ASSESSMENT OF RISK AND RISK MANAGEMENT MEASURES AMONG MFIs IN KUMASI

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DECLARATION

We hereby declare that this work is our own research towards the award of a degree in Bachelor of Business Administration and it contains no material formerly published by any person nor does it contain any material which has been accepted for the award of any other degree of the university except where suitable acknowledgement has been made in the text.

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ABSTRACT

Micro finance has become a major economic development tool that seeks to provide financial and social intermediation services to the low income, self-employed clients. Since microfinance products are flexible enough to offer adequate financial services to the large percentage of Ghanaians whose lifestyles and work finds little attention in the commercial banking system, it has become a very important institution which needs to adopt comprehensive approaches to ensure its long term sustainability.

The purpose of this research was to delve into issues regarding: the various risks encountered by this industry; the management measures put in place to manage the occurrence of these risks and the challenges faced in their implementation. Questionnaires administration, observations and interviews were conducted by way of methodology into three segments of this industry with a sample size of 50 respondent institutions.

It was found that; loan default and loan delay, human errors and errors emanating from the application of information technology; fraud and armed robbery; exchange and interest rate fluctuations; heightened competition from new entrants and the cost of legal liability, in their order of severity and prevalence as the main risk factors affecting this industry. It was learnt that measures like good credit assessment, records analysis and employee training are used to manage these risks. Human resources and financial costs required for implementing these measures were some challenges faced in this regard.

From the responses, it was realized that though risk management was inevitable it was not given the required level of attention in this industry. Recommendations given had to do with a radical approach to provide some training to the managers especially of the semiformal and informal sector and also to step up education on financial literacy in the industry.

DEDICATION

We dedicate this work to our parents and guardians whose sacrifices in our quest for this degree have been profound and immense. We appreciate your effort so much.

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INTRODUCTION

1.0 Background

Micro finance is an economic developmental tool that seeks to provide financial and social intermediation services to the low income self-employed clients. In Ghana, an estimated 80 percent of the eligible population is said to be either unbanked or under banked **(**thestatesmanonline.com by Adu Koranteng**)**. The obvious reason is the incompatibility of many stiff jacketed operations of the commercial banks with the informal economic life styles of the indigenous and/or less educated low income micro entrepreneurs. Since microfinance products are flexible and tailored to offer adequate financial services to this large percentage of people who do not fit into the commercial banking system, it is very important that micro finance institutions adopt comprehensive approaches to ensure the long term sustainability of this all important institution.

According to the institute of international Finance (IIF), there are number of risks that an MFI has to face. These risks could be of delinquencies, frauds, staff turnover, interest rate changes, liquidity, regulatory constraints etc. However, all these risks can broadly be classified into four major categories namely; Credit risk; Operational risk; Market risk and Strategic risk.

Of the above four categories Credit risk and Market risk are directly of financial nature and hence are called **Financial risks** while Operational risk and Strategic risk are of **non-financial character** and result mainly from human errors, system failures, frauds, natural disasters or through regulatory environment, weak board, poor strategy, etc. nevertheless, operational and strategic risk, as and when they materialize will also translate into financial losses for the organisation.

Considering the crippling effects the failure of these MFIs can have on the institutions and most especially the millions of clients they serve, it is very important that these institutions become conscious of the risks and risk management measures/systems that can mar the performances of an MFI's. Rather than focus on the current or historical financial performance, regulators and proactive managers focus on an organisation's ability to identify and manage future risks as the best predictor of long term sustainability. Effective risk management requires an institution to fore see the probability of an adverse event occurring; assessing its frequency and severity and preparing adequately to manage them to an acceptable range or to a limit set by the institution.

1.1 PROBLEM STATEMENT

Challenges abound as microfinance institutions commit themselves to improving risk management practices (Institute of International Finance – IIF). The large percentage of the unbanked economically active people in Ghana has triggered the proliferation of both officially and non-officially recognized microfinance institutions providing financial services such as savings, loans and remittances as well as other social intermediation services to millions of Ghanaians all over the country **(**thestatesmanonline.com**)**. However essential these institutions are -giving their quest to liberate people from financial insecurity- its clientele is so massive that a collapse or mismanagement of these institutions can deal a hefty economic shock to millions of people in the country.

The microfinance industry is characterized by numerous teething problems. These emanate from their calibre of target customers and the seemingly liberal and/or informal system of operations undertaken mostly by non-professionals. All these culminate into various risks including credit risks; operational risks; financial risks and strategic risks. The micro finance institutions mostly target low micro entrepreneurs in the informal sector with very little if any historical financial documentation to aid an in-depth assessment of their credit worthiness. Furthermore, they are to a large extent able to accommodate collateral-free lending. MFIs are also hindered in their search for highly professional staff in the rural areas they operate. This leads to so many operational challenges which stream into losses. Most of these institutions are also mostly viewed as charitable institutions with little regard for inculcation of formal corporate governance structures in their managerial affairs. With all these issues that pose very risky threats, how do these institutions view risks? Do risks occur at all in these institutions? And what structures, policies and procedures have the successful MFIs put in place to keep afloat and keep growing strong with all these issues still at play in the industry? This research seeks to do a fair assessment into the risk management systems adopted and used by microfinance institutions to address the risks they face and the challenges they face in implementing these measures. This defines the course and objectives of this research.

1.2 THE RESEARCH OBJECTIVES

The main objective of this study will be to identify risks and risk management systems adopted and used by microfinance institutions in Kumasi and the challenges they face in implementing these measures. Specifically, the study will aim to;

1. Identify risk sand assess their severity among MFI’s in Kumasi
2. To find out measures that MFIs in Kumasi put in place to manage risk

3. To find out challenges that MFIs in Kumasi face in implementing and monitoring risk management measures

1.3 RESEARCH QUESTIONS

This research seeks to find adequate information to address the following questions;

- What are the significant risks affecting the microfinance sector in Ghana?
- How severe and frequent are these risks?
- What are the strategies and policies used to manage MFI's related risks?
- What challenges do MFI's faces in managing those risks?
- What measures can MFIs put in place to monitor risk management strategies?

1.4 RELEVANCE OF THE STUDY

This research is to expose the managers of MFIs to the various risks factors that are likely to hinder the progress and sustainability of the industry. It is aimed to urge microfinance institutions to be conscious of the various risks and the adverse effects that ignoring them can pose to their institutions. It is to aid managers to appreciate the all-important concept of risk management as an essential aspect of management which needs to be accorded relevance. It seeks to promote the proactive management approach towards risk management as against the remedial or reactive approaches to risk management which offers little chance of recovery from adverse happenings.

1.5 SCOPE OF THE STUDY

This research conducts a study into the general information on the level of awareness of risk and practice of risk management in microfinance in Kumasi. In order to give a comprehensive outlook on the subject matter, the microfinance industry is divided into three sectors namely the formal sector, the semiformal sector and the informal sector of the microfinance industry. Institutions covered were limited only to those located in the Kumasi metropolis.

1.6 ORGANISATION OF THE STUDY

The beginning chapter of this research sets the tone and direction of the research by introducing the subject matter. It gives information on the background objectives and scope of the study. Chapter two of this research gives a literature that covers the issue of risk management as used in its broad sense and in business in general. It further gives a synopsis of the evolution of the microfinance industry in Ghana. It then narrows down to the major issue by expounding on the risk management in the context of microfinance. Chapter four of the study deals solely with the results of the finding and their interpretations. The final chapter is then devoted to the summary of finding; the conclusions and some constructive recommendations.

CHAPTER TWO

LITERATURE REVIEW

2.0 INTRODUCTION

This chapter seeks to review the theoretical and empirical studies on the various issues relating to the topic under study. It covers general concept of Risk and Risk Management issues basically pertaining to businesses. It offers some insight into the concept of Micro Finance and the Evolution of the Micro Finance Industry in Ghana. It after wards gives a review of the Concept of Risk in MFIs; Major Risks facing Microfinance Institutions; **Approaches to Managing Risk; the Importance of Risk Management to microfinance institutions and Challenges Associated with Managing Risk in Microfinance Institutions.**

2.1 DIFFERENT MEANINGS OF RISK

The term risk has a variety of meanings in business and everyday life. This review basically deals with that of businesses and financial institutions. At its most general level, risk is used to describe any situation where there is uncertainty about what will occur. It is the probability or threat of damage, injury, liability, loss, or other negative occurrence that is caused by external or internal vulnerabilities, and that may be neutralized through pre-emptive action. In probability and statistics, financial management, and investment management, risk is often used in a more specific sense to indicate possible variability in outcomes around some expected value.

In other situations, the term risk may refer to the expected losses associated with a situation. In insurance markets, for example, it is common to refer to risk as a situation in which the probability distribution of a variable (such as burning down of a building) is known but its mode of occurrence or actual value (whether the fire will occur at a particular property) is not. A risk is not an uncertainty (where neither the probability nor the mode of the occurrence is known), a peril (cause of loss), or a hazard (agent or condition that makes the occurrence of a peril more likely or more severe).

In finance also risk is referred to as the probability that an actual return on an investment will be lower than the expected return. Risk therefore has no specific meaning used by every type of endeavour. Every organisation has its meaning of risk tailored to suit its line of operations.

2.2 TYPES OF RISK FACING BUSINESSES AND INDIVIDUALS

Generally risks are either direct or indirect. A direct risk is the immediate loss to an asset caused by an unforeseen circumstance. Indirect losses are the additional losses that arise as a result of the occurrence of direct losses. Indirect losses arise as a consequence of direct losses. The possibility of indirect losses is one of the main reasons that businesses try to reduce risk. For example, damage to productive assets can produce an indirect loss by reducing or eliminating the normal profit (net cash flow) that the asset would have generated if the damage had not occurred. Large direct losses also can lead to indirect losses if they threaten the viability of the business and thereby reduce the willingness of customers and suppliers to deal with the business or change the terms (prices) at which they transact. Risks have been classified into various types explained as follows:

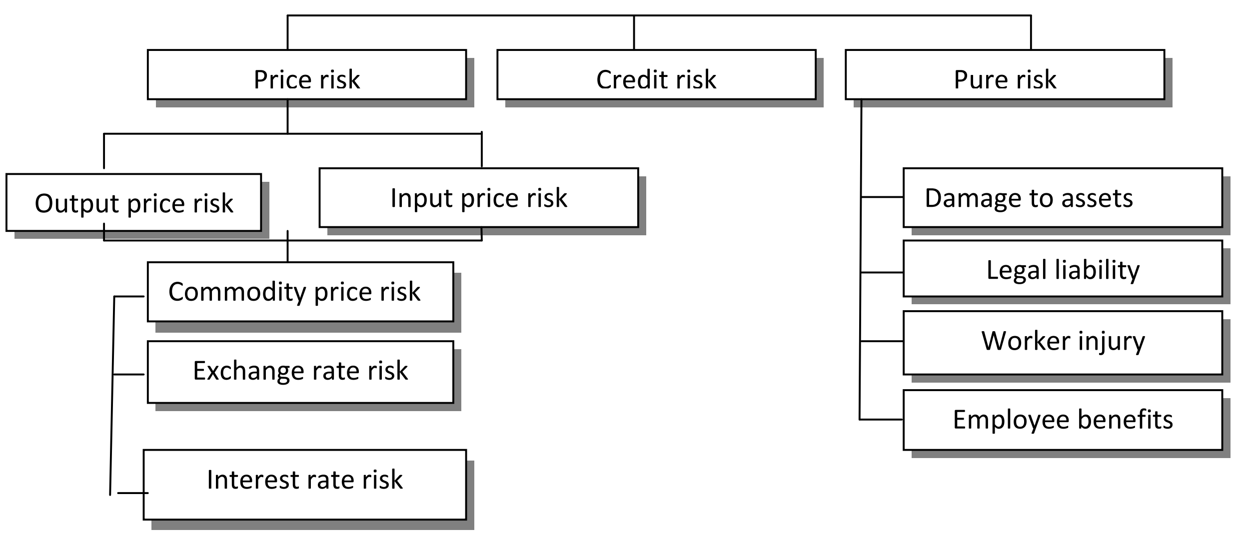
2.2.1 Business Risk

Broadly defined, business risk management is concerned with possible reductions in business value from any source. Business value to shareholders, as reflected in the value of the firm's common stock, depends fundamentally on the expected size, timing, and risk (variability) associated with the firm's future net cash flows (cash inflows less cash outflows). Unexpected changes in expected future net cash flows are a major source of fluctuations in business value. In particular, unexpected reductions in cash inflows or increases in cash outflows can significantly reduce business value. The major business risks that give rise to variation in cash flows and business value are price risk, credit risk and pure risk. (See figure A).

2.2.1.1 Price Risk

Price risk refers to uncertainty over the magnitude of cash flows due to possible changes in output and input prices. Output price risk refers to the risk of changes in the prices that a firm can demand for its goods and services. Input price risk refers to the risk to changes in the prices that a firm must pay for labour, materials, and other inputs to its production of existing and future products and services plays a central role in strategic management. Thus, most strategic risks and operational risks can be viewed as particular examples of price risk.

Fig. A



Three specific types of price risk are commodity price risk, exchange rate risk, and interest rate risk. Commodity price risk arises from fluctuations in the prices of commodities, such as coal, copper, oil, gas and electricity, which are inputs for some firms and outputs for others. Given the globalization of economic activity, output and input prices for many firms fluctuate due to changes in interest rates. For example, increases in interest rates may alter a firm's revenues by affecting both the terms of credit allowed and the speed with which customers pay for products purchased on credit. Changes in interest rates also affect the firm's cost of borrowing funds to finance its operations.

2.2.1.2 Credit risk

The risk that a firm's customers and the parties to which it has lent money will delay or fail to make promised payments is known as credit risk. Most firms face some credit risk for account receivables. The exposure to credit risk is particular large for financial institutions, such as commercial banks, that routinely make loans that are subject to risk of default by the borrower. When firms borrow money, they in turn expose lenders to credit risk (i.e., the risk that the firm will default on its promised payments). As a consequence, borrowing exposes the firm's owners to the risk that the firm will be unable to pay its debts and thus be forced into bankruptcy, and the firm generally will have to pay more to borrow money as credit risk increases.

2.2.1.3 Pure risk

The risk management function in medium-to-large corporations (and the term risk management) has traditionally focused on the management of what is known as pure risk. As summarise d in figure 1.3, the major types of pure risk that affect businesses include:

1. The risk of reduction in value of business assets due to physical damage, theft, and expropriation (i.e., seizure of assets by foreign governments).
2. The risk of legal liability for damages for harm to customers, suppliers, shareholders, and other parties.
3. The risk associated with paying benefits to injured workers under workers' compensation laws and the risk of legal liability for injuries or other harms to employees that are not governed by workers' compensation laws.
4. The risk of default, illness, and disability to employees (and sometimes family members) for which businesses have agreed to make payment under employee benefit plans, including obligations to employees under pension and other retirement savings plans.

2.2.2 Personal risk

The risks faced by individuals and families can be classified in a variety of ways. We classify personal risk into six categories: earnings risk, medical expense risk, liability risk, physical asset risk, financial asset risk, and longevity risk. Earnings risk refers to the potential fluctuation in a family's earnings, which can occur as a result of a decline in the value of an income earner's productivity due to death, disability, aging, or a change in technology. A family's expenses also are uncertain. Health care costs liability suits, in particular, can cause large unexpected expenses. A family also faces the risk of a loss in the value of the physical assets that it owns. Automobiles, homes, boats and computers can be lost, stolen, or damaged. Financial assets' values also are subject to fluctuation due to changes in the real values of stocks and bonds. Finally, longevity risk refers to the possibility that retired people will outlive their financial resources. Often individuals obtain advice about personal risk management from professionals, such as insurance agents, accountants, lawyers and financial planners.

