April 2016

Kevin Fryatt

Case Study

Leveraging Risk Management for Future Growth: A Business Case of UNTU Microfinance in Zimbabwe

Financial institutions are continuously looking for investments that will sustainably drive growth. Developing risk management capacity often takes significant human and financial investment, but through this investment an institution can begin setting itself apart from its competitors and positioning itself to create long-term value for its stakeholders. This paper presents the case study of UNTU Microfinance in Zimbabwe and how it improved its risk management through adopting the Risk Management Graduation Model.

Risk Management Initiative in Microfinance

RIM

UNTU

Triple Jump
Responsible Investment Management & Advisory

Introduction

Like many microfinance institutions (MFIs) and other organizations of its kind, the Zimbabwe-based UNTU Microfinance, or UNTU, is faced with a variety of risks it must manage in order to continually create economic and social value for its stakeholders. One risk posing a constant threat in Zimbabwe is liquidity risk, which is due to a shortage of liquidity in the local market, lack of foreign investment in the country, and ongoing delinquency challenges. Under these conditions, the economy has suffered with significant job layoffs; the environment has suffered as well, and this has subsequently forced MFIs engaged in salary and agricultural lending to consider diversifying their loan books. Despite the challenges faced in Zimbabwe, UNTU has persevered and become one of the leading microfinance institutions in the country.

Since its founding in 2009, UNTU has been able to take advantage of low penetration rates in the informal sector and grow its loan book to US $4.4 million, delivering financial services to clients through six branches with a focus on providing individual loans to microenterprises and SMEs.[1] Building upon the success of its first five years of operation, UNTU plans to leverage its success toward increased growth and market share. Its leaders understand that with growth comes the need to develop a formal system that can decentralize and integrate risk management, as well as evaluate and manage the risk inherent to growth.

Role of Risk Management

The role of the risk management function for UNTU is to identify, measure, prioritize, monitor, and manage all risks faced by the business. However, UNTU's lean organizational structure in its early stages of growth, along with its largely undocumented and informal risk management process, have meant relying heavily on the technical expertise of its board of directors and CEO.

A fully established risk management function will have all "three lines of defense": the business line operations, risk management function, and internal audit. However, for UNTU, as is the case with many smaller growing institutions, the risk taker (who is involved in business line operations) and the risk manager (the risk management function) are often the same person. As UNTU develops, the functions of risk taker (currently performed by the CEO) and risk manager (the board of directors and CEO) will need to gradually separate until the full realization of an independent risk management function. This will allow UNTU to identify, measure, prioritize, monitor, and actively manage all risks faced by the business within the company's board-approved risk management framework.

When an MFI integrates the risk management function formally and in a way that makes it central to the core functioning of the business, it can realize several potential benefits. Table 1 provides a list of benefits UNTU can expect from a formal risk management function.

1. Figures as of September 2015.

Table 1 – Expected Benefits of Formalizing UNTU's Risk Management Function

- Increased certainty that UNTU will achieve its financial and social goals
- Increased investor confidence in UNTU's ability to manage risk
- Increased capability of UNTU to prepare for and manage external shocks
- Increased capability of UNTU's senior management to express and monitor risk appetite
- Increased confidence that risk-taking is within UNTU's board-approved risk appetite

Developing UNTU's Risk Management Framework: Leading by Example

UNTU's goal in developing a formal risk management framework was to create a scalable set of policies, limits, and risk management and monitoring tools for executing a risk management process that is thorough and continuous.

In choosing the basis for its risk management framework, UNTU considered the following important factors:

1. Compliance with or adaptability to Reserve Bank of Zimbabwe guidelines
2. Comprehensiveness[2]
3. Scalability[3]
4. Appropriateness[4]

Faced with the common challenge of limited financial and human resources, UNTU engaged in a step-by-step, institutional process of improving risk management which allowed it to not only tailor its risk management framework to its institutional needs, but also ensure that its framework was in line with international best practices. UNTU chose to employ RIM's Risk Management Graduation Model (RMGM)[5] because it wanted a risk management framework that would help UNTU identify areas of excellence as well as areas of improvement and be benchmarked against global best practices. UNTU followed RIM's process in improving institutional risk management outlined in the chart on pages 3 and 4. This process is recommended for all financial institutions with a double-bottom-line mission regardless of organizational size, legal status, or number of years in existence. Shown next are the detailed steps of this process and insights into UNTU's experience with implementing it.

