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TECHNOLOGY, RISK
& FINANCIAL
INCLUSION

The YieldReport

In this issue

Market Watch

According to media reports, there is an imminent 'clean up' of the microfinance sector by Bank of Ghana, the country's financial sector regulator in charge of the money markets. This exercise is expected to focus primarily on deposit-taking institutions but may also affect non-deposit taking operators in the area of compliance.

USING THE PREFF® TOOL

Manging credit risks requires comprehensive information that allows for risk management along the entire credit management chain; application, approval, disbursement, monitoring, collection and recoveries.

PREFF® stands for

P – Personal Info

R – Related Information

E – Economic Information

F – Financial Data

F – Facility Details

A useful KYC data sheet must be PREFF-compliant.

Modern Portfolio Theory: How micro-creditors can manage volatility

1952 was the year, and Harry Markowitz is the name. If this doesn't ring a bell, then a quick review of Modern Portfolio Theory will provide a useful foundation to understand the complexities underlying risk and return in your portfolio as a micro-creditor. Originally propounded to guide investment decision-making, Modern Portfolio Theory has expanded its remit of intellectual utility by providing explanatory power to why credit providers see diversification as a critical tool to optimize the risk/return balance. In Portfolio Selection (see Journal of Finance), Markowitz (1952) argues, that an asset's inclusion in a portfolio must be on the basis of the level of covariance with other assets in the portfolio. To put more simply, an aset must be selected not only on the basis of its unque characteristics but how it contributes to the overall risk and return profile fo the portfolio. Assets with high negative covariance with other assets are preferrable, given that market downturns will have limited portfolio impact.

So what does this mean for the micro-creditor? How can a Tier 3 or Tier 4 micro-creditor contstruct their credit portfolio to optimize the risk/reward balance?

First, its important to recognize the sources of risk in the current portfolio structure. Its not uncommon to find

About 90%+ of micro-credit portfolios concentrated in the retail trade sector and allied sectors such as food vending. Minority assets include private transport operators and other petty traders. There is no gainsaying the level of exposure to volatilities in the macro environment. Shifts in currency valuation and its consequent impact on consumer price trends inevitably affects margins in the retail trade sector, thereby increasing default risk on assets in the category. This is the principal argument in favor of ensuring portfolio diversifacation The second reason is the ability to spread default probabilities across several sectors which shows different directions and degrees of covariance with assets in the portfolio. For instance, a working capital facility for a tech company that provide network services to other companies, may have a zero covariance with currency depreciation. For this reason, the efficient frontier of a micro-creditor's portfolio must include "non-traditional assets". In selecting such assets however, emphasis should be placed on a detailed understanding of the default probability of that asset and its overal conrtibution to the risk/reward balance of the entire portfolio.

Modelling Enterprise Risk: The GCOF® Framework

How can you tell if a particular business is ready for external finance and what risk measure do you use? That's the question that many micro-creditors wrestle with as they seek to expand their portfolio footprint in the SME sector.

Many financial outfits consider SME lending to be high-risk, and justifiably so, due to weak governance systems, inestimable commercial viability and high operational risks.

Having an effectiver SME risk modelling framework is very critical for ensuring portfolio quality. The GCOF® Framework is one such proprietary model that has been development by YieldRock. The model evaluates 73 risk areas under four brooad rubrics; Governanace, Commercial, Operations and Financial. The scoring categorizes exceptions ratios below 20% to be LOW risk, between 21% and 50% - MEDIUM risk, while 51%+ exception ratios are HIGH risk. The key advantage of the model is the ability to rank portfolio assets according to risk and grade levels. The GCOF® Framework is a Microsoft Excel-based program that employs complex nested conditionals as basis of algorithmic decision-making.

Is cyber security risk an issue in the micro-credit sector?

$229.9 million lost to cyber crime between 2016 and 2018, according to the Criminal Investigation Department (CID),Ghana Police Service.

As more and more licensed operators deploy core banking platforms for their operations, the imperative for cyber security has become even more urgent. According to the Cybercrime Unit of the Criminal Investigation Department (CID) of the Ghana Police Service, $229.9 million was lost to cyber crime between 2016 and 2018. Henry Kerali, World Bank Country Director in Ghana, put the figure at an estimated $3.5 billion for the whole of Africa.

In recognition of the increasing threat, the Central Bank of Ghana, in October 2018 issued a 131-page Cyber and Information Security Directive to govern decision-making related to digital assets. The Directive, issued under the powers conferred on Bank of Ghana under Section 92(1) of the Banks & Specialised Deposit Taking Institutions Act, 2016 (Act 930)), apply to regulated financial institutions licensed or registered under the Act 930 and any other entity regulated by the Bank of Ghana under any other enactment. This automatically ropes in all NBFIs including Tier 3 and Tier 4 operators.