2.2.3 Financial Risk

Financial risk is referred to as the probability that an actual return on an investment will be lower than the expected return. Financial risk is divided into the following general categories: (1) Basis risk. Example: Changes in interest rates will cause interest-bearing liabilities (deposits) to re-price at a rate higher than that of the interest-bearing assets (loans). (2) Capital risk. Example: Losses from un-recovered loans will affect the financial institution's capital base and may necessitate floating of a new stock (share) issue. (3) Country risk. Example: Economic and political changes in a foreign country will affect loan-repayments from debtors. (4) Default risk. Example: Borrowers will not be able to repay principal and interest as arranged (also called credit risk). (5) Delivery risk. Example: Buyer or seller of a financial instrument or foreign currency will not be able to meet associated delivery obligations on their maturity. (6) Economic risk. Example: Changes in the state of economy will impair the debtors' ability to pay or the potential borrower's ability to borrow. (7) Exchange rate risk. Example: Appreciation or depreciation of a currency will result in a loss or a naked-position. (8) Interest rate risk. Example: Decline in net interest income will result from changes in relationship between interest income and interest expense. (9) Liquidity risk. Example: There will not be enough cash and/or cash equivalents to meet the needs of depositors and borrowers. (10) Operations risk. Example: Failure of data processing equipment will prevent the bank from maintaining its critical operations to the customers' satisfaction. (11) Payment system risk. Example: The payment system of a major bank will malfunction and will hinder its payments. (12) Political risk. Example: Political changes in a debtor's country will jeopardize debt-service payments. (13) Refinancing risk. Example: It will not be possible to refinance maturing liabilities (deposits) when they fall due, at economic cost and terms. (14) Reinvestment risk. Example: It will not be possible to reinvest interest-earning assets at current market rates. (15) Settlement risk. Example: Failure of a major bank will result in a chain reaction, reducing other banks' ability to honour payment commitments. (16) Sovereign risk. Example: Local or foreign debtor-government will refuse to honour its debt obligations on their due date. (17) Underwriting risk. Example: New issue of securities underwritten by the institution will not be sold or its market price will drop.

2.3 RISK MANAGEMENT

2.3.1 The Risk Management Process

Regardless of the type of risk being considered the risk management process involves several key steps:

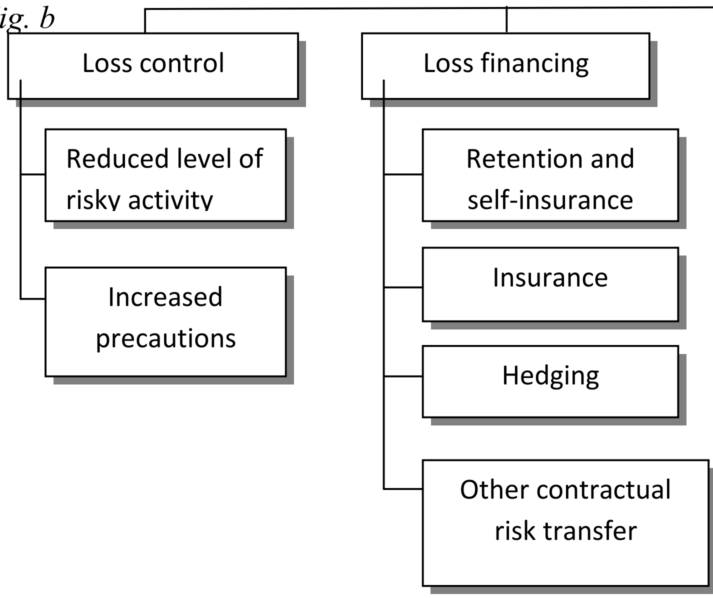
1. Identify all significant risks
2. Evaluate the potential frequency and severity of losses
3. Develop and select methods for managing risk.
4. Implement the risk management methods chosen.
5. Monitor the performance and suitability of the risk management methods and strategies on an ongoing basis.

The same general framework applies to business and individual risk management. The following topic now looks at the various methods that can be applied in managing risks.

2.3.2 Risk management methods

Figure B summarizes the major methods of managing risk. These methods, which are not mutually exclusive, can be broadly classified as (1) loss control, (2) loss financing, and (3) internal risk reduction. Loss control and internal risk reduction commonly involve decisions to invest (or forgo investing) resources to reduce expected losses. Loss financing decisions refer to decisions about how to pay for losses if they do occur.

Fig. b



- **Loss control**

Actions that reduce the expected cost of losses by reducing the frequency of losses and/or the severity (size) of losses that occur are known as loss control. Loss control also is sometimes known as risk control. Actions that primarily affect the frequency of losses are commonly called loss prevention methods. Actions that primarily influence the severity of losses that do occur are often called loss reduction methods. An example of loss prevention would be routine inspection of aircraft for mechanical problems. These inspections help reduce the frequency of crashes; they have little impact on the magnitude of losses for crashes that occur. An example of loss reduction is the installation of heat- or smoke-activated sprinkler systems that are designed to minimize fire damage in the event of a fire.

Many types of loss control influence both the frequency and severity of losses and cannot be readily classified as either loss prevention or loss reduction. For example, thorough safety testing of consumer products will likely reduce the number of injuries, but it also could affect the severity of injuries. Similarly, equipping automobiles with airbags in most cases should reduce the severity of injuries, but airbags also might influence the frequency of injuries. Whether injuries increase or decrease depends on whether the number of injuries that are completely presented for accidents that occur exceeds the number of injuries that might be caused by airbags inflating at the wrong time or too forcefully, as well as any increase in accidents and injuries that could occur if protection by airbags causes some drivers less safely. Viewed from another perspective, there are two general approaches to loss control:

- ✓ Reducing the level of risky activity
- ✓ Increasing precautions against loss for activities that are undertaken.

First, exposure to loss can be reduced by reducing the level of risky activities, for example, by cutting back production of risky products or shifting attention to less risky product lines. Limiting the level of risky activity primarily affects the frequency of losses. The main cost of this strategy is that it forgoes any benefits of the risky activity that would have been achieved apart from the risk involved. In the limit, exposure to losses can be completely eliminated by reducing the level of activity to zero; that is, by not engaging in the activity at all. This strategy is called risk avoidance.

As a specific example of limiting the level of risky activity, consider a trucking firm that hauls toxic chemicals that might harm people or the environment in the case of an accident and thereby produce claims by cutting back on the number of shipments that it hauls. Alternatively, it could avoid the risk completely by not hauling toxic chemicals and instead hauling nontoxic substances (such as clothing or, apart from cholesterol, cheese).

The second major approach to loss control is to increase the amount of precautions (level of care) for a given level of risky activity. The goal here is to make the activity safer and thus reduce the frequency and/or severity of losses. Thorough testing for safety and installation of safety equipment are examples of increased precautions. The trucking firm in the example above could give its drivers extensive training in safety, limited the number of hours driven by a driver in a day, and reinforce containers to reduce the likelihood of leakage. Increased precautions usually involve direct expenditure or other costs (e.g. the increased time and attention required to drive an automobile more safely).

- **Loss Financing**

Methods used to pay for or offset losses that occur are known as **loss financing** (sometimes called risk financing). There are four broad methods of financing losses: retention, insurance, hedging and other contractual risk transfers. These approaches are not mutually exclusive; that is, they often are used in combination.

With **retention**, a business or individual retains the obligation to pay for part or all of the losses. For example, a trucking company might decide to retain the risk that cash flows will drop due to oil price increases. When coupled with a formal plan to fund losses for medium-to-large businesses, retention often is called self-insurance. Firms can pay retained losses using either internal or external funds. Internal funds include cash flow from ongoing activities and investments in liquid assets that are dedicated to financing losses. External sources of funds include borrowing and issuing new stock, but these approaches may be very costly following large losses. It must be noted that these approaches still involve retention even though they employ external sources of funds. For example, the firm must pay back any funds borrowed to finance losses. When new stock is issued, the firm must share future profits with new stockholders.

The second major method of financing losses is the purchase of insurance contracts. As you most likely already know, the typical insurance contract requires the insurer to provide funds to pay for specified losses (thus financing these losses) in exchange for receiving a premium from the purchaser at the inception of the contract. Insurance contracts reduce risk for the buyer by transferring some of the risk of loss to the insurer. Insurers in turn reduce risk through diversification. For example, they sell large numbers of contracts that provide coverage for a variety of different losses.

The third broad method of loss financing is **hedging.** Financial derivatives, such as forwards, futures, options, and swaps, are used extensively to manage various types of risk, most notably price risk. These contracts can be used to hedge risk; that is. They may be used to offset losses that occur from changes in interest rates, commodity prices, foreign exchange rates, and the like. Some derivatives have begun to be used in the management of pure risk, and it is possible that their use in pure risk management will expand in the future.

Individuals and small businesses do relatively little hedging with derivatives. At this point, it is useful to illustrate hedging with a very simple example Firms that use oil in the production process are subject to loss from unexpected increases in oil prices; oil producers are subject to loss from unexpected decreases in oil prices. Both types of firms can hedge their risk by entering into a forward contract that requires the oil producers to provide the oil user with a specified amount of oil on a specified future delivery date at a predetermined price (known as the forward price), regardless of the market price of oil on that date. Because the forward prices is agreed upon when the contract is written, the oil user and the oil producer both reduce their price risk.

The fourth major method of loss financing is to use one or more of a variety of **other contractual risk transfers** that allow businesses to transfer risk to another party. Like insurance contracts and derivatives, the use of these contracts also is pervasive in risk management. For example, businesses that engage independent contractors to perform some task routinely enter into contracts, commonly known as hold harmless and indemnity agreements that require the contractor to protect the business from losing money from lawsuits that might arise if persons are injured by the contractor.

- **Internal Risk Reduction**

In addition to loss financing methods that allow businesses and individuals to reduce risk by transferring it to another entity, businesses can reduce risk internally. There are two major forms of internal risk reduction: diversification, and investment in information.

Regarding the first of these, firms can reduce risk internally by diversifying their activities (i.e. not putting all of their eggs in one basket). Individuals also routinely diversify risk by investing their savings in many different stocks. The ability of shareholders to reduce risk through portfolio diversification is an important factor affecting insurance and hedging decisions of firms.

The second major method of reducing risk internally is to invest in information to obtain superior forecasts of expected losses. Investing in information can produce more accurate estimates or forecasts of future cash flows, thus reducing variability of cash flow around the predicted value.

Examples abound, including estimates of the frequency and severity of losses from pure risk, marketing research on the potential demand for different products to reduce output price risk is by specializing in the analysis of data to obtain accurate forecasts of losses. Medium-to-large businesses often find it advantageous to reduce pure risk in this manner as well. Given the large demand for accurate forecasts of key variables that affects business value and determine the price of contracts that can be used to reduce risk (such as insurance and derivatives), many firms specialize in providing information and forecasts to other firms and parties.

2.4 BUSINESS RISK MANAGEMENT IN ORGANISATIONS

The main question this section addresses is “where does the risk management function fit within the overall organisational structure of businesses?” In general, the views of senior management concerning the need for, scope. And importance of risk management and possible administrative efficiencies determines how the risk management function is structured and the exact responsibilities of units devoted to risk management. Most large companies have a specific department responsible for managing pure risk that is headed by the risk manager (or director of risk management). However, given that losses can arise from numerous sources, the overall risk management process ideally reflects a coordinated effort between all of the corporation’s major departments and business units, including production, marketing, finance, and human resources.

Depending on a company’s size, a typical risk management department includes various staff specializing in areas such as property-liability insurance, workers’ compensation, safety and environmental hazards, claims management, and, in many cases, employee benefits. Given the complexity of modern risk management, most firms with significant exposure to price risk related to the cost of raw materials, interest rate changes, or changes in foreign exchange rates have separate departments or staff members that deal with these risks. Whether there will be more movement in the future toward combining the management of these risks with pure risk management within a unified risk management department is uncertain.

In most firms, the risk management function is subordinate to and thus reports to the finance (treasury) department. This is because of the close relationships between protecting assets from loss, financing losses, and the finance function. However, some firms with substantial liability exposures have the risk management department report to the legal department. A smaller proportion of firms have the risk management unit report to the human resources department.

Firms also vary in the extent to which the risk management function is centralised, as opposed to having responsibility spread among the operating units. Centralization may achieve possible economies of scale in arranging loss financing. Moreover, many risk management decisions are strategic in nature, and centralization facilities effectives' interaction between the risk manager and senior management.

A possible limitation of a centralised risk management function is that it can reduce concern for risk management among the managers and employees of a firm's various operating units. However, allocating the cost of risk or losses to particular units often can improve incentives for unit managers to control costs even if the overall risk management function is centralized. On the other hand, there are advantages to decentralizing certain risk management activities, such as routine safety and environmental issues. In these cases, operating managers are close to the risk and can deal effectively and directly with many issues.

2.5 THE MICRO FINANCE INDUSTRY

This section of the study gives a synopsis of the concept of micro finance: what it is all about;

what services it offers; the contributions they offer in terms of development and what bodies predominantly offer these services. It further goes on to give a brief but informative overview into the Micro Finance Industry in Ghana.

Microfinance consists primarily of providing financial services including, savings, micro credit, micro insurance, micro leasing and transfers in relatively small transactions designed to be accessible to micro-enterprises and to low-income households. Microfinance may be complemented by non-financial services, especially training, to improve the ability of clients to utilize the facilities effectively. Microfinance encompasses the provision of financial services and the management of small amounts of money through a range of products and a system of intermediary functions that are targeted at low income clients. Microfinance is thus, one of the critical dimensions of the broad range of financial tools for the poor. Its operations also include other social intervention services. These social intervention services include human capital development and they are addressed through education, training, social capital and achieved through local organization building which enables people to move out of poverty. These social intermediations also consist of group formation, training in financial literacy and management capabilities among members of a group. By providing material capital to a poor person, their sense of dignity is strengthened and this can help to empower one to participate in the economy and society (Otero, 1999). Thus, the definition of microfinance encompasses both financial and social intermediation services. Also, micro finance is not just banking but a development tool. Microfinance activities usually involve:

- Small loans typically for working capital
- Informal appraisal of borrower and investments
- Collateral substitutes such as group guarantees and compulsory savings

- Access to repeat and larger loans based on repayment performance
- Streamlined loan disbursement and monitoring
- Secure-savings products

Micro finance is usually offered by Non Governments Organisations [NGOs]; saving and Loans Companies; Corporative; Credit Unions; Rural Banks; Commercial Banks and other Non-Bank Financial Institutions. Their main clients are usually the low income economically active people both in the urban and the rural areas. They are made up of traders; street venders; small farmers; service providers [hair dresses, rickshaw drivers] and small producers black smiths and seamstresses. Usually these clients are engaged in activities that provide a stable source of finance often from more than one activity. Although they are termed as poor, they are generally not considered poorest among the poor. Money lenders and rotating saving and credit associations are informal micro finance providers and are also important sources of financial intermediation. The key factors that has led to the developments of the microfinance industry emanates from the realization of**:**

- ✓ The fact that the poor need access to productive resources, with financial services being a key resource, if they are to be able to improve their conditions of life
- ✓ The realization that the poor have the capacity to use loans effectively for income-generation, to save and re-pay loans;
- ✓ The observation that the formal financial sector has provided very little or no services to low-income people, creating a high demand for credit and savings services amongst the poor;
- ✓ The view that microfinance is viable and can become sustainable and achieve full cost recovery;

- ✓ The recognition that microfinance can have significant impact on cross cutting issues such as women's empowerment, reducing the spread of HIV/AIDS and environmental degradation as well as improving social indicators such as education, housing and health.