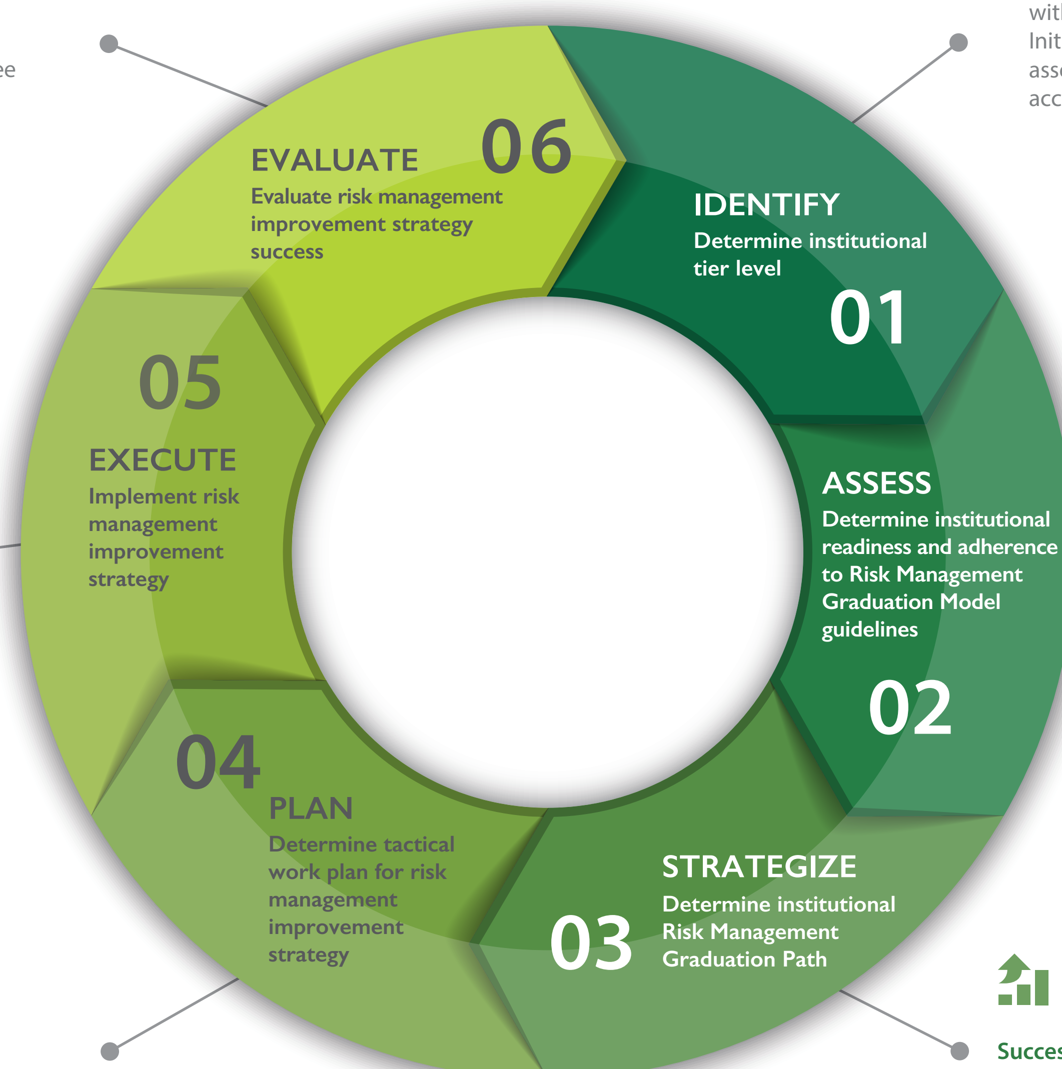
2. A risk management framework must always be comprehensive in nature so as to consider the full array of risks to which a financial institution may be exposed.

3. A risk management framework should be scalable so as to provide a financial institution with a view to future risk management needs aligned with future growth plans.

4. In the financial inclusion arena, a risk management framework should consider both the risk to its financial (financial sustainability) and social (social performance) goals.

5. For more information on the RIM's RMGM, please download the RIM paper *Risk Management Graduation Model for MFIs*, available at http://www.riminitiative.org/graduation-model/#toggle-id-5.