So what must micro-creditors do to safeguard themselves against cyber attacks?

First, CEOs and their Advisory boards must familiarize themselves the content of the Cyber and Information Security Risk Directive (2018). Secondly, a clear policy framework setting out processes and procedures for identifying and managing cyber and information security risks is a basic requirement.

Its critical to have a Cyber and Info Security Risk Management Policy for starters"

Other corporate governance pre-requisites are also essential to ensure an integrated approach to protect digital assets and infrastructure. The challenge for Tier 4 micro-creditors especially, is always the issue of budget and staff strength. Most big corporates in the banking sector or higher tier NBFIs outsource their infrastructure security to ICT firms. Fortunately, vendors or core banking platforms that are popularly used by Some micro-creditors, provide technical support as part of the package.

What software should I use for my micro-credit business?

The choice of a core banking platform for a micro-credit startup is a complex one for several reasons. First, budget is an issue. A significant portion of micro-creditors have valuations below GH¢100,000 ($20,000) within th first two years. This is because barriers to entry are low, and so zero minimum capital is required for market entry. The decision therefore to spend huge sums on software seem uneconomical to many. Secondly, many off-the-shell products lack the techical features needed to facilitate regulatory compliance. So essentially, a good core banking platform should be affordable, have useful technical features, support prudential reporting and track portfolio performance.

A cursory survey of the core banking platform market suggests that at least five options are popular among Tier 3 and Tier 4 Micro-creditors; Proprietary MS Exce cum Access software, QuickBooks (by Intuit), Zigloi (by Logiciel), mBanking (by TVSS) and G-mx Solution (by Corporate Solutions Ltd). Proprietary Microsoft Excel is popular for one reason, its FREE! A key disadvantage is the challenge of incorporating essential features such as. charts of accounts, nominal/general ledgers, and and financial accounts. The second most popular is Zigloi, by Logiciel. mBanking is increasingly gaining recognition among operators for robustness, technical utility and good economics. Current installations include 5 microfinance companies, one Rural bank and 12 micro-creditors. G-mx Solution, a new and rising star in this space offers a useful platform that incorporates portolio tracking, financial reports and data for prudential report. Still, there are others not featured here so no matter the choice one makes, functionality, utility and economics should be a guide in making purchase decisions.

Bernest pioneers group lending in Peki, Volta

Bernest Micro-credit Services is one of the Tier 4 operators licensed by Bank of Ghana to carry on the object of financial inclusion in the Volta region. Located in Kpeve, South Dayo district, Bernest serves adjacent markets such as Hohoe, Peki and other surrounding catchment markets.

In Q1. 2019 Bernest introduced group lending in the Peki market area where the entire collective are sub-categorized into solidarity groups based on proxmity and economic sector. With credit limit of up to GH¢500 for first cycle applicants, group members are given first right of refusal at the solidarity group level, after which all pre-approvals are escalated to the main group executive committee for review and final approval. “Our approach has improved portfolio quality, “said Mr. Ernest Agbeko, CEO of Bernest Micro-credit.

Following the remarkable success of Bernest in the implementation of group lending YieldRock has made arrangement for peer coaching for other micro-creditors to benchmark their best practice.

Fintech: Current Trends

Few sectors have been susceptible to technological disruption as the finance sector has been in the last decade. New frontiers of innovation have created competing markets. Typical example is the mobile money market. Consumers can now access loans up to GH¢1,000 on their mobile money wallet. AfB Loans, Fido Money Lending and PayLater are few of the actors in this emerging market. Mobile has opened up new channels to a substantial market for consumer lending. This represents remarkable progress towards financial inclusion.

SOFTWARE
Monthly Pick

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How to get interest rate credits as a customer of YieldRock

- **Address risk and complinace issues in risk register.**

  To enable our clients improve their corporate governance risk profile, we generate risk registers to enable customers pin-point vulnerable areas. As an incentive, we provide interest rate discounts for addressing issues raised.

- **Refer a good customer.**

  We pride ourselves on having good quality customers that are committed to business growth and ethical leadership. For this cause, we place a lot of premium on those that come highly recommended by our current customers. Rate discounts are just another way of saying thank you.

- **Avoid overdue payments.**

  Overdue repayments triggers portfolio impairment provisioning as mandated by Bank of Ghana. This adds undue administrative and financial cost that could be avoided. Our pricing aligorithm accounts for repayment history.

- **Environmental, Social or Governance (ESG) projects.**

  We believe that businesses that make themselves relevant to the communities by giving back, derives benefits through positive brand image and future cashflow. We take community-oriented projects very seriously and reward same faithfully.

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