Studies have shown that micro-finance plays three broad roles in development:

- It helps very poor households meet basic needs and protects against risks,
- It is associated with improvements in household economic welfare,
- It helps to empower women by supporting women's economic participation and so promotes gender equity.

More recently, commentators such as Littlefield, Murduch and Hashemi (2003), Simanowitz and Brody (2004) and the IMF (2005) have commented on the critical role of micro-credit in achieving the Millennium Development Goals. According to Simanowitz and Brody (2004, p.1), micro-credit is a key strategy in reaching the MDGs and in building global financial systems that meet the needs of the most poor people." Littlefield, Murduch and Hashemi (2003) state "micro-credit is a critical contextual factor with strong impact on the achievements of the MDGs. Micro-credit is unique among development interventions. It can deliver social benefits on an ongoing, permanent basis and on a large scale". It is worth noting that Microfinance has emerged globally as a leading and effective strategy for poverty reduction with the potential for far-reaching impact in transforming the lives of poor people. It is argued that microfinance can facilitate the achievement of the Millennium Development Goals (MDGs) as well as National Policies that target poverty reduction, empowering women, assisting vulnerable groups, and improving standards of living. As pointed out by the former UN Secretary General Kofi Annan during the launch of the International Year of Micro Credit (2005), Sustainable access to microfinance helps alleviate poverty by generating income, creating jobs, allowing children to go to school, enabling families to obtain health care, and empowering people to make the choices that best serve their needs." (Kofi Annan). ***Source***: www.economicswebinstitute.org

2.6 EVOLUTION OF THE MICROFINANCE SUB-SECTOR IN GHANA

The concept of microfinance is not new in Ghana. There has always been the tradition of people saving and/or taking small loans from individuals and groups within the context of self-help to start businesses or farming ventures. For example, available evidence suggests that the first credit union in Africa was established in Northern Ghana in 1955 by Canadian Catholic missionaries. However, Susu, which is one of the microfinance schemes in Ghana, is thought to have originated from Nigeria and spread to Ghana in the early twentieth century.

Over the years, the microfinance sector has thrived and evolved into its current state thanks to various financial sector policies and programmes undertaken by different governments since independence. Among these are**:**

- Provision of subsidized credits in the 1950s;
- Establishment of the Agricultural Development Bank in 1965 specifically to address the financial needs of the fisheries and agricultural sector;
- Establishment of Rural and Community Banks (RCBs), and the introduction of regulations such as commercial banks being required to set aside 20% of total portfolio, to promote lending to agriculture and small scale industries in the 1970s and early 1980s;
- Shifting from a restrictive financial sector regime to a liberalized regime in 1986; promulgation of PNDC Law 328 in 1991 to allow the establishment of different categories of non-bank financial institutions, including savings and loans companies, and credit unions.

The policies have led to the emergence of three broad categories of microfinance

Institutions. These are:

- Formal suppliers such as savings and loans companies, rural and community banks, as well as some development and commercial banks;
- Semi-formal suppliers such as credit unions, financial non-governmental organizations (FNGOs), and cooperatives;
- Informal suppliers such as Susu collectors and clubs, rotating and accumulating savings and credit associations (ROSCAs and ASCAs), traders, moneylenders and other individuals.

In terms of the regulatory framework, rural and community banks are regulated under the Banking Act 2004 (Act 673), while the Savings and Loans Companies are currently regulated under the Non-Bank Financial Institutions (NBFI) Law 1993 (PNDCL 328. On the other hand, the regulatory framework for credit unions is now being prepared, and this would recognize their dual nature as cooperatives and financial institutions. The rest of the players such as FNGOs, ROSCAS, and ASCAs do not have legal and regulatory frameworks.

Programmes currently addressing the sub-sector in Ghana include the Financial Sector Improvement Project, Financial Sector Strategic Plan (FINSSP), the Rural Financial Services Project (RFSP), the United Nations Development Programme (UNDP) Microfinance Project, the Social Investment Fund (SIF), the Community Based Rural Development Programme (CBRDP), Rural Enterprise Project (REP), and Agricultural Services Investment Project (ASSIP).

Structure and Key Stakeholders of Microfinance in Ghana

The structure and key microfinance stakeholders in Ghana consist of the following:

- The Rural and Community Banks,
- Savings and Loans Companies

- Financial NGOs
- Primary Societies of CUA
- Susu Collectors Association of GCSCA
- Development and commercial banks with microfinance programs and linkages
- Micro-insurance and micro-leasing services

Microfinance Apex Bodies, namely:

- Association of Rural Banks (ARB)
- ARB Apex Bank
- Association of Financial NGOs (ASSFIN)
- Ghana Cooperative Credit Unions Association (CUA)
- Ghana Cooperative Susu Collectors Association (GCSCA)

End Users

- Economically active poor who are clients of microfinance products and services. Micro finance clients are typically self-employed low income entrepreneurs in both urban and rural areas.

Supporting Institutions

- Microfinance and Small Loans Center (MASLOC);
- The Ghana Microfinance Institutions Network (GHAMFIN);
- Development partners and international non-governmental organisations Universities, training and research institutions.

Government Institutions

- Ministry of Finance and Economic Planning
- Ministries, Departments, Agencies (MDAs) and Metropolitan, Municipal and District

Assemblies (MMDAs)

- Bank of Ghana.

2.7 CHALLENGES FACING THE MICROFINANCE SECTOR IN GHANA

Generally, since the beginning of government involvement in microfinance in the 1950s, the sub-sector has operated without specific policy guidelines and goals. This partially accounts for the slow growth of the sub-sector, and the apparent lack of direction, fragmentation and lack of coordination. There has so far not been a coherent approach to dealing with the constraints facing the sub-sector. Among the constraints are inappropriate institutional arrangements, poor regulatory environment, inadequate capacities, lack of coordination and collaboration, poor institutional linkages, no specific set of criteria developed to categorize beneficiaries, channelling of funds by MDAs, lack of linkages between formal and informal financial institutions, inadequate skills and professionalism, and inadequate capital. Better coordination and collaboration among key stakeholders including the development partners, government and other agencies, could help to better integrate microfinance with the development of the overall financial sector. The sector in Ghana thus experiences some very teething challenges which include:

- **Institutional Arrangement**

The stakeholders in the sub-sector play various roles which are expected to be complementary. Due to the lack of defined areas of operation, the roles and responsibilities of stakeholders currently overlap in some cases. The overlap is also due partly to the fact that organizational and institutional hierarchy and reporting relationships among all the stakeholders are not clearly defined. Commercial banks could play an increasing role. There is the need therefore to clearly define relationships and roles to enhance effective implementation and delivery of services.

- **Capacity building and funding for the sector**

In order to promote the sub-sector, the various stakeholders organize training programmes and activities with the view to upgrading the human capital in the industry. Nevertheless, the staffing and competency level being achieved with these training programmes is still below what is desired. Thus, the human capacity of some key stakeholders and institutions including MASLOC, GHAMFIN, MFIs, relevant Ministries, and technical service providers needs to be enhanced for microfinance operations. The random and incoherent nature of training programmes has also probably hampered the achievements of the projected gains for the sub-sector, as the flaw in the human capacity of all the stakeholders may have had a rippling effect on the governance and structure of the industry. Furthermore, the current microfinance Apex bodies lack an adequate cadre of in-house trainers and/or facilitators as well as in-house monitoring and evaluation units to continually measure progress of their activities consistently over time. Infrastructural capacity in the sub-sector is yet to be developed around an integrated and holistic logistical support and internal operating systems. Funding for the sub-sector has been from three sources: the institutions themselves, government, and development partners. Firstly, available funds have not fully 'met the needs for developing and expanding the sub-sector; and, secondly, the varying sources come with their conditions, and distort the market in some cases. There is considered to be a need for a central microfinance fund to which MFIs can apply for on-lending and/or capacity building support, building on experience such as the Training Fund under the Rural Financial Services Project.

- **Credit Delivery and Management**

The current strategies for credit delivery are not adequately diversified or efficient, and therefore are unable to fully meet the varying demands of the market and different categories of end-users. There is no framework for categorizing and upgrading some of the emerging microfinance institutions in the semi-formal and informal sub-sectors in accordance with their operational capacities and capabilities. The objective of microfinance is to provide resources for the poor. Nonetheless, there is yet to be adequate, reliable and acceptable methods for classifying various poverty levels to enhance the categorization of potential and actual MFI clients and other forms of support that may be more appropriate for some groups.

- **Targeting the Vulnerable and the Marginalized**

People with disabilities and impairments do not have products and services designed to meet their needs and also are not adequately served by existing microfinance funds and services. This target group in particular could benefit from complementary skills training programmes. The existing skills training and funding arrangements for women do not seem to be market-driven. Thus, specific services and products that target women for entrepreneurship development to enable them engage in economic activities and become more self-reliant need to be more coherent. Young people aged 15-24 years account for about a third of the population of Ghana and constitute over half of the **unemployed population**. There is a need for special microfinance, grant and training programmes that target the youth for entrepreneurial development.

- **Data/Information Gathering and Dissemination**

Generally, there is paucity of information on microfinance institutions, their operations and clients in the country. Approaches to and methodology for data and information gathering at the national level are not uniform, making it difficult to centrally monitor progress of the sub-sector. The current attempt to develop a national data bank on microfinance is yet to be fully realized.

There is a lack of well-defined reporting system by both the government and development partners with regards to their interventions. The outcome is inadequate data base for decision-making and planning. At the institutional level, data/information gathering and dissemination are weak within and between institutions. The lack of common benchmarks, methods for measuring and information sharing further inhibits the performance of the sub-sector. Lack of adequate and reliable information on outreach in terms of its depth and breadth remains one of the most daunting in the sub-sector. This lack of information has affected targeting of clients and ultimate poverty reduction.

- **Regulation and Supervision**

There is a need for dialogue on the formulation, implementation and review of regulatory and supervisory policies and procedures to ensure consistency and cost-effective approaches to regulation across different types of microfinance institutions and products. There is a need to balance permitting continued evolution of a variety of institutions providing microfinance products and services with the need to protect depositors' funds, provide adequate information and protection to consumers, and coordinate expansion and regulation of different segments of the market. Microfinance institutions in this category face rigid regulatory and supervisory systems that present some challenges for product innovativeness, outreach and ultimately the performance of the institutions. There is a lack of well specified guidelines for operations among apex bodies namely, CUA, GCSCA, ASSFIN and Cooperative Council. This leads to uncoordinated activities and invariably hampers the performance and outreach of their member institutions.

- **Collaboration and Coordination**

There is no national body which is responsible for coordinating all activities associated with microfinance, nor is there a forum for dialogue among stakeholders on policy and programme issues. As a result there is lack of coherent approach, fragmentation, duplication and inadequate collaboration between and among MDAs, MMDAs, development partners, service providers, practitioners and end users. In this regard, the role of GHAMFIN as an umbrella body for microfinance apex institutions, as well as their member institutions, needs to be strengthened to ensure the transfer of best practices and setting of standards for the industry. The existing institutional structure does not include all practitioners and service providers, and needs to be addressed. In all, the potential economic benefits of sustainable microfinance in Ghana are compelling, and its potential effects on the development process cannot be understated. This calls for a holistic approach, as discussed to facilitate the development of the microfinance sub sector and thereby unleash its potential for accelerated growth and development.

Finally, notwithstanding all the challenges this sector faces, it is gratifying to note that the Government of Ghana has adopted microfinance as one of the important strategies for poverty reduction and wealth creation. Recognizing the role various institutions and individuals can play to ensure the achievement of this national vision of achieving the MDGs and also becoming a middle income country by the year 2015, there is the need to quicken the pace of reforms in the microfinance sector in order to unleash its full potential for accelerated growth and poverty reduction.

2.8 THE CONCEPT OF RISK TO MICROFINANCE INSTITUTIONS

Risk is the possibility of an adverse event occurring and its potential for negative implications to the microfinance institution (MFI). Microfinance institutions face many risks that threaten their financial viability and long-term sustainability. Some of the most serious risks come from the external environment in which the MFI operates.

When financial institutions issue loans, there is a risk of borrower default. When banks collect deposits and on-lend them to other clients (i.e. conduct financial intermediation), they put clients' savings at risk. Any institution that conducts cash transactions or makes investments risks the loss of those funds. Development finance institutions should neither avoid risk (thus limiting their scope and impact) nor ignore risk (at their folly). Like all financial institutions, microfinance institutions (MFIs) face risks that they must manage efficiently and effectively to be successful. If the MFI does not manage its risks well, it will likely fail to meet its social and financial objectives. When poorly managed risks begin to result in financial losses, donors, investors, lenders, borrowers and savers tend to lose confidence in the organization and funds begin to dry up. When funds dry up, an MFI is not able to meet its social objective of providing services to the poor and quickly goes out of business. To tone down these risks, the MFIs employ various management strategies, which include risk avoidance, transferring of risk and mitigating risks. Mitigation of risks is regarded as the most effective risk management strategy. Specifically, reconciliation of loan accounts and loan data is considered as the most effective risk management in determining financial sustainability of the MFIs.

Major Risks Faced by Microfinance Institutions

Many risks are common to all financial institutions. From banks to unregulated MFIs, these include credit risk, liquidity risk, market or pricing risk, operational risk, compliance and legal risk, and strategic risk. In one of its publications, Deutsche Gesellschaft für Technische

Zusammenarbeit (GTZ, 2000) identified three major categories of risks facing microfinance institutions to be financial risks, operational risks and strategic risks.

Major Risk Categories

***Source**: Geetha Nagarajan and Karen Doyle*

Financial Risks	**Operational Risks**	**Strategic Risks**
Credit Risk • Transaction risk • Portfolio risk	• Human resources risk, • Information technology risk	**Governance Risk** • Ineffective oversight • Poor governance structure
Liquidity Risk	Fraud (Integrity) Risk	Reputation Risk
Transaction Risk	Legal & Compliance Risk	External Business Risks
Market Risk • Interest rate risk, Foreign exchange • Investment portfolio risk.		• Event risk

Financial institution managers (and regulators) review these risks in light of:

- The institution's potential exposure to loss,
- The quality of internal risk management and information systems, and
- The adequacy of capital and cash to absorb both identified and unidentified potential losses.

In other words, management determines whether the risk can be adequately measured and managed, considers the size of the potential loss, and assesses the institution's ability to withstand such a loss.

Financial Risks

MFIs are well aware of Financial Risks that are inherent in the business environment that they are operating in and modify their lending methodologies in order to minimize these risks (GTZ, 2000). They have as one of their core business, to manage financial risks, which include credit risks, liquidity risks, interest rate risks, foreign exchange risks and investment portfolio risks. They focus heavily on minimizing risks due to late or non-payment of loan obligations – credit risks. Credit Risks include both risks due to individual loans characteristics (transaction risk) and the risks inherent in the composition of the overall loan portfolio (portfolio risk).

Financial risk management requires a sophisticated treasury function, usually centralized at the head office, which manages liquidity risk, interest rate risk, and investment portfolio risk. As MFIs face more choices in funding sources and more product differentiation among loan assets, it becomes increasingly important to manage these risks well.