Institutional Risk Management Improvement Process[6]



Evaluation Methods and Measures of Success

Success Factors
- Using RMGM adherence level as a quantifiable and measurable goal
- Management Risk Committee Coordinator reviewing progress of risk management improvement
- Reassessing RMGM adherence prior to next strategic planning exercise, engaging Internal Audit for independence

Key Stakeholders Involved
- Board of Directors
- Chief Executive Officer
- Internal Auditor
- Management Risk Committee

Project Management, Availability, and Accountability

Success Factors
- Ensuring clear responsibility and ownership through a newly formed Management Risk Committee.
- Ensuring buy-in with Board of Directors, senior management, and staff.
- Board Credit Committee assuming role of oversight to Management Risk Committee.

Key Stakeholders Involved
- Board of Directors
- Chief Executive Officer
- Management Risk Committee

Internal Staffing, External Expertise, Financing, Strategy Alignment

Success Factors
- Priority given to internal human resources in order to develop ownership in the process
- All stakeholders involved in reviewing the Graduation Path to develop internal buy-in
- Management Risk Committee formed to ensure a clear plan for implementation, communication, and monitoring of Graduation Path implementation
- Internal Audit reviewed and approved the Graduation Path to ensure alignment with their own recommendations

Key Stakeholders Involved
- Board of Directors (review only)
- Chief Executive Officer
- Credit Manager
- Managers (*representing all key departments*)
- Internal Audit

Risk Management Graduation Model

Success Factors
- UNTU was forward-looking and aligned its tier level with its future strategic goals of scale and growth. Initially identified as Tier 3, UNTU chose to be assessed and build out risk management structures according to a higher tier category - Tier 2.

Key Stakeholders Involved
- Board of Directors
- Chief Executive Officer
- Management Team (Senior and Middle)

Assessment Tool

Success Factors
- Objective assessment carried out, comparing written policies and procedures, interviewee responses, and practical observations
- Information cross-checked with multiple departments to assess accuracy
- External auditors' input provided history and objective opinion
- Designated staff assigned to coordinate assessment
- CEO provided with frequent progress reports and highlights

Key Stakeholders Involved
- Board of Directors
- Chief Executive Officer
- Credit Manager
- Managers (*representing all key departments*)
- Internal and External Audit
- Branch staff
- Clients

Graduation Path

Success Factors
- Graduation Path workshop and strategic planning workshop occurred concurrently
- UNTU focused on quick wins
- UNTU prioritized risk management improvement goals which facilitated the achievement of other goals

Key Stakeholders Involved
- Board of Directors (review only)
- Chief Executive Officer
- Credit Manager
- Managers (*representing all key departments*)

6. For more information, please visit http://www.riminitiative.org/improvement-process/

Step 1: Identify – Determine Institutional Tier Level[7]

Developing a risk management function appropriate to UNTU's institutional tier level ensures that UNTU allocates resources to systems and structures which are best suited to its stage of organizational development. UNTU proactively chose a Tier 2 financial institution designation (within the RMGM tier identification), as it is currently in transition from Tier 3 to Tier 2. In so doing, UNTU has ensured that in the years to come the activities it carries out regarding its organizational readiness and development of its risk management capacity align with its goal of becoming a Tier 2 institution.

Step 2: Assess – Determine Institutional Readiness and Adherence

Institutional readiness for formal risk management rests on having solid organizational foundations in place, including governance and strategy, risk culture, and internal control and a management information system.[8] UNTU's on-site assessment of its institutional readiness was conducted within the framework of RIM's Risk Management House and covered its organizational foundations, risk management categories, and ability to manage and monitor its financial and social goals. The Risk Management House is depicted in Figure 1.

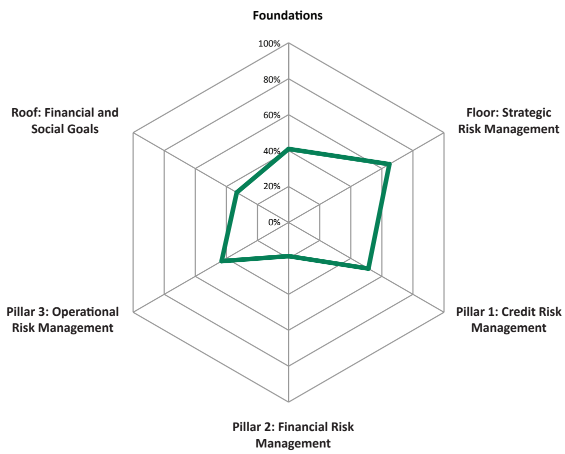
Figure 1 – Risk Management House

UNTU and its partner Triple Jump Advisory Services hired an external consultant to lead it through this assessment. All of UNTU's key business documents were reviewed along with its policies and procedures in conjunction with interviews with board members, an external auditor, senior management, department heads, and branch staff of two of the six UNTU branches. Through this assessment, the consultant aimed to determine the adequacy of UNTU's policies, procedures, and risk management structures, as well as the adequacy of its current risk management and monitoring tools. The assessment was able to identify foundational areas to strengthen with relatively minimal investment, allowing UNTU to focus more time and resources on developing the formal risk management function. The results of the assessment are provided in Figure 2.

