



# Deutsches Mikrofinanz Institut (DMI)

Germany

## Project Name

Early risk warning system for high-growth MFIs.

## Initiative Presented for the Award

When MFIs are fully occupied with managing their growth (coping with high case load, hiring new staff, etc.), they generally neglect their monitoring and risk management duties. In such cases a neutral supervisory body is needed that controls market risks. In Germany, DMI has taken over this function. At the end of 2011, problems and aberrations occurred within individual German MFIs due to their rapid growth (some MFIs grew more than 200% on a yearly basis). DMI wanted to draw lessons for the whole sector from this situation. The existing DMI benchmarking and risk reporting that had been scientifically developed in 2006 was already very detailed and had proven its worth in making apparent diverse inherent risks such as “window-dressing”. However it still had a weak point when it came to making transparent the risk concealed by growth. Therefore, in April 2012, with funding from the German Federal Ministry for Labour and Social Affairs, DMI ran a pilot project with the aim of developing and testing an early risk warning system to better control dynamically developing MFIs. Designed by a consultant in cooperation with two German MFI practitioners, this new system was subsequently built into the DMI monitoring and risk management system InthePro. As of May 2012, it can be used by all DMI member MFIs.



### Success story: **indaro Mikrofinanz GmbH & Co. KG – a high growth MFI using the risk prevention system**

indaro is a microfinance institution established in 2010 in Stuttgart and accredited by DMI. It provides microloans up to €20,000 on a nation-wide level to small entrepreneurs and business start-ups to finance orders, investment and working capital, temporary liquidity constraints, and all other start-up or development purchases. By cooperating with consultants (indaro Advisors GmbH) indaro also provides support services to its clients for drafting business concepts, business planning as well as controlling services. The institution is currently one of the largest MFIs in Germany with over 2,500 microloans disbursed for a total volume of approximately 10 million euro. Between 2011 and 2012 indaro has grown by more than 100%. Despite indaro's quick growth it has managed to control risk. In order to carry out effective portfolio management, the institution has used DMI's risk prevention system since 2012. indaro regularly monitors its growth rate and calculates its delayed risk ratio (at 3 and 6 months) in order to more realistically assess its exposure to risk. Moreover clustered risk has been analysed thoroughly. Currently, indaro's portfolio's PAR 15 has constantly been below 9% and PAR 30 below 5%.

## Innovation

The DMI high-growth early warning system enables rapidly expanding MFIs, as well as higher-level bodies, to closely monitor and control risk. Warning levels are defined and made visible via a traffic light function and concern 3 main areas:

- Monitoring directly growth-related risk: the growth rate measures the dynamics of growth indicating whether the loan volume exposed to risk grows faster than the total loan volume; in addition the delayed risk ratio shows the real risk a high-growth MFI faces.
- Managing cluster risk: monitor the portfolio risk regarding certain characteristics such as the cooperation/sales partners who recommended them, target groups / sectors as well as loan sizes.
- Calculating expected future loss: the system is derived from the "classical" banking sector: based on the past repayment behavior of existing clients, a prediction about future loan loss is made. A prognosis is thus made about an essential component of an MFI's sustainability.

## Sustainability

The high-growth early risk warning system has become an essential part of the German microfinance sector: (i) it can be used by all DMI members via the DMI Inthepro MIS provided by DMI for free; (ii) it has been included into the DMI accreditation and re-accreditation procedure. From a strictly cost-perspective, the system is sustainable. The cost of development and testing amounted to a total sum of approximately 6,000 euro. This means the project was covered financially after one single loan was prevented from defaulting with its help (the average loan amount in Germany is 6,000 euro). Finally, the system is also highly beneficial from an MFI point of view. A study carried out by DMI in 2012 on processing costs showed that an MFI's total revenue for an average microloan of 6,000 euro amounts to a maximum of 1,000 euro. This means a German MFI needs to disburse six or seven loans in order to recover the revenue of only one defaulted 5,000 euro-loan.