- **Credit risk**

Credit risk, the most frequently addressed risk for MFIs, is the risk to earnings or capital due to borrowers' late and non-payment of loan obligations. Credit risk encompasses both the loss of income resulting from the MFI's inability to collect anticipated interest earnings as well as the loss of principle resulting from loan defaults. Credit risk includes both transaction risk and portfolio risk. Transaction risk refers to the risk within individual loans. MFIs mitigate transaction risk through borrower screening techniques, underwriting criteria, and quality procedures for loan disbursement, monitoring, and collection. Portfolio risk also refers to the risk inherent in the composition of the overall loan portfolio. Policies on diversification (avoiding concentration in a particular sector or area), maximum loan size, types of loans, and loan structures lessen portfolio risk *(GTZ, January 2000).*

- **Liquidity risk**

Liquidity risk is the possibility of negative effects on the interests of owners, customers and other stakeholders of the financial institution resulting from the inability to meet current cash obligations in a timely and cost-efficient manner. Liquidity risk usually arises from management's inability to adequately anticipate and plan for changes in funding sources and cash needs. Efficient liquidity management requires maintaining sufficient cash reserves on hand (to meet client withdrawals, disburse loans and fund unexpected cash shortages) while also investing as many funds as possible to maximize earnings (Jain, 1997)

- **Market risk**

Market Risks are environmental in nature and encompass risks that might arise from financial losses due to changes in market interest rates (interest risk), or due to inadequate protection from fluctuations in currencies (foreign exchange risk), or due to long term asset and liability management (investment portfolio risk). Market risk includes interest rate risk, foreign currency risk, and investment portfolio risk (GTZ, 2000).

Interest rate risk arises from the possibility of a change in the value of assets and liabilities in response to changes in market interest rates. Also known as asset and liability management risk, interest rate risk is a critical treasury function, in which financial institutions match the maturity schedules and risk profiles of their funding sources (liabilities) to the terms of the loans they are funding (assets). In MFIs, the greatest interest rate risk occurs when the cost of funds goes up faster than the institution can or is willing to adjust its lending rates. The cost of funds can sometimes exceed the interest earned on loans and investments, resulting in a loss to the MFI. Interest rate changes can also affect fee income, since most fee income is associated with loan products that are interest rate sensitive (Greenbaum, Stuart- April 1998).

Foreign exchange risk is the potential for loss of earnings or capital resulting from fluctuations in currency values. Microfinance institutions most often experience foreign exchange risk when they borrow or mobilize savings in one currency and lend in another (Greenbaum, Stuart- April 1998).The **investment portfolio** represents the source of funds for reserves, for operating expenses, for future loans or for other productive investments. Investment portfolio risk refers mainly to longer-term investment decisions rather than short term liquidity or cash management decisions (Greenbaum, Stuart- April 1998). The investment portfolio must balance credit risks (for investments), income goals and timing to meet medium to long term liquidity needs. An aggressive approach to portfolio management maximizes investment income by investing in higher risk securities.

- **Operational Risks**

Operational risk arises from the possibility of human or system related errors during the delivery of products or services. It transcends all divisions and products of a financial institution. It is the potential that inadequate information systems, operational problems, insufficient human resources, inadequate staff skills, or breaches of integrity (fraud) will result in unexpected financial losses (***source***: GTZ, 2000**)**.

The most obvious source of operational risk lies in the client-loan officer interactions where financial transactions take place (transaction risks). When traditional banks transact, the staff carrying it out is usually a trained professional and there are multiple levels of cross-checking put into place. Since loan officers in MFIs usually handle far more numerous short-term loans of very tiny amounts, this same degree of cross-checking is not cost effective; this increases the opportunities for both error and fraud (fraud risk).Operational risk includes the potential that inadequate technology and information systems, operational problems, insufficient human resources, or breaches of integrity (i.e. fraud) will result in unexpected losses. This risk is a function of internal controls, information systems, employee integrity, and operating processes **(*source***: A Handbook, CGAP, 1999**)**.

- **Fraud risk**

Until recently, fraud risk has been one of the least addressed risks in microfinance to date (Anita Campion, 2000). Also referred to as integrity risk, fraud risk is the risk of loss of earnings or capital as a result of intentional deception by an employee or client. The most common type of fraud in an MFI is the direct theft of funds by loan officers or other branch staff. Other forms of fraudulent activities include the creation of misleading financial statements, bribes, kickbacks, and phantom loans.

- **Regulatory and legal compliance risk**

Compliance risk arises out of violations of or non-conformance with laws, rules, and regulations, prescribed practices, or ethical standards, which vary from country to country. The costs of non-conformance to norms, rules, regulations or laws range from fines and lawsuits to the voiding of contracts, loss of reputation or business opportunities, or shut-down by the regulatory authorities. Many non-government organizations that provide microfinance are choosing to transform into regulated entities, which exposes them to regulatory and compliance risks. Even those microfinance NGOs that are not transforming are increasingly subjected to external regulations (Case Studies in Microfinance, World Bank, 1998).

- **Strategic Risks**

Strategic risks arise when a MFI has inadequate governance structure in place (governance risk) or if its market reputation suffers due to mismanaged operations or client interactions (reputation risk) or due to external market factors (external business risks and even risks). (***Source***: GTZ, 2000). Strategic risks include internal risks like those from adverse business decisions or improper implementation of those decisions, poor leadership, or ineffective governance and oversight, as well as external risks, such as changes in the business or competitive environment (Campion and White, 1999). Strategic risk includes, Governance Risk, reputational risk, Business Environment Risk, and Regulatory risk.

- **Governance risk**

One of the most understated and an underestimated risk within any organization is the risk associated with inadequate governance or a poor governance structure. To protect against the risks associated with poor governance structure, MFIs should ensure that their boards comprise the right mix of individuals who collectively represent the technical and personal skills and backgrounds needed by the institution (Campion and White, 1999).

- **Reputational risk**

This refers to the risk to earnings or capital arising from negative public opinion, which may affect an MFI’s ability to sell products and services or its access to capital or cash funds.

Reputations are much easier to lose than to rebuild, and should be valued as an intangible asset for any organization.

Most successful MFIs cultivate their reputations carefully with specific audiences, such as with customers (their market), their funders and investors (sources of capital), and regulators or officials. A comprehensive risk management approach and good management information reporting helps an MFI speak the "language" of financial institutions and can strengthen an MFI's reputation with regulators or sources of funding (Campion and White, 1999).

- **External business environment risk**

Business environment risk refers to the inherent risks of the MFI's business activity and the external business environment. To minimize business risk, the microfinance institution must react to changes in the external business environment to take advantage of opportunities, to respond to competition, and to maintain a good public reputation (Anita Campion, A Survey Summary, October 1998).

2.9 RISK MANAGEMENT IN MICROFINANCE INSTITUTIONS

The vocabulary of Risk Management is defined in ISO Guide 73, "Risk management Vocabulary" as the identification, assessment, and prioritization of risks followed by coordinated and economical application of resources to minimize, monitor, and control the probability and/or impact of unfortunate events or to maximize the realization of opportunities (defined in I31000). Risk management, in the context of a microfinance institution, is defined as "the process of controlling the likelihood and potential severity of an adverse event: it is about systematically identifying, measuring, limiting, and monitoring risks faced by an institution" (Fernando, 2008, p 21). A risk management system also a method of systematically identifying, assessing, and managing the various risks faced by an MFI (HPMS White Paper).Since internal risks and external risks change over time, risk management is a process, not an event. It is a continual process of systematically assessing, measuring, monitoring, and managing risks in the organization.

All financial intermediation carries an element of risk and one of the key challenges that financial institutions face is to identify and hedge them. These risks vary in nature and severity for different institutions even when they operate within the same business environment. Each Microfinance Institution is, therefore, faced with its own unique set of financial, strategic & operational risk which must be identified and managed in order for it to sustain operations. MFIs also need to be aware that risk management is a continuous process and should be treated so, not as a 'one-off' exercise that is carried out annually or bi-annually. The risk management processes should have its own champions within the organization and senior management needs to be an active part of this process. Indeed the entire risk management process should be led by senior management with feedback and recommendations coming to them from all levels of the organization. Traditionally, microfinance institutions (MFIs) tend to grow organically and mature their operational policies as they grow. From the time they start operations; most MFIs are aware of and try to mitigate their financial risks. These are the most obvious to spot and MFIs develop mechanisms to minimize their credit and liquidity risks. But as their operation grows in size and their loan portfolios diversify, a number of different types of risks begin to manifest themselves beyond the obvious financial ones.

Effective risk management ensures that the "big picture" is not lost to the urgent demands of day to day management. Effective risk management encompasses a "feedback loop" from the branch to senior managers, and sometimes to the board of directors, to make sure that policies and strategies are appropriate and that the risk levels are within the risk parameters set by the institution. Creating a risk management infrastructure and system to incorporate that process into the organization's culture helps ensure that all staff is focused on identifying and anticipating potential risks, and not hiding them or denying that they exist. Since risk parameters and tolerances vary over time and among institutions, a systematic internal discipline is needed to reexamine and reassess risks on a regular basis (Sonia Saltzman and Darcy Salinger, September 1998).In ideal risk management, a prioritization process is followed whereby the risks with the greatest loss (or impact) and the greatest probability of occurring are handled first, and risks with lower probability of occurrence and lower loss are handled in descending order. In practice the process of assessing overall risk can be difficult, and balancing resources used to mitigate between risks with a high probability of occurrence but lower loss versus a risk with high loss but lower probability of occurrence can often be mishandled.

The Importance of Risk Management Systems to MFIs

As MFIs play an increasingly important role in local financial economies and compete for customers and resources, the rewards of good performance and costs of poor performance rises. Those MFIs that manage risk effectively (creating the systematic approach that applies across product lines and activities and considers the aggregate impact or probability of risks) are less likely to be surprised by unexpected losses (down-side risk) and more likely to build market credibility and capitalize on new opportunities (up-side risk).

The core of risk management is making educated decisions about how much risk to tolerate, how to mitigate those that cannot be tolerated, and how to manage the real risks that are part of the business. For MFIs that evaluate their performance on both financial and social objectives, those decisions can be more challenging than for an institution driven solely by profit. A risk management framework allows senior managers and directors to make conscious decisions about risk, to identify the most cost-effective approaches to manage those risks, and to cultivate an internal culture that rewards good risk management without discouraging risk-taking.

Many MFIs have grown or growing rapidly, serving more customers and larger geographic areas and offering a wider range of financial services and products. This calls for a very good risk management system to continue to operate efficiently and effectively. Meanwhile, in order to fuel their lending growth, MFI increasingly rely on market- driven source of funds, whether from outside investors or from local deposit and member savings preserving assess to those funding sources will require maintaining good financial performance and avoiding unexpected losses, without a good risk management system this cannot be.

Again, the organization structures and operating environment of MFIs can provide unique challenges. They may be much decentralized or too centralized, tend to be labor and transaction – intensive, have concentration risk in certain regions or sectors due to the mission, and often operate in volatile less mature financial markets.

Early warning system for potential problems: A systematic process for evaluating and measuring risk identifies problems early on, before they become larger problems or drain management time and resources. Less time fixing problems means more time for production and growth.

More efficient resource allocation (capital and cash): A good risk management framework allows management to quantitatively measure risk and fine – turn capital allocation and liquidity needs and to evaluate the impact of potential shocks to the financial system or institution.

Better information on potential consequences, both positive and negative. A proactive and forward – thinking organizational culture will help managers identify and assess new market opportunities, foster continuous improvement of existing operations, and more effectively align performance incentives with the organization's strategic goals.

Approaches to Managing Risk in Microfinance

The intrinsic and environmental risks that microfinance institutions (MFI) face are unique to it. While broad categories of risks might remain the same, the urgency and possible adverse impact of these risks are different for individual MFIs. There is no 'comprehensive risk management' strategy that is applicable for all MFIs and risk minimization processes that work for one MFI (however large and successful be) might not work for another. Each microfinance institution must, therefore, mitigate risk on its own terms, considering its own variables. According to GTZ (2000), classic risk management takes a four step process**:**

- Identifying and assessing risks in terms of their severity (either frequency or consequences);
- Measure risks and evaluating your risk tolerance or risk appetite;
- Monitor the identified risks on a regular basis and identify any new ones; and
- Manage these risks through close oversight

✓ **Managing credit risk**

Most microfinance institutions have put most of their resources into developing a methodology that reduces individual credit risks and maintaining quality portfolios. The importance of a **"**credit culture**"** in minimizing problems and increasing operational efficiencies cannot be overstated. MFI senior managers need to set up systems that compel and offer incentives to loan officers to prevent, disclose, and respond to problem loans quickly, so as to limit potential credit-related losses. To control credit risk, microfinance institutions that use savings deposits as a source of loan funds must have sufficient cash to fund loans and withdrawals from savings. Effective approaches to managing credit risk in MFIs include**:**

- Well-designed borrower screening, careful loan structuring, close monitoring, clear collection procedures, and active oversight by senior management. Delinquency should be understood and addressed promptly to avoid its rapid spread and potential for significant loss.
- Good portfolio reporting that accurately reflects the status and monthly trends in delinquency, including a portfolio-at-risk aging schedule and separate reports by loan product.
- A routine process for comparing concentrations of credit risk with the adequacy of loan loss reserves and detecting patterns (e.g., by loan product, by branch, etc.).

Managing Credit Risk is an integral part of **ASA financial institution's (**Bangladesh**)** operating methodology, and ways to reduce these risks can be found in almost every aspect of their operations. Some of the mechanisms that have found to be most effective are:

- **Relationship building:** ASA puts a lot of emphasis on building and maintaining a cordial relationship between itself and clients. Loan Officers visit clients every week to collect instalments and spend time with them to understand their needs and issues. Regular visits are also made to the client's place of business to monitor the health of their business and to further strengthen the relationships. ASA's experience over the years have shown that in collateral free lending situations, one of the key factors that influence timely repayment is the relationship between the clients and the institution.
- **Engaging in group lending:** Although ASA provides loans to individuals, the clients still have to form peer groups of 8 – 10 members each and are responsible for selecting

and nominating members to receive loans. The group members are ultimately responsible for ensuring the repayments of loans by individuals in that group – this is usually done through peer based discussions and negotiations. Non-performance of a single member affects the credit standing of the others in the group, thus creating a social pressure towards the non-performing member to make timely repayments. This also ensures that groups nominate only those they think are capable of timely repaying, this providing an effective initial screening mechanism.

- **100% borrower verification:** loan officers are responsible for visiting and verifying each and every client's place of business, and residence, to ensure that the client has provided accurate information and have the capacity to borrow and pay back the loan. Inquiries are made to neighbours and peers regarding their standing in society and the performance of their business enterprise. These mechanisms help in preventing 'ghost' or fake loans and ensure that the clients are not over-leveraged.
- **Product standardization:** loan products are standardized across the organization ensuring that the loan portfolio is made up of homogeneous products which are easy to manage and monitor.
- **Regular reports:** regular portfolio performance reports are sent to the head office via regional offices. These management summary reports are designed to provide 'at a glance' information where key progress indicators are tracked. Exceptions are easily identified and corrective measures are suggested where required.

In addition, the ASA methodology promotes a strong 'credit culture' within the organization where staff are encouraged to prevent, disclose and respond to problems arising in individual loans rapidly so as to limit potential credit losses.

Sinapi Aba's (SAT) approach to managing credit risk

SAT uses the following tactics to manage credit risk and safely expand operations:

- Simple products and standardized procedures
- A strong credit culture pervades the organization
- Products and processes structured to reduce credit risk
- Transparency in credit operations through regular reporting
- Strict organizational control over loan transactions
- Operating systems designed for maximum performance:

✓ **Managing liquidity risk**

Liquidity management is not a one-time activity in which the MFI determines the optimal level of cash it should hold. Liquidity management is an ongoing effort to strike a balance between having too much cash and too little cash. If the MFI holds too much cash, it may not be able to make sufficient returns to cover the costs of its operations, resulting in the need to increase interest rates above competitive levels. If the MFI holds too little cash, it could face a crisis of confidence and lose clients who no longer trust the institution to have funds available when needed. Effective liquidity management protects the MFI from cash shortages while also ensuring a sufficient return on investments. Effective liquidity risk management requires a good understanding of the impact of changing market conditions and the ability to quickly liquidate assets to meet increased demand for loans or withdrawals from savings (Campion and White, 1999).