7. For more information on tier identification within RIM's RMGM, please see page 15 of *Risk Management Graduation Model for MFIs*.

8. For more information on the risk management categories within RIM's RMGM, please see page 9 of *Risk Management Graduation Model for MFIs*.

Figure 2 – Tier 2 MFI Score Summary



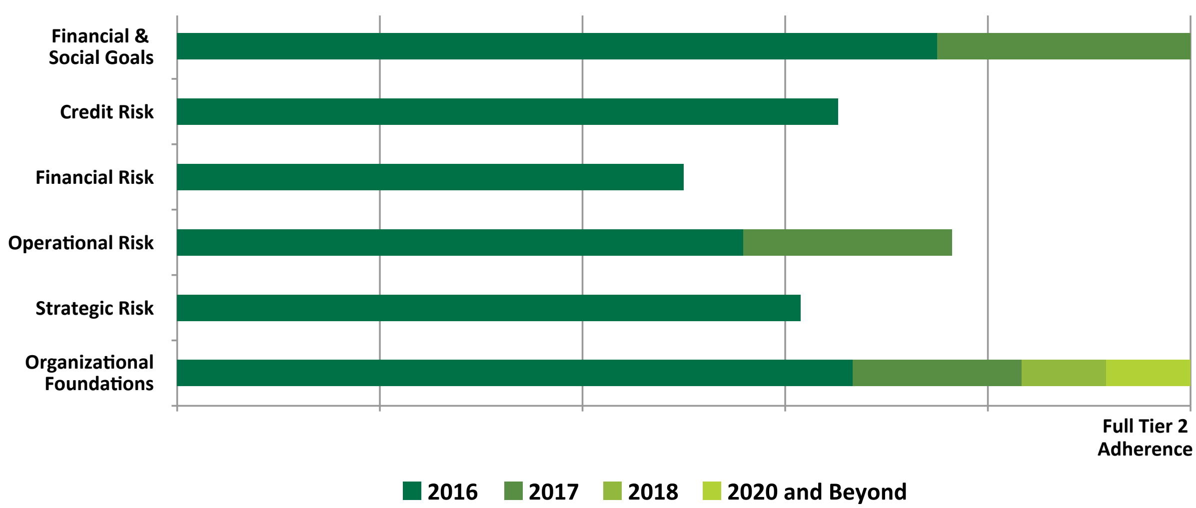
Step 3: Strategize – Determine Institutional Risk Management Graduation Path

An Institutional Risk Management Graduation Path is a strategic improvement plan through which UNTU can proactively address key risk management gaps vis-à-vis the RMGM. UNTU's path, as depicted in Figure 3, enabled them to prioritize the closing of key risk management gaps, such as a formal set of portfolio diversification policies, as part of its strategic and operational plans. As a rapidly growing credit-only financial institution which has recently diversified its funding sources, UNTU assigned immediate priority to address critical gaps in credit, operational, and financial risk management. UNTU's CEO informally managed financial risk while recruiting a CFO to assume that duty. The new CFO has subsequently assumed this duty.

Step 4: Plan – Determine Tactical Work Plan for Risk Management Improvement Strategy

In the near term, UNTU chose to focus its improvement of credit risk management on activities in which they could leverage internal personnel,

Figure 3 – UNTU's Institutional Risk Management Graduation Path*



* The cumulative bars represent UNTU's planned progression towards RMGM Tier 2 adherence within a stated timeframe.

thereby building ownership of its risk management function. This aligned with the strategic focus on growing market share while managing risk of the institution's largest asset, the loan book. In the planning process, UNTU also identified areas that will need sourcing of external support.

To build the sense of ownership over risk management that UNTU desires, the Board Credit Committee's recommendations to management have incorporated the Institutional Risk Management Graduation Path, which enhances the board's involvement in risk management decisions and maximizes the follow-up to bridge the prioritized and strategic gaps.

Step 5: Execute – Implement Risk Management Improvement Strategy

For effective execution of its risk management improvement strategy, UNTU must ensure that the board, senior management, and staff exhibit the necessary buy-in to ensure accountability in the implementation process and subsequent risk management function.

