal oversight, service providers face a mix of new and old risks. Risk management has come down three positions to No.5, but improvements observed in risk management frameworks in many regions have been largely offset by the uncertainties of operating in such a fast-changing market. Ernest Dzandu, a consultant in Ghana, said that governance (No.7) "remains a huge challenge, and in my view this is the mother of all risks. This is not about to change anytime soon. Owner/shareholder directors who do not understand microfinance are on the boards; directors are largely family and friends; directors do not participate in training sessions; and no one holds [them] accountable when MFIs fail."

Staffing is another worry, particularly the retention of talent, which jumped seven places to No.8. Traditional institutions are finding it increasingly difficult to hold on to ambitious people when they cannot offer them the salary, challenging work or career advancement opportunities available elsewhere, and poaching is rife. A consequence is that technical skills are in short supply.

The risk of poor management, at No.9, rounded off the top 10. An industry observer in the UK commented: "As regulatory and market pressures grow, the calibre of people will need to follow. It's not clear if the sector has the ability to attract these skills either for money or culture."

Lower down the rankings were some hopeful developments and other more troubling ones. Macro-economic risk has fallen five positions to No.11 because growth is occurring in many parts of the world, although rising interest rates are a worry as the industrial countries end quantitative easing.

However, crime has jumped from a distant bottom in 2016 to No.12 this year, and is seen as only becoming more urgent in the future. Respondents emphasised the threat of cyber attacks as the industry's growth makes it become a more attractive target for criminals, and fraud is facilitated by the deepening of digital financial services. A microfinance specialist in the Middle East warned that crime is "very likely to damage service providers due to issues with lack of standards, supervision and regulation in many countries".

Given the focus on technology risks in this survey, it is perhaps surprising that client relationships (No.13) were only a moderate concern. There is a generational split here: older people are more likely to be negatively affected by the growing remoteness between client and provider caused by automation. But "younger generations appreciate technologies that avoid time-consuming procedures and red tape", said an investor in Peru. Tech-based products might even strengthen, rather than diminish, clients' loyalty to a particular institution if they work smoothly.

It is often the case that in these surveys the bottom end of the table holds Banana Skins where complacency might be creeping in. While reputation risk was down at No.16, it was widely recognised that exploitative practices in some quarters are damaging trust in service providers – and this could lead to a loss in funding (No.17). Service delivery risk ranked last, but there were concerns about individuals choosing their partners poorly. A consultant in Canada warned: "More players means more risk; every partner has their own agenda and it isn't always transparent."

> *"It is very risky to assume governments are always right and poor people simply need to be educated*

There are also the more imponderable questions, such as whether the people that the financial inclusion industry is trying to reach actually want formal financial services. An adviser in Peru spoke of "the rational decision to remain outside the financial system by low-income populations".

"Financial inclusion should not be interpreted as an opportunity to tax the poor, obliging them to become formalised by opening mandatory accounts or eliminating cash," she said. "Financial inclusion is the result of giving low-income populations the tools to become more productive so they can grow to the point where being informal is not efficient any longer… It is very risky to assume governments are always right, and poor people simply need to be educated." ■

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