To minimize liquidity risk, all **ASA** Branches prepare a 'Daily Fund Plan' that anticipates the cash inflow and outflow for that branch on the next day. It takes into account the cash inflow from loan and savings instalment collections (that takes place in the morning) and matches it against the cash outflow from loan disbursements (that takes places in the afternoon) plus operational expenses. Any surplus funds are deposited with a correspondent bank at the end of the day and any anticipated shortfall is covered by withdrawing funds from the bank early in the day. Branches are not allowed to hold cash overnight to reduce risks of theft or misappropriation. The branches also prepare a monthly fund plan that outlines the number of loans it anticipates to give out the next month, the amount of savings withdrawals expected and projected operating expense. This ensures that the finance department can anticipate funding needs of individual branches and identify branches with potential cash surplus or shortfall. Surplus funds are routed to the central treasury account and funds are sent to branches that have a shortfall, any idle funds are invested in short term deposits. Quarterly fund plans are also prepared to allow the Treasury Unit anticipate medium term funding needs and allows ASA to plan its borrowings from external sources.

***Source*:** Deutsche Gesellschaft für Technische Zusammenarbeit **(**GTZ, 2000**)**

Some principles of liquidity management that most micro finance institutions use include**:**

- Maintaining detailed estimates of projected cash inflows and outflows for the next few weeks or months so that net cash requirements can be identified.
- Using branch procedures to limit unexpected increases in cash needs.
- Maintaining investment accounts that can be easily liquidated into cash, or lines of credit with local banks to meet unexpected needs.
- Anticipating the potential cash requirements of new product introductions or seasonal variations in deposits or withdrawals.

- ✓ **Managing market risk**

To reduce the mismatch between short-term variable rate liabilities (e.g. savings deposits) and long-term fixed rate loans, managers may refinance some of the short-term borrowings with long-term fixed rate borrowings. This might include offering one and two-year term deposits as a product and borrowing five to 10 year funds from other sources. Such a step reduces interest rate risk and liquidity risk, even if the MFI pays a slightly higher rate on those funding sources.

To boost profitability, MFIs may purposely **"**mismatch**"** assets and liabilities in anticipation of changes in interest rates. If the asset liability managers think interest rates will fall in the near future, they may decide to make more long-term loans at existing fixed rates, and shorten the term of the MFI's liabilities.

To manage its market risk, **ASA International** has established a Treasury Unit that studies market condition in the countries it operates in. Interest rates are established for each country after studying the prevailing market lending and borrowing rates. These rates are monitored on a continuous basis by a team of experts and changes are made to mitigate any interest rate risks.

Source**:** Deutsche Gesellschaft für Technische Zusammenarbeit **(**GTZ, 2000**).**

- ✓ **Managing operational risk**

Managing this risk require a combination of an effective internal control framework, appropriate information technology systems, employee integrity, and streamlined operating processesEffective internal controls play a key role in protecting against fraud at the branch level, since line staff handles large amounts of client and MFI funds. While fraud risks exist in all financial institutions, if left uncontrolled, they inevitably increase as fraudulent behaviors tend to be learned and shared by employees. Internal controls should include *ex-ante* controls that are incorporated within the methodology and design or procedures (prior to operation), as well as *ex-post* controls that verify that policies and procedures are respected (after operations).

To minimize Legal and Compliance risks, **ASA** International's in-house legal team works closely with local legal advisors in all its operating countries to ensure that it meets all statutory and legal requirements (***source:*** GTZ,2000). To minimize transaction and fraud risks, **some of the measures utilized by ASA are:**

- Use of a **"**Daily Collection Board**":** the money due to be collected on any given day (both loan instalments and savings collection) is posted against the names of each loan officer on a large board placed in the branch. This enhances transparency, sets daily collection targets for the loan officers and helps prevent the scope for misappropriation.
- Collections in group meetings**:** all savings and loan instalments are collected in group meetings in full view of all group members. This ensures that the clients witness all financial transactions and helps prevent misappropriation as well as increase client confidence in the organization.
- Rotation of loan accounts**:** every six months, the client accounts looked after by one loan officer is transferred to another within the same branch. This ensures transparency and accuracy in record keeping, performs an ad hoc six monthly audit, and helps in detecting fraud or errors.
- Periodic review of passbooks**:** all client passbooks are checked at least once every quarter by the respective branch manager to ensure that the transaction details noted in the client's passbook tallies up with the figures in branch documents. This helps identify fraudulent or erroneous transactions. Random checks are also done by head office staff and field managers when they visit clients.

- Disbursements are made from branch offices**:** clients come to the Branch Office where loans are disbursed in presence of all loan officers and branch manager; all of who sign the loan application form indicating that they have verified disbursement of the sum approved on the application form. This helps avoid misappropriation by ensuring that the entire loan amount is handed over to the clients, not a part of it.
- Peer-group cross checking**:** peer based cross-checking is a continuous process within ASA and exists at all levels of operations. Loan officers cross check each other's books of records weekly and branch managers cross-audit each other's branches monthly. This helps in rapidly identifying irregularities in branches.
- Cashbook duty rotated**:** since ASA branches do not employ dedicated accountants or cashiers, one of the loan officers perform the duty of a cashier and maintains the branch cashbook. This duty is rotated on a regular basis to ensure that no single person keeps custody of the cashbook for a long period of time and helps identify errors or fraud.

Source**:** Deutsche Gesellschaft für Technische Zusammenarbeit **(**GTZ, 2000**)**

✓ **ASA's strategy for managing strategic risk**

All ASA International entities are governed by experienced staff members who are deputed from ASA Bangladesh to these institutions. Most have over 10 years working experience with ASA in Bangladesh and are therefore well acquainted with both ASA's philosophies and its core principles. As entities mature, their Board of Directors is expanded to include individuals who have specialized knowledge of a market and are aligned with the mission of ASA International. Every single ASA and ASA International staff members are made aware of ASA's core philosophy of focusing on its clients first. This, coupled with ASA's strategy of fostering close ties with its clients, minimizes reputation risks. To minimized external risks or event risks, ASA International's Business Development Unit keeps track of major macroeconomic, legal, regulatory and fiscal policy trends that have the potential to affect operations for each operating country. Regular reports are prepared for senior managers and corrective actions are taken as required.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This chapter analyses the research methods and justifies the choice used for this research. It also shows the main procedure and technique used in collecting relevant data, gathering data and the method of analysis used. This is to show in the coherent manner the systematic steps that were taken during the data collection stages.

3.1 Population of the Study

For this study, the population was about one-twenty microfinance institutions in Kumasi. The study covered only MFIs within Kumasi. The institutions in the microfinance industry were segmented into the formal, the semiformal and the informal sector. For the purpose of this research and the kind of information that was desired, the large incorporated institutions in this industry of the likes of Sinapi Aba Trust were deemed to be in the formal sector, Credit Unions were covered as being in the semiformal sector with the Susu Schemes constituting the informal sector. This provided the relevant information for the study.

3.2 Sample size and sampling procedure

For easy attainment of goals, probability sampling was used. This aided the research into consciously seeking out respondents at both ends of the spectrum. It also helped to ensure that, all viewpoints were adequately represented. A sample of 50 respondents consisting of 20 formal, 15 semi-formal and 15 informal sectors were chosen.

3.3 Data Collection Instruments and Procedure

A questionnaire was used to collect data. The instrument had both open-ended and close-ended questions. Warwick & Linger (1975) stated that, researchers should settle on instruments, which provide utmost accuracy, generalizability and explanatory power with low cost, rapid speed, and a minimum of management demands, with high administrative convenience.

Data collection procedures for the formal sector as segmented by the study, involved getting the introduction letter from the university administration and visiting the MFIs to give some notification of our intensions to the targeted respondents. The managers later introduced the research group to the respondents. For the semiformal and informal sector, a brief official introduction of our intentions on the fore page of the questionnaires served this purpose. The questionnaires for the formal side and a large part of the semiformal sector were self-administered and later picked after allowing the respondents one week to complete them. For the informal sector that needed some sort of help and monitoring, it took the form of interviewing using the survey questionnaires. **Some observations were also done to ascertain the veracity of some of the submissions given by the respondents.**

3.4 Research Design

Saunder et al (2007), defined research design as the general plan of how the researcher answers the research question. In this study, a mixed approach of qualitative and quantitative research was used to triangulate and gain some fair insight into the information received. Quantitative research refers to the systematic empirical investigation of quantitative properties and phenomena and their relationships. Qualitative research is a method of enquiry employed in many academic disciplines. Qualitative research seeks to investigate the why and how of decision making not just what, where and when (***source***: Google search-Wikipedia). Unlike quantitative research which is associated with a deductive approach to testing theory, a qualitative approach uses an inductive approach to generate data. On the other hand, qualitative research refers to a set of research techniques where data is obtained from a relatively small group of respondents and not analyzed with statistical methods.

3.6 Data Sources

3.6.1 Primary data sources

The main method used for data collection mainly in the informal sector was interviews using a survey questionnaire. For the formal and semi-formal sectors, questionnaires were self-administered and retrieved after a week. These instruments were supported with observations.

(i) ***Survey:*** *Q*uestionnaires were designed to collect data in the survey. The questionnaires contain both open-ended questions and closed ended questions. The open-ended questions were meant to allow respondents to express their views on some issues under consideration. We planned to administer 50 questionnaires in three broad categories of the Microfinance Industry as shown in Table 1. The unit of analysis were the Microfinance Institutions; the Credit Unions and the Corporate Susu Schemes. For each of the institutions one questionnaire was administered. Respondents were basically the senior staff in charge of risk management. The questionnaire was structured to address all the three objectives of this study.

Table 1. Sampling frame

MFI category	Sample size	Description
Formal	20	MFIs like SAT, Money Link financial service
Semi-formal	15	Credit Unions
Informal	15	Susu

ii*. *Observations: Observations were used where feasible and during the surveys. Responses such as risk management measures put in place were checked. For example, if a respondent said that he had some equipment like calculators and computer systems to check human errors, we either asked or checked to see its existence. Also if any answer was given to the effect that there was a documented risk management policies, it was inspected to ascertain the veracity of that information.

3.6.2 Secondary data sources

Secondary data was collected through literature and document reviews, which included existing literature both published and unpublished such as books, journals, newsletters, newspapers and website. These sources of data were mostly used in the literature review of similar works.

3.6 Data analysis and interpretation

Both quantitative and qualitative methods were being employed in the analysis of data. For the quantitative aspect of the study, analyses of the data were undertaken with the aid of tables and charts. Excel was also used to draw a better conclusion of the data. For the qualitative part of this study, all responses were recorded in notes by the interviewer. Questionnaires, observations and interviews were structured into sub-themes that guided the analysis.

CHAPTER FOUR

FINDINGS, ANALYSIS AND DISCUSSIONS

4.0 Introduction

This chapter seeks to analyze and interpret survey data gathered from the field through interviews and questionnaire administered on the subject matter. The chapter also provides information on the analyses of the data and findings. Inferences are drawn to establish relationship among variables. The data collected from the questionnaires and interviews were analyzed using Microsoft excel, charts and tables.

4.1 SEX OF RESPONDENTS

The respondents comprise both males and females based on random selection. Out of the 50 respondents selected, 27 of them were males representing 54% and 23 of them being females representing 46% as depicted in Figure 4.1 below.

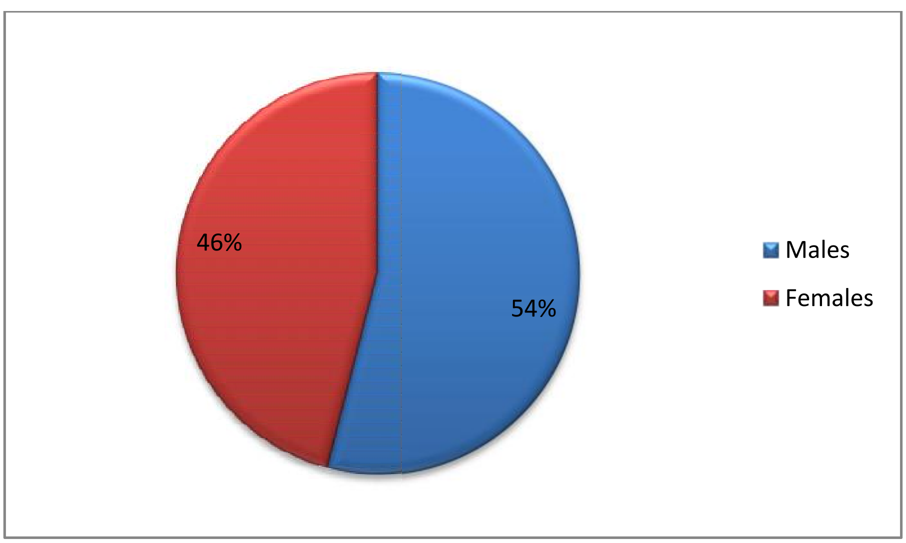


Fig 4.1: sex of respondents

4.2 AGE OF RESPONDENTS

In the diagram, the respondents under the age of 20-25 represented 42%. Those under 26-40 represented 46% and the respondents under 41-60 years also represented 12%. The outlook on the range of ages suggests that, the senior officers of these MFIs fall within the younger generation ranging between 21-41 years.

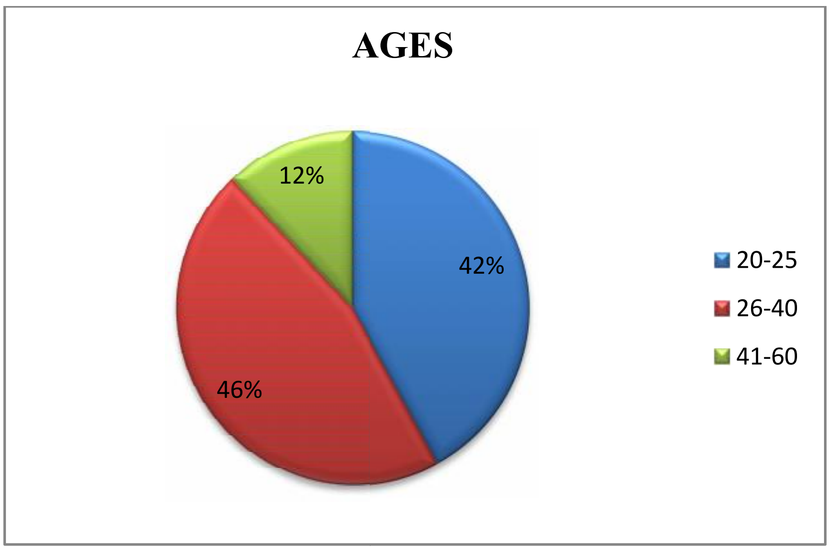


Fig 4.2: Age of respondents

4.3 FORMS OF MICROFINANCE INSTITUTIONS

One of the targets of this research was to come out with comprehensive findings that cover all the sectors of the microfinance industry in Ghana. Among them were; the formal sector that consists of the Micro financial institutions; the semi- formal sector that consists of the Credit Unions and the informal sector that consists of the Corporate Susu operators. Out of the total number of 50 respondents, 40% represented the formal sector, 30% represented semi-formal sector and 30% represented the informal sector. This is depicted in Figure 4.3 below.