The risk management improvement process at UNTU will be managed and monitored by a newly formed Management Risk Committee. This committee is composed of key department heads and will include the Internal Auditor for one year. This group will operate during UNTU's transition from risk management through the "first and third lines of defense" (business line and internal audit responsibilities) to more comprehensive risk management through the newly built, separate "second line of defense," the risk management department itself. As a third line of defense, the Internal Auditor plays a key role in risk management. The committee's sole purpose is to manage the development of UNTU's risk management function by managing and monitoring progress within its Institutional Risk Management Graduation Path. Additionally, UNTU has developed a risk dashboard and matrix which integrates tracking of its RMGM adherence scores. Similarly, the Management Risk Committee's reports, which will chart progress against the RMGM, will be included in the Board Credit Committee's board pack, while the Internal Auditor will evaluate progress against the RMGM before reporting the outcome to the Board Audit Committee.

Step 6: Evaluate – Evaluate the Success of Risk Management Improvement Strategy

Evaluating the improvement of risk management through RMGM assessment and implementation will require a clear definition of what success looks like. Moving forward, UNTU will measure implementation success through a number of key metrics, including:

- Third-party rating scores;
- Loss outcomes;
- Whether risk metrics are being analyzed, reported, and monitored at appropriate levels and frequencies; and

- Whether RMGM assessments are being conducted in conjunction with annual strategic planning, and monitoring score (level of adherence) against yearly goals.

Value to UNTU Microfinance

As a market leader in risk management improvement, UNTU has identified a number of key benefits in developing its formal risk management framework through the adoption of RIM's RMGM:

- Going through a process with all stakeholders that yields a shared conceptual understanding of the risk management process using a comprehensive framework.
- Identifying the key risk management gaps using world-class benchmarks that also takes into account future issues arising from institutional growth.
- Developing an action plan which will result in the more effective management of key risks and greater ability to meet institutional objectives.
- Having the ability to measure progress using a robust framework which can communicate specifically how the institution has attained company-wide goals.

Upon reflecting on UNTU's own risk management improvement process and the adoption of the RMGM, CEO Clive Msipha stated, "This exercise has allowed us to critically think through the key risk management issues, using best-in-class tools, with a specific view of better meeting the company's objectives."

Risk Management Initiative in Microfinance

About the Author

Kevin Fryatt is a microfinance risk management expert and Director of the Risk management Initiative in Microfinance (RIM). Kevin is also a Risk Management Subject Matter Expert in Accion's Africa Board Fellowship Program. Over the course of his career, Kevin served as Director of Advisory Services with MFX Solutions, providing Asset/Liability Management advisory services to 35-plus MFIs/banks in sub-Saharan Africa, and Microfinance Technical Advisor for World Relief, overseeing its global microfinance network. Kevin has experience in 20-plus countries, including MFI board of director roles in Kosovo, Liberia, Burundi, and the Democratic Republic of the Congo, and has served with the SEEP Financial Services Working Group focused on the development of the Microfinance Reporting Standards. Kevin has an MA in International Development from Eastern University, specialized Asset/Liability Management training from the IFF, and is a Certified Expert in Risk Management from the Frankfurt School of Finance and Management.

Special Thanks

A special thanks goes to Triple Jump Advisory Services for financing this paper as well as Sa-Eun Park (founder, MagpieVenture Consulting) and Clive Msipha (CEO, UNTU Microfinance) for contributing to its contents. A special thanks also goes to Sarah Grey and Jonathan Stephanoff for ultimately bringing it to life.

Additional Information

For more information:

- UNTU: visit www.untu-capital.com.
- Triple Jump Advisory Services: visit http://www.triplejump.eu/about-us/triple-jump-advisory-services-2014/ or contact Marnix Mulder, Head of Advisory Services (marnix@triplejump.eu).
- Risk management Initiative in Microfinance (RIM) and the RMGM: visit www.riminitiative.org or contact Kevin Fryatt, Director (director@riminitiative.org).

Risk management Initiative in Microfinance (RIM) is a collaboration of organizations with a vested interest in raising the standards of risk management in the microfinance industry.

Founding Members

ada, Calmeadow, Center for Financial Inclusion Accion, MEDA, mfx currency risk solutions, microfinanza, Oikocredit, Triple Jump

Contributing Members

AccessHolding Microfinance AG, Aga Khan Agency for Microfinance, Pakistan Microfinance Network, pamiga

www.riminitiative.org
info@riminitiative.org
1 (202) 684-9371

1050 17th Street NW
Suite 550
Washington, DC 20036