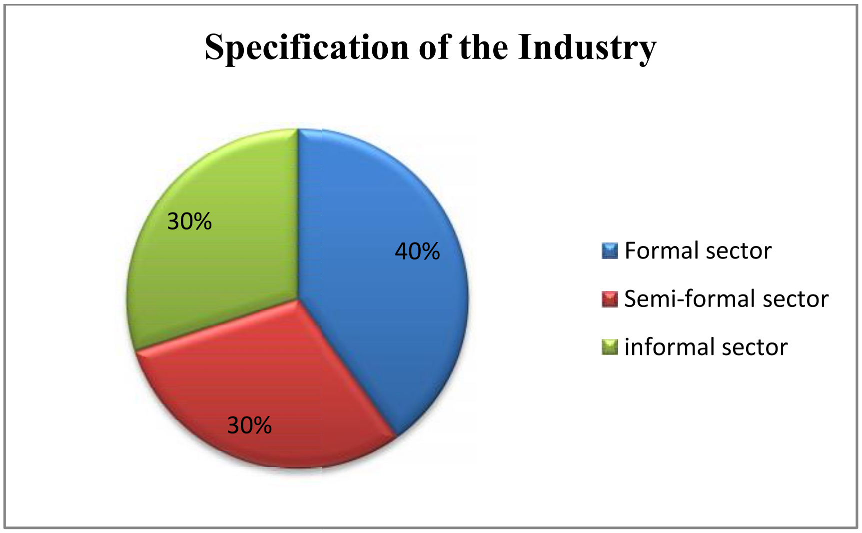


Fig 4.3: Specification of the Industry

Variation of the percentages of the sectors chosen was informed primarily by the following considerations;

- The ease of location of their (sector) institutions
- Availability of information in individual sectors in the industry
- The relative population of clientele held by these sectors.

4.4 POSITION OF THE RESPONDENTS IN THE MFI

This research targeted staff with oversight responsibility in matters of risk management to be the main respondents for their institutions. For the formal sector, MFIs had 28% senior manager/owners overseeing this function. 56% were seen to be undertaken by functional managers with 16% being overseen by the operational managers. In the semi-formal sector, 38.5% were done by their managers/owners; 38.5% of functional level staff undertook this responsibility while 23.1% were undertaken by operational level staffs. For the informal sector, 25% of the owners were found out to take such responsibilities while 58.3% and 16.7% went for the supervisors and operational level staff respectively.**Fig4.4a** and **4.4b** below represent the information on the position of the respondents at their various institutions.

Source: Field Survey, April, 2012

	TOP MANAGERS/ OWNERS	FUNCTIONAL MANAGERS/ SUPERVISORS	OPERATIONAL MANAGERS
FORMAL	**7 (28%)**	**14 (56%)**	**4 (16%)**
SEMI-FORMAL	**5 (38.5%)**	**5 (38.5%)**	**3 (23.1%)**
INFORMAL	**3 (25%)**	**7 (58.3%)**	**2 (16.7%)**

Fig 4.4a

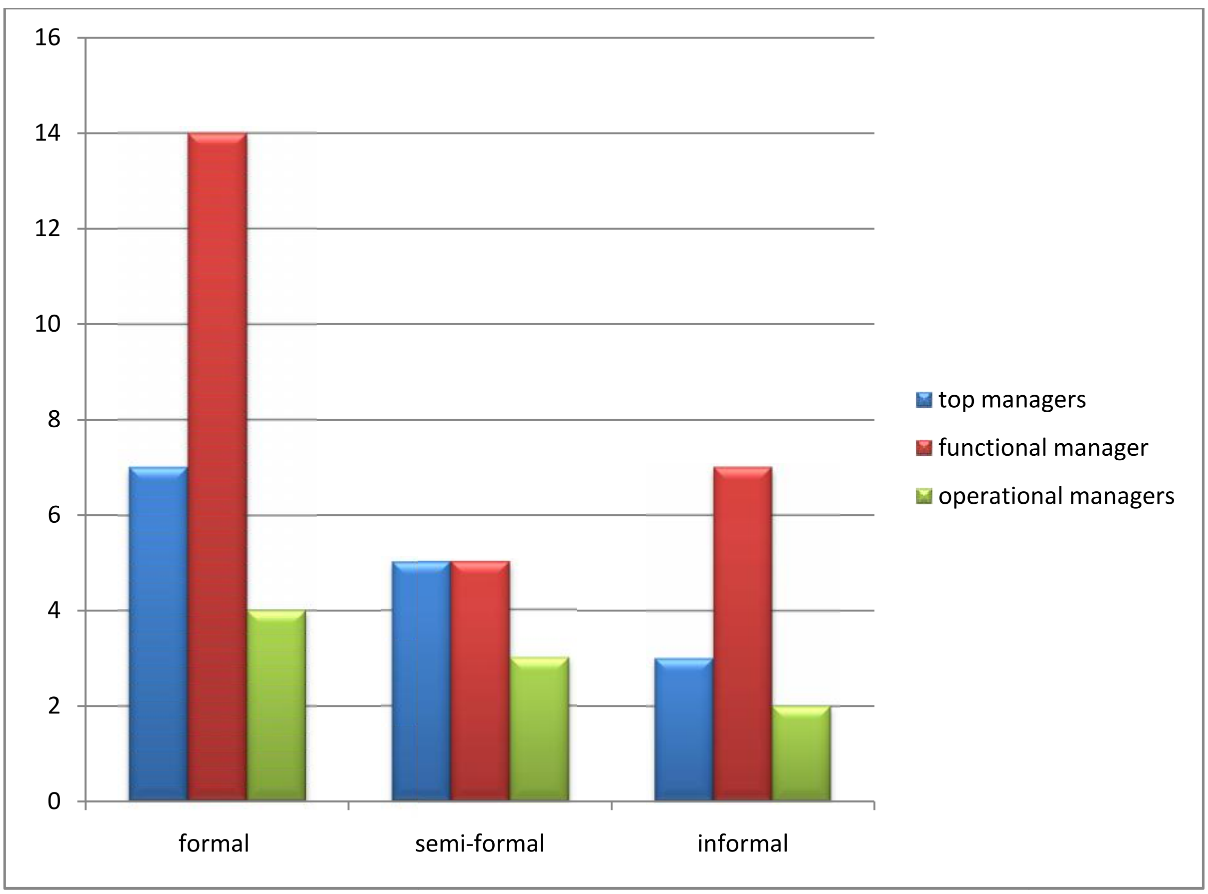


Fig 4.4b ***Source: Field Survey, April, 2012***

4.5 EDUCATIONAL LEVEL OF RESPONDENTS

From the distribution, respondents with tertiary level education were found to be the majority with 90%. The lowest level of education which formed the minority was the secondary level and it represented 10%. It thus, can be deduced that, MFIs have bright prospects of becoming more sophisticated in their operations in the near future. It also gives good indications that more standard practices could be easily integrated into these institutions for the industry to gain firmer grounds in the country. More innovations are also bound to spring up from the young graduates entering into this relatively infant industry in Ghana. Fig.4.5 represents the information.

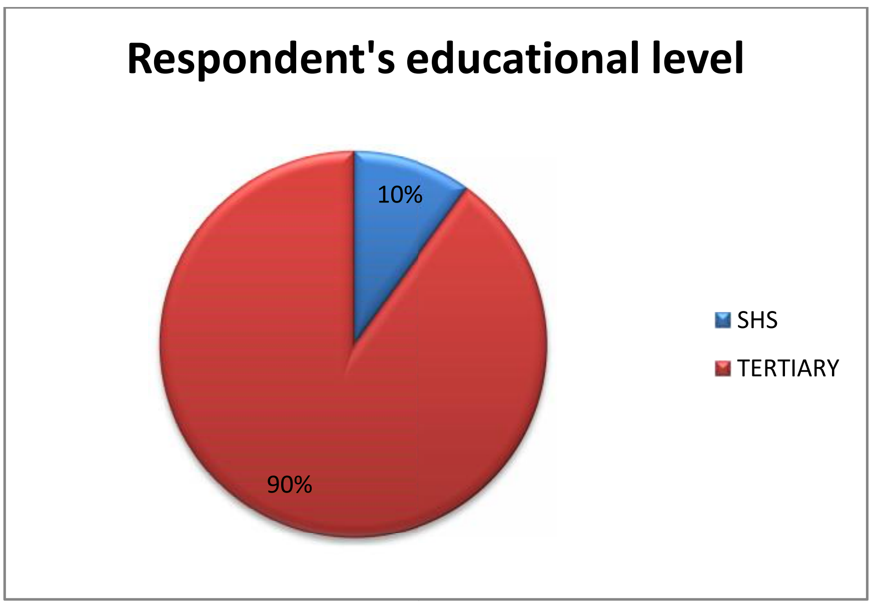


Fig 4.5

4.6 AN OVERVIEW OF THE RATE OF GROWTH

Various responses were given for the trends of growth in the various sectors in the industry. Not withstanding the risks prone to the microfinance industry, responses from the formal sector was positive with a majority of 55% of the firms indicating faster growth with just a few of 30% subscribing to moderate growth and yet a lesser few of 15% speaking of a steady unsatisfactory rate of growth. This highly positive rate of growth is readily attributable to the high sense of innovation and customer centered performance of this sector. Even though competition in this sector could not be ruled out, the players were found to demonstrate an impressive sense of gaining and sustaining competitive advantage among these institutions. These institutions also demonstrated high aspirations of extending the coverage of their operations through branches to reach prospective customer groups with their services.

For the semi formal, as many as said their organisations were experiencing a fast pace of growth said their growth was steady. Just a few of 13.3% mentioned that growth was slow. The firms that experienced a moderate or steady growth as well as those that experienced a slower pace of growth gave comments that suggested that, they faced a considerable level of competition. For the firms that gave an impression of high level of growth, the differentiating factor was that, they were seen to be offering more innovative products that could catch the attention of the target customers. This proved that, this sector still has a potential of growth if only the organisations in question demonstrated some magnanimity in coming out with some innovative target-customer-tailored products.

The informal sector as designated by this research gave a rather indifferent posture regarding the trends of growth in this sector with 20% giving some indications of satisfaction. They seem to have all concentrated on offering the same type of services to the same group of loyal customers. There seem to be very little indication of a deliberate attempt to either create more products or market themselves to other groups of prospective customers. Even though there could be more opportunities they could tap into for growth, satisfaction with mediocre performance and a rather unexpected sense of complacency seems to dominantly characterize this sector.

4.7 RISK THAT MICROFINANCE INDUSTRY FACE

Since identification of risks constitutes the first step in any risk management process, the next part of this research was to find out the various types of risk pertaining to the various sectors of microfinance industry under the study.

4.7.1 Credit Risk

Credit risk which is the risk to earnings or capital due to borrowers' late and non-payment of loan obligations was the most prevalent among the MFIs.The main issues highlighted under credit risk from respondents were in the areas of Loan default and Delays in repayment of loans which could technically be termed as delinquency. Another factor that respondents raised as posing a significant credit risk to them was the Lack of adequate proper information about the addresses/places of abode or residence of the clients they offered loans. This stems from the poor settlement planning of many communities in Kumasi and the issue of unnamed streets. A lot of inconsistencies froth the house numbering system in Kumasi making it very costly and difficult to track down debtors and recover unpaid monies. Some information gathered suggested that, acquiring a land property pledged as collateral in Kumasi was biased to be an unethical act that could seriously smear the reputation of the purchaser. This social factor posed a significant hindrance to the formal MFIs to grant loans of substantial amounts secured by such properties. It could be realized that most of the MFIs didn't really have in-depth knowledge about the technicalities of credit risk as to pay close attention to critical areas like transaction risk and portfolio risk. Just a negligible percentage from the fast growing formal sector was quick to mention portfolio risk (***Source: Field Survey, April, 2012).***

4.7.2 Market Risk

Responses to market risk which encompass risks that might arise from financial losses due to changes in market interest rates or due to inadequate protection from fluctuations in currencies or due to long term asset and liability management were not seen as much as credit risk affected the industry. There were just a few notably in the formal sector which highlighted fluctuations in exchange rates as a threat. Organisations of this calibre were those that were set up as conglomerates of similar foreign companies. They thus, have the potential of either borrowing money from their home countries for business or contribute to joint/group accounts used to assess the overall performance of their group of subsidiaries as a whole. A few of the institutions from both the formal and semiformal sector attributed some threats to the high interest rates on loans which had the potential to limit the market demand for their loans.

4.7.3 Operational Risk

It is the potential that inadequate information systems, operational problems, insufficient human resources, inadequate staff skills, or breaches of integrity (fraud) will result in unexpected financial losses. Many MFIs gave the indication of serious exhibitions of such risks in their operations. Their responses covered areas of Human error and mistakes in record keeping attributing it to long paper work. The long paper works comes about as a result of the staff having to deal with large number of client transactions in small amounts of cedis and pesewa. Some also stated IT risks in terms of mistakes in transferring records from the books into their computer systems as a factor that could lead to substantial omissions of some transactions. All sectors of respondent spoke of Employee theft and pilfering which could be due to the generally cash based nature of their operations. Some other risks they revealed were to do with their mobile bankers becoming targets of robbery. Other respondents stated Fraud and Stealing of company assets as major operational risks affecting their institutions. Good observations of the nature of clients of these institutions show that a majority of them usually employed people with secondary cycle academic background for their transaction processing functions. Though this calibre of employees could have an impact on cost cutting, their relatively unskilled nature could be a cause of high level of operational risks to these institutions.

4.7.4 Legal Compliance Risk

Compliance risk arises out of violations of or non-conformance with laws, rules, and regulations, prescribed practices, or ethical standards, which vary from country to country. The costs of non-conformance to norms, rules, regulations or laws range from fines and lawsuits to the voiding of contracts, loss of reputation or business opportunities, or shut-down by the regulatory authorities. The regulatory bodies of the microfinance industry have in the recent years engaged in strict supervision exercises which have led to the closing down of some MFIs with the accounts of others frozen until further investigations are carried out. Some respondents from the formal sector of this industry who fall under well structured regulatory systems stated the Cost of legal defaults as one of their risks. Others indicated Employees protection laws as one threat to their profitability as they need to pay nothing below minimum wage for their labour intensive operations (***Source: Field Survey, April, 2012).***

4.7.5 Business Environment Risk

Business environment risk refers to the inherent risks of the MFI's business activity and the external business environment. The major environment risk stated by the semiformal and formal institutions is to do with threats of stiffer competition from other firms entering into the industry.

For the second step of risk management being the identification of the severity of these risks, the study sought to find out the various risks that were predominantly and severely occurring in these institutions. **From the counts, the following were formulated on a scale of severity and predominance:**

1. Credit risk
2. Operational risk
3. Business Environment Risk
4. Market Risk
5. Legal Compliance Risk

To give further in-depth knowledge about their criteria for ranking these risks on their scale of risk severity, respondents' conclusions were given as depicted in the following diagram.

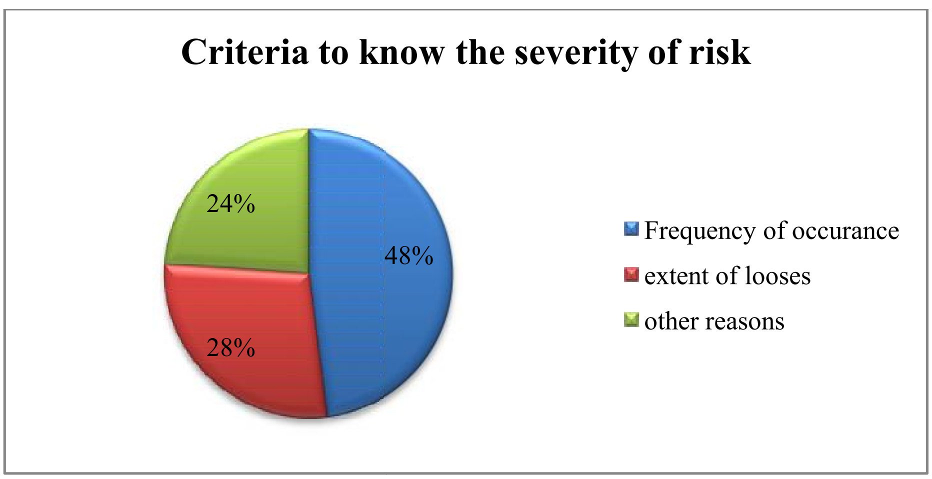


Fig 4.6: criteria to know the severity of risk

To ascertain the criteria these institutions used to evaluate various the risks as predominant and severe [due to frequency of occurrence or due to extent of losses/costs incurred] the following was gathered**:**

- 48% respondents used the frequency of occurrence as their criteria
- 28%used the extent of losses incurred as the best criteria
- 24% of respondents gave no consent to any of the above criteria and also had no clear cut criteria for ranking these risks.

This suggests that a majority of the institutions came to the conclusion of the severity of risks in the light of their frequencies of occurrence than its extent of loss caused. It could be interpreted that, these risks actually happen frequently in the industry but their impact in causing losses in this sector is not so severe. This could easily be an incentive for many of these institutions to loosen their grip in tracking and monitoring risks.

4.8 HOW MFIs MANAGE THE VARIOUS FORMS OF RISK

After assessing the various risks pertinent to the micro finance industry, the next step was to know the measures that these institutions put in place to manage these risks. Information was sought into the risk management measures used by the various microfinance sectors. A further aim of this section of the research was to come out with some insight about the level of knowledge and practice of risk management among the individual sectors.

4.8.1 Formal Sector Risk Management Measures

Credit Risk

For issues of loan delays the following responses were given as measures employed to mitigate its occurrence**:**

- ✓ Clearly spelt out or laid down terms of payment are specified to clients.

- ✓ Clients are cautioned about loosing their credibility for taking future loans if they delayed repayments.
- ✓ Concurrently, prompt repayment of loans becomes guarantee for easy access to future and/or higher loan facilities. The former serves as a disincentive for delayed payments while the latter served as an incentive for prompt repayment of debts.
- ✓ Strategies are also put in place to constantly monitor debtors. Some forms of penalties were also found to be taken for delayed payments.

- Loan Defaults

To curb loan defaults, respondents gave the following measures**:**

- ✓ Clients seeking loans go through some form of credit assessment before loans are given out. These measures seek to find out the credit worthiness of the client as in their occupation and standing in the society. If it is a business entity, the capability; capacity; cash flow; capital base and collateral [which some respondents called the 5Cs] will be carefully considered before credit worthiness is approved.
- ✓ Collateral is sometimes demanded of loan amounts exceeding certain limits.
- ✓ Some form of force is applied to threaten some stubborn debtors. These could be in the form of threats of legal action.
- ✓ Group lending was also found to be used where by group members serve as checks and guarantors for debtors.

Operational Risks

Under operational risks, measures put in place were seen to either mitigate fraud risk or human error risks. Responses for Human Errors suggested that**;** Staffs are provided with all the right tools and materials required for their work. Also employees are regularly given some form of training. Some sort of record verification processes were given where all records are thoroughly checked before filing. Some respondents also spoke of a conscious effort to employ well educated and competent staff. Others just saw cautioning of workers against mistakes as the way to manage this risk.

For **Fraud Risks**, most respondents employed God fearing staff. Some background records of staff were thoroughly checked before employment decisions were taken. Interestingly, some of the institutions offered some counselling and advisory sessions to strengthen the ethical and moral resolve of their employees. There were some respondents who had come out with some disciplinary measures and code of ethics put in place to keep a check on staff. In some institutions, well motivation of staff was used as a measure to keep them away from engaging in theft and fraudulent activities. Some institutions stated continuous assessment of existing employees and consistent monitoring of their operations as an appropriate measure.

Armed robbery risk measures predominantly given were to close before late hours and employing of security personnel to guard their institutions.

For this sector, **80%** of respondents gave very satisfactory indications that they were really putting in measures to manage some clearly identified risks. A minority of **20%** gave little or no indication of any awareness and practices of risk management measures. Some institutions gave responses to the impression that, some of the risks had not yet occurred in their organisations to prompt the implementation of any actions of the sort.

4.8.2 Semi Formal Sector Risk Management

- Credit Risk Management

Loan Delay risk mitigation measures in this sector was given as follows**:**

- ✓ Customers are made to pay in instalments.
- ✓ Penalties are also requested from debtors past due in order to make delays costly.
- ✓ Policies were used to prevent clients that delay repayments from accessing second loans.

- Loan Default risk management

Loan Default management measures were also given as follows**:**

- ✓ Good credit assessment is undertaken before loans are advanced to clients.
- ✓ Group lending is used and members of each group nominee are held accountable for the people who qualify to take loans.
- ✓ Collaterals are taken to offset the unfortunate eventuality of debts that have gone bad with debtors showing clear signs of inability to make payments.
- ✓ Compulsory Savings is required for any person seeking loan facilities. These savings accounts could be frozen for the period within which loan is still outstanding.

Similarly, some **Credit Unions** would only advance loans to clients who have made some regular contributions to their accounts for some specified number of months.

- Human Errors

To check human errors the following responses were given**:**

- ✓ Equipment like calculators is provided to employees to prevent certain errors.
- ✓ Computer Data Base is used for keeping all transactions.
- ✓ Training programmes offered to staff to minimize the frequency of mistakes.
- ✓ Records are also regularly checked and cross checked for any mistakes.

The general outlook on the kind of responses given for risk management given by these institutions proved quite satisfactory. **67%** gave very good indications of measures they had put in place to minimize the spate of occurrence of risks. The remaining **33%** gave either illogical or no knowledge of anything they have been doing to manage these risks that are bound to happen in these institutions.

4.8.3 Informal Sector Risk Management

- Credit Risk Management

The measures put in place to check **loan default** include the following**:**

- ✓ Properly laid down procedures for assessing and issuing loans. These are clearly seen as part of the organisations policies that are strictly applied to every loan application to either approve or disapprove loans.
- ✓ Trust worthiness was predominantly found to be used as the basis for issuing loans to loyal customers.
- ✓ Group lending is also very much used here with group guarantees serving as securities for loans. The group lending coupled with trust-based lending used predominantly in this sector is a clear indication of their limitations in taking any collateral from the kind of target group they deal with.

For **loan delays,** the following were given**:**

- ✓ Penalties are charged for late repayment of loans and consistent checking is done with debtors to track back loans.

- Operational Risk Management

Concerning Operational Risk Management (Human Errors),the only suggestion that was made by these Corporate Susu Schemes was that, Staff is advised to be careful in their book keeping activities. Little information on risk management was given from this sector with as high as **40%** giving no responses to this regard. A good number of the remaining **60%** gave a grin picture about actual use of the risk management measures in their various institutions. From the above responses from the various sectors, it can be inferred that an average of **62.33%** of players in the micro finance industry in the Kumasi metropolis are aware of and are quite competent enough to identify risk management measures that can be implemented to mitigate/manage risk in their institutions.

4.9. A. CHALLENGES MFIs FACE IN IMPLEMENTING RISK MANAGEMENT MEASURES

The next stage of this research was to gain some insight into the challenges that these institutions faced implementing these risk management measures. Similar responses were given across the three sectors and were summarized as follows**:**

Almost all respondents made notice of the high cost involved in the process. Their financial constraints afforded them little or no chance to cover some of the elements involved in operating and monitoring performance in risk management.

Other respondents gave the assertion that, it is difficult to obtain qualified and committed people for the implementation. The respondents indicated that qualified and committed personnel are needed to monitor risk. Getting them comes with its attendant costs and they also are hard to come by

Others complained of the difficulty in implementation. They saw the whole risk management process as complex and complicated to practice. Some institutions were honest about the long time it could take to exhaustively go through these cross-checking processes and monitoring activities. They attributed the frustration of this process to the bureaucracy and the large number of paper-work undertaken in their institutions.

Some spoke of the difficulty in detection of upcoming risks. Others were just at a loss at the right management measures to be put in place to monitor and minimize these risks.

It was realized that responses to this section came in the majority from the formal sector; with a few scattered responses from the semi-formal sector and no recognizable input coming from the informal sector. This gives further information to the probe into the actual practice of the risk management in the various sectors under study.

4.9. B. RISK MONITORING MEASURES

Further information was sought into the structures put in place by these institutions to monitor risks. Two preambles were used to ascertain whether or not tangible structures were put in place for this purpose. These were;

1. Whether they had a documentation of risk management policies or
2. Whether a department was specially designated to oversee risk management issues in their institutions.

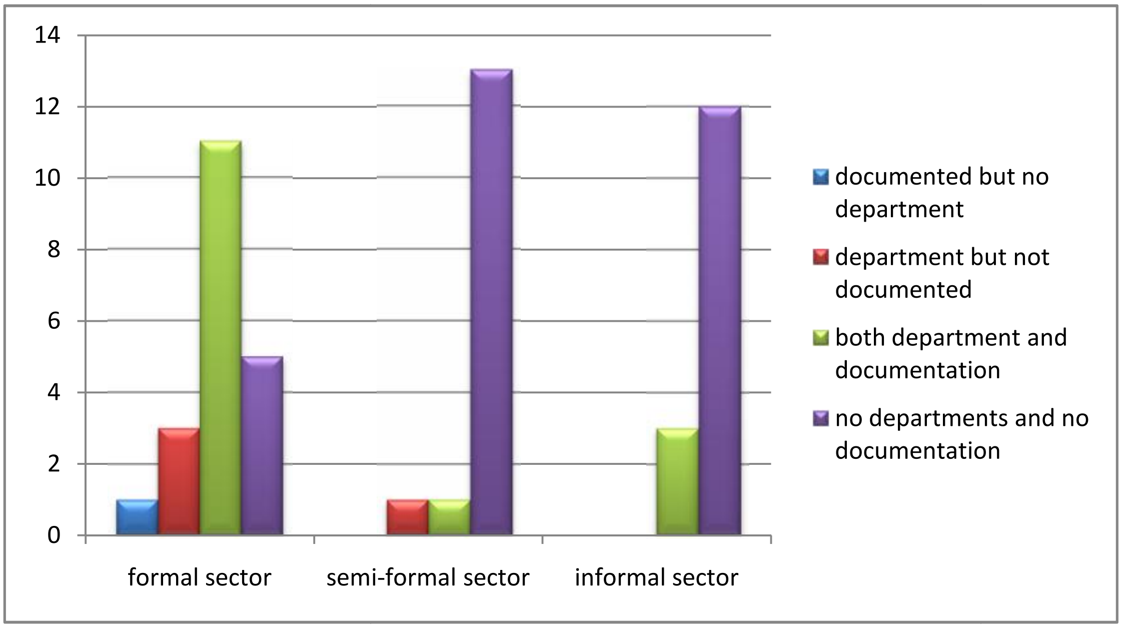
In the formal sector, **25%** were found out to have neither of the two. **5%** were found to have only documentations of their risk management policies but not a tangible department for managing risk management affairs. **15%** were found to have risk management departments but no documented risk management policies. **55%** were found to have both.

In the semiformal sector, **86%** were found out to have neither of the two. **None** was found to have only documentations of their risk management policies but not a tangible department for managing risk management affairs. **6.7%** were found to have risk management departments but no documented risk management policies. **6.7%** were found to have both.

For the informal sector, **80%** were found out to have neither of the two. **None** was found to have only documentations of their risk management policies but not a tangible department for managing risk management affairs. **None** was found to have risk management departments but no documented risk management policies. **20%** were found to have both.

Fig 4.7a represents the number of respondents with documented policies and departments; documented policies but no departments; departments but no documentation and neither departments nor documented risk management policies.

Fig.4.7a ***(Source: Field Survey, April, 2012).***



In general (from all sectors), respondents with risk management departments constituted **40%** by indicating **'Yes'.60%** of the respondents indicated **'No'**, implying that, they did not have risk management departments. **Fig 4.7b** represents the respective percentages.

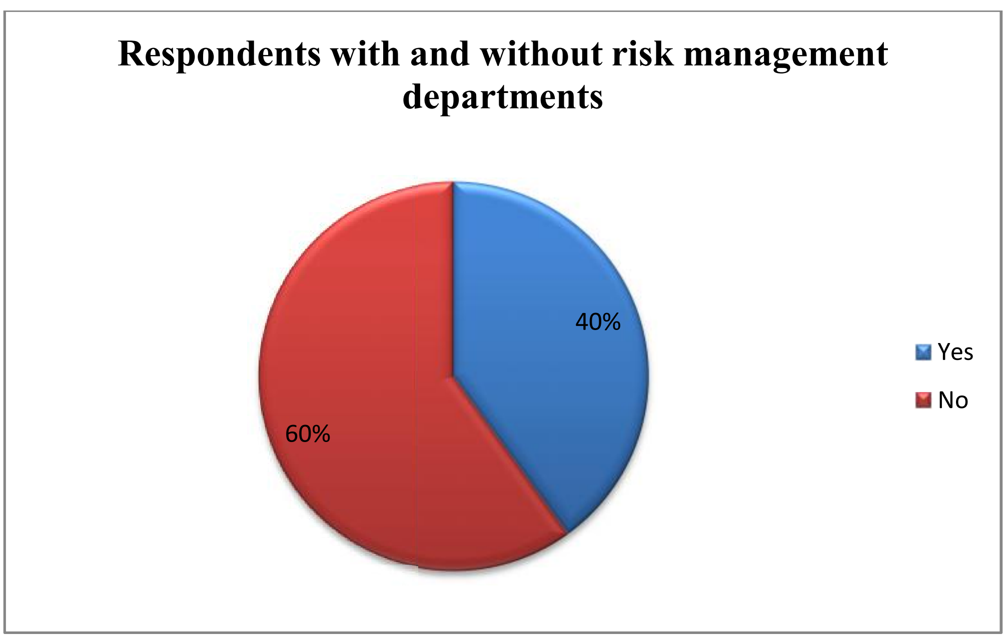


Fig 4.7b: respondents with and without risk management departments

CHAPTER FIVE

SUMMARY OF FINDINGS, RECOMMENDATION AND CONCLUSION

5.0 Introduction

This section of the study covers the summary of findings and recommendations given to the micro finance industry. It finally draws conclusion and provides guidance for further research on the topic.

5.1 Summary of Findings

The topic ‘assessment of risk and risk management measures among MFIs in Kumasi’ researched into the microfinance industry specifically in Kumasi. To give a more comprehensive outlook of the results gathered from this industry, the industry was segmented into three main groups. These were the ‘formal sector’ which consisted of the institutions generically known as the microfinance institutions in the like of Sinapi Aba Trust [SAT]; the ‘semiformal sector’ which included institutions in the like of ‘credit unions’ like Grace Baptist credit union and the ‘informal sector’ with Corporate Susu Schemes.

The target respondents who were deemed to be in the best position to represent their institutions on this matter were mainly staff who had superintendent influence on matters of risk and its management. The outlook on their ages and educational backgrounds showed a majority of them being in the younger generation under forty and a majority having sound tertiary education. This sector therefore has a good potential for learning and consequential growth. For the formal sector, most of them have grown enough to delegate this function to functional managers while the percentage of this trend declines from the semi to informal sector where the owners/managers take full responsibilities of such functions.

Growth rates in this sector was realized to hinge on the institutions long term aspiration of growth; a deliberate sense of innovation and a well calculated strategy to gain and maintain competitive advantage. The sector that really showed clear signs of inculcating such values in their operations were seen more to be in the formal sector and this accounts for the greatest rate of growth. The informal sector showed a lower spate of growth with the informal sector registering very little indications of growth. While the formal sector had long term intentions prospecting for a larger customer base through marketing and innovation of more customer centric products, a considerable number of the other sector players seemed to stick to their loyal customer base and passively expected the number to increase. This attitude obviously reflects in their rate of growth as compared with other sector.

As regards the first step of the risk management process being the identification of risks, some study was conducted into the main risks that these institutions faced in the microfinance industry. Credit risk was the most prevalent among the MFIs.The main issues highlighted under credit risk from respondents were in the areas of Loan default and Delays in repayment of loans which could technically be termed as delinquency. Most respondents related this particularly to the lack of any proper information on the location of places of residence of clients and their inability to take collateral among others. Market risk which encompassed risks that might arise from financial losses due to changes in market interest rates or due to inadequate protection from fluctuations in currencies also had some lighter form of expression in this sector. Exchange rate risks were only realized in the formal MFIs that were owned by foreign entities with a few firms expressing high interest rates as a threat to the market demand for their loans. Operational risk was found to be very much present in the microfinance industry. The responses gathered covered areas of Human error and mistakes in both manual and electronic record keeping; Employee theft and pilfering; their mobile bankers becoming targets of robbery; Fraud and Stealing of company assets. A lot of these high occurrences were attributed to the Long paper work [resulting from this industry's characteristic large number of client transactions in small amounts of cedis and pesewa] and the generally cash based nature of their operations. Risks like legal compliance and business environment risk were scarcely found to be a considerable risk except for those that spoke of the increasing rate of competition from new entrants. Risks like liquidity, governance and strategic risks were however not found among these institutions studied. The overall picture of severity and prevalence of these risks saw credit risk topping the list followed by operational risk, market risk, business environment risk and legal compliance risk in that order. The main criteria used for judging and ranking these risks in order of their severity and prevalence in the industry mostly had to do with their frequency of occurrence than in the extent of losses they (risk) had caused. It was realized that the technicalities of risk management as in the generic names of the various risks [such as the credit and strategic risks] and the sub risks that fell under these risks [e.g. portfolio and transactional or governance risk, compliance risk and business environment risk] was not known to a majority of respondents who were meant to oversee such factors. Especially in the informal sector, some managers were even at a loss at the term risk and impliedly suggested that the technicalities studied in schools had no bearing with what they encountered on the ground. It sometimes had to take some briefing to get them to know that, 'risk' was some of the very issues they empirically faced to get their responses.

Another important part of this study was to come out with the kind of measures that our microfinance industry had put in place to check the risk factors that confronts this industry, it was realized that across the various sectors, the risk measures used were more geared towards credit and operational risk which constituted the most evident risks encountered in their day to day operations.

For the formal sector **credit risk management**, some well structured credit assessment procedures which applied to both individuals and business entities as well as some collateral demanded for loans exceeding some amounts were the measures most used to manage loan default risks.

For the semi formal sector, **the Credit Unions** were also found to use some credit assessment coupled with a minimal amount of collateral taking. Some requirements of compulsory savings loyal membership and group guarantees are also used here as a security for loan default.

The informal sector shows some amount of credit assessment with strong group guarantee and trust or character-based-lending undertones in their attempt to deal with default risks. For **loan delinquency managements**, similar trends of clauses either explicitly or implicitly stated were seen in all sectors understudied. These constituted penalties payments for loans past due; possibility of loosing credit worthiness and persistent debtor monitoring with some scores of threats of legal action in extreme cases. Under **operational risks**, measures put in place were seen to either mitigate fraud risk or human error risks. For the formal sector operational risk management, measures as Provision of the right tools and materials, staff training, consistent record verification processes and employment of the adequately educated staff were predominantly used to check the risks of Human Errors. The semiformal sector basically managed these occurrences of errors with the provision of equipment like calculators and computers as well as persistent cross checking exercises with the informal sector relying on advising staff to be meticulous in their record keeping operations.

For issues of checking fraud, responses from the formal sector was in employing people with strong God fearing and moral backgrounds; continuous assessment and monitoring of staff; staff motivation, administering of some advisory and counselling sessions for staff as well as the formulation of codes of ethics and disciplinary measures for staff. Responses in terms of risk management measures were largely gathered from the formal microfinance institutions which inferably suggested their actual recognition and practice in their business operations. The responses from the other sectors leave the knowledge and practices of risk management measures suspect.

A further step was taken to inquire into the challenges that these institutions could point out as impediments in their implementation of risk management concepts. The challenges stated were of the high cost involved in the process; the difficulty of obtaining the quality and committed personnel for the implementation; the complexity and strenuous lengths of time it took to go through the meticulous steps involved and the lack of expert knowledge on the whole concept of risk management.

Some enquiry was finally sought into the authentic existence of tangible structures put in place in this microfinance industry to manage risk. It revealed that about half of the institutions from the formal side impressively had both risk management departments and some well documented policies for managing the risk factors pertinent to their institutions. A fewer number and yet the least number of institutions in the informal and semiformal sector respectively were found to have same features, for documentations of risk management policies and the availability of a risk management department, all the sectors gave very poor signs of being committed to any of these. The poorest responses came from the informal and semiformal sectors. Even for the formal sector, which is expected to do better, some were found to claim having a risk management department with no properly documented policy structures to follow in any eventuality.

5.2 CONCLUSION

After the research, it was observed that risk management practices were not a concept consciously given deliberate attention in the micro finance industry. The questions posed to the respondents almost always needed some briefing about the subject matter before respondents could get the cue to build their answers from. Some sought in the initial stages of the interactions to portray the 'risk management' we researched about as some of the 'book long' theories that was far-fetched from realities in their work. However, after some succinct enlightenment which was carefully delivered in a way not to influence their responses, some respondents could easily relate it to their day to day activities and give answers to the questions. It was evidently realized that there is a woefully lack of information on best practices in this all important industry, which needs not be considering the volatile nature of their operations.

It was also noted from this research that Microfinance Risk management looks to be much more of an intuitive art than a strict systematic or scientific process. The reason being that almost every one of these institutions have unique intrinsic and environmental risk factors in terms of their predominant calibre of clients, their location as well as the kind of human resource they are able to attract into their institutions. The business terrain for each sector covered, had its own complexities and distinctive intricacies which could demand exceptional recommendations and approaches to risk management. It therefore makes it quite difficult to give blanket statements and across board recommendations on the kind of measures any institution should put in place to identify and manage probable risk that can be universally applicable. Even where broad categories of risks might remain the same, the urgency and possible adverse impact of these risks are different for individual MFIs. There is therefore no clear cut ‘comprehensive risk management’ strategy that is applicable for all MFIs. Risk minimization processes that work for one MFI (however large and successful be) might not necessarily work for another. Each microfinance institution must, therefore, mitigate risk on its own terms, considering its own variables and dynamics pertinent to its operations.

This sector really shows signs of willingness to learn and inculcate some of these professional concepts like risk management in their institutions. However little seems to be done by the regulatory bodies of this sector to provide training seminars and monitoring for this sector especially in the informal sector.

5.3 RECOMMENDATIONS

- It is about time this sector gained some consideration for the inestimable contributions it is making to the economic growth of the country. It should cease to be viewed as an institution which could be set up by anybody and run anyhow with no specific direction and structures. The regulating bodies of this sector must really show some magnanimity to bridge the woeful knowledge inadequacies persistent in this industry. The unacceptable trend of ignorance to such imperative subjects as risk management is analogous of the proverbial nightingale that sings and hops in abject obliviousness of the hunters bow accurately aimed in its direction.
- The regulatory bodies should do more to enhance knowledge of best practices in the microfinance industry. The Micro Finance Secretariat of the Bank of Ghana as well as GHAMFIN and the Ghana Money Lenders Association should liaise with some institutions that offer courses in this area to organise regular seminars and training

sessions for the managers of these institutions. Such programmes should seek to simplify the management practices as that of risk management to suit every sector of the industry. It would be even more effective if these institutions are well segmented and trained by sectors since factors pertaining to each sector could be unique to it.

- Some microfinance studies should be inculcated into the tertiary finance programmes both at the university and polytechnic levels. If possible some institutions like ICA Ghana should for national interest add some aspects of microfinance to their line of courses to enlighten a lot more people on the uniqueness and exciting intricacies of the microfinance sector. Graduates with such knowledge should also be encouraged to delve into and cease some of the opportunities in the semiformal and informal sectors. It shouldn't be left solely to novices and the less educated. They must be orientated to come to the true realities that there is a fallow land of vast opportunities presented by these less regarded sectors that could be tapped into and expected to give off good returns.

5.4 FURTHER PROPOSED RESEARCH AREAS

This research has dealt with risk management in general. However further studies could be done into specific areas of risk and the measures that can be put in place to manage these risks. A topic like Assessing Credit Risk [or "Operational Risk"; "Market Risk" or "Legal Compliance Risk"] and its Management in the Microfinance Industry in Accra'' could be looked into. This research provided an overview into the broad picture of the microfinance industry but further research could be done also into individual sectors of microfinance. For instance a topic like "Assessing the Knowledge and Practice of Risk Management in the Semiformal Sector Microfinance Industry-Credit Unions in Takoradi" could be an interesting topic to delve into. It could further be narrowed down to case studies of some of the successful microfinance institutions to be of help to other institutions of the like. A typical topic of this kind could be **"**Assessing Risk Management Systems and Its Challenges in Micro Finance Institutions: a case study of Sinapi Aba Trust (SAT)**".** The findings of this research also came out with some indication of a lack of proper supervision of the semiformal and informal sectors of this industry. It could also provide a pedestal for some research into how on top of issues the regulating agencies are in their monitoring and supervision exercises and what they have really put in place to inure to the benefit and growth of this sector.

LIST OF ACRONYMS

Acronyms	Full Meaning
MFI	Microfinance institution
GTZ, 2000	Deutsche Gesellschaft für Technische Zusammenarbeit
SAT	Sinapi Aba Trust
ARB/Apex	Association of Rural Banks Apex Bank
ASCAs	Accumulating Savings and Credit Associations
ASSFIN	Association of Financial Non-Governmental Organizations
ARB/Apex	Association of Rural Banks Apex Bank
ASCAs	Accumulating Savings and Credit Associations
ASSFIN	Association of Financial Non-Governmental Organizations
ARB/Apex	Association of Rural Banks Apex Bank
ASCAs	Accumulating Savings and Credit Associations
ASSFIN	Association of Financial Non-Governmental Organizations
CUA	Credit Unions Association
FINSSP	Financial Sector Strategic Plan
FNGO	Financial Non-Governmental Organization
GCSCA	Ghana Cooperative Susu Collectors Association
GHAMFIN	Ghana Microfinance Institutions Network
GHAMP	Ghana Microfinance Policy
RFSP	Rural Financial Services Project
MFI	Microfinance Institutions
RFSP	Rural Financial Services Project
RMFIs	Rural Microfinance Institutions
ROSCAs	Rotating Savings and Credit Associations

RMFIs	Rural Microfinance Institutions
ROSCAs	Rotating Savings and Credit Associations

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APPENDIX

MFI Survey Questionnaire

Name of Enumerator: _________________________

Date of Interview: ___________________________

Community Name: _____________________________

Introduction

[Enumerator: Read the following introductory statement].

We are students from Christian Service University College (CSUC) and are conducting a survey on risks that microfinance institutions (MFIs) in Kumasi face and how it is manage. The research is for our final year project and will help us understand some of the challenges in the MFIs with regard to risk management. We also hope the relevant authorities will make use of our study recommendations to make MFIs even more beneficial to Ghanaians. We are collecting information from various kinds of MFIs in Kumasi. The interview will be completely confidential and will take about 20 minutes.

I. BACKGROUND INFORMATION

A. ON RESPONDENTS

1. [Enumerator: What is the gender of the respondent? Please tick]

____ (1) Male

____ (2) Female

2. Age of respondent

___ (1) less than 20

____ (2) 20-25

____ (3)26-40

____ (4) 41-60

3. Position at the MFI

_____ (1) Owner

______ (2) Employee: Specify position …………………………………

4. How long have you worked here?

____ (1) less than 2 yrs

____ (2) 2-5 yrs

____ (3) More than 5 yrs

5. Highest level of education of respondent

____ (1) Primary school

____ (2) JHS / JSS

____ (3) SSS /SHS

____ (4) Tertiary

B: ON MFI

6. [Enumerator: Specify the kind of MFI?]

____ (1) Formal

____ (2) Semi-formal

____ (3) Informal

7. [Enumerator: Specify the location (suburb) of MFI?]

----

8. How long has this business been operating in Kumasi?

____ (1) less than 2 yrs

____ (2) 2-4 yrs

____ (4) 4 -10 yrs

____ (3) More than 10 yrs

9. How has your growth been over the years?

……………………………………………………………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

……

10. How many branches do you have in Ghana?

____ (1) 1-2 branches

____ (2) 3-5 branches

____ (3) more than 5 branches

11. How many employees does the MFI have?

(a) In this branch?

____ (1) less than 5 employees

____ (2) 5-10 employees

____ (3)10-25 employees

____ (4) More than 25 employees

B. RISK THAT MFIs FACE

12. What kind of risk does MFIs in general face? [Enumerator: List as many as the respondent can mention]

____
____
____
____

13. Of these risks, which one do you think are the 3 most serious ones which your kind of MFI faces?

- ____
- ____
- ____

14. What criteria do you use to know the severity (most serious ones)? [Enumerator: You can tick more than one]

    ____ (1) Frequency of occurrence

    ____ (2) Extent of losses – cost incurred

    ____ (3) other – specify……………………………………

15. I have a list of some risks that we think your kind of business face. Please indicate your awareness and extent of occurrence of this in your MFI [Enumerator: Just read the risk and tick or cross as applicable. If risk listed was already named above by respondent, then don't ask, but use previous responses to tick or cross it).

Risk	Forms	Prone to your kind of MFI	Occurred to you	Severity (indicate as: High, Medium, Low
Credit Risk	Loan default			
	Loan delay			
	Portfolio risk			
Liquidity risk				
Market risk	High interest rates			
	Exchange rates Risk			

Operational risk	Human Error risk			
	IT risk			
	Fraud			
Legal compliance risk (damages, legal suits etc)				
Strategic Risk				
Governance Risk Reputational risk				

C. MANAGEMENT OF RISKS

16. How do you manage these risks [Enumerator: Assess 3 of what has actually happened and 2 that the business is prone to and has not happened]

Risk	How you manage the risk (Enumerator: Write details, including costs)
Risk 1:…………………	
Risk 2:……………………	
Risk 3:……………….	
Risk 4:……….	

17. How do you monitor to ensure that the management measures you have described are implemented according to the plan so that they become effective?

…………………………………………………………………………………………………

…………………………………………………………………………………………………

…………………………………………………………………………………………………

………………………………………………………………………………………………

18. What are the challenges that you face in implementing and monitoring risk management measures in your MFI?

……
……
……
………………………………………………………………………………………………….

19. Does your MFI have a department for managing risk ------------------------------

20. For the risk management methods stated, are they

a. Documented

b. Tackled as they occur without any documentation

This is the end of our interview. Thank you very much for your time and assistance.