## Impact-Outreach

The impact and potential impact of the early warning system for high growth MFIs is significant. First of all, it leads to a change of focus as the system sets the focus from the beginning on a controlled and well-balanced growth with a positive impact, on both the MFI and the microfinance clients. Secondly, the system has the potential of preventing the whole German microfinance market, which is still rapidly growing (nearly 240% from 2010 to 2011 and another 75% from 2011 to 2012), from collapsing or being buried by a risk-avalanche. As of December 2012, the German sector has very low risk and default rates: 10.5% PAR15 and 4.2% write-off. Thirdly, the warning system contributes to maintaining the good image of microfinance, considering that if only one MFI should collapse, all others will suffer due to negative headlines and bad reputation. Finally, the potential impact of the system is significant for microfinance markets in other EU countries.

## Replication

Due to its simple formula and relatively low cost, the early warning system can be easily adapted to other microfinance markets. It can be used by individual MFIs and programmed into their MIS system and/or operated by a national microfinance umbrella network or fund manager through a national IT platform. An essential pre-condition is the availability of reliable and complete data, which can be a challenging task, especially if there are several partners cooperating in the system such as in Germany. To sum up, there are three main tasks to replicate the system successfully:

- There must be a well-functioning user-network interface between several IT-systems.
- If there is an umbrella organisation then political consciousness is needed to give this organisation the potency to monitor and sanction their member MFIs if risk in their credit-portfolio becomes too large.
- At the latest, if an MFI gets in trouble, a programme for crisis-advisory and training is recommended in order to offer quick help.



indaro Mikrofinanz GmbH & Co. KG, DMI's member

# Institutional Profile

## History

At the end of the 1990s, it became evident that a financing gap exists for business start-ups and business consolidation in Germany. Against this background, regional microfinance pilot projects emerged, supported by the German Federal Ministry for Labour and Social Affairs, several foundations and banks. The involved actors knew that in order to develop a sustainable microfinance solution for Germany, a common, nationwide structure would be needed. Thus, they joined together and founded Deutsches Mikrofinanz Institut e.V. (DMI) which was registered as an association in April 2004 in Berlin.

## Mission

The central mission of DMI is to develop and ensure the responsible and high quality provision of microloans in Germany. In order to reach this goal DMI works in different areas; these areas include inter alia (re-)accrediting MFIs, supporting them through counseling and training as well as providing the management software Inthepro.

## Governance Structure

DMI's governance structure is composed of a General Assembly; a Supervisory Board (8 people confirmed every 3 years) which determines the guidelines of the business policy and supervises and supports the management; the "Assembly of Accredited MFIs" which defines the needs and elects every two years the "Committee of Accredited MFIs" (5 MFI representatives). The Management team leads the dealings of the association.

## Organisational Structure

To date DMI has 73 members. Out of these, 61 are accredited MFIs; the remaining members are business consulting organisations, research centres, public bodies as well as individuals.

## Target Clients

Generally speaking DMI's accredited member MFIs target people who do not have access to bank finance for business purposes. However, some MFIs target specific groups such as migrants (mainly of Russian or Turkish origin), women or specific business sectors.

## Geographical Area of Operation

DMI acts on a German-wide basis; its members come from all German regions. However the individual MFI's regional outreach varies: while some MFIs operate on a local or regional basis, others act on the whole German territory.

## Product and Services

In line with its mission DMI provides the following services to its members:

- Accreditation of MFIs: DMI accredits and re-accredits MFIs on the basis of its accreditation scheme.
- Provision of risk management software: all DMI member MFIs have access to the DMI risk management and monitoring software Inthepro.
- Counseling and training: DMI advises and trains microfinance actors, including MFI management as well as other potential microfinance actors such as banks, municipalities, foundations, federal states or fund administrators.
- Research and Development: by means of know-how transfer with other European countries, DMI analyses internationally successful microcredit schemes, implements pilot projects, and develops methods and instruments for the German sector.
- Representation of interest: the association regularly carries out meetings for accredited MFIs, advises policy-makers and acts as negotiation partner for MFIs vis-à-vis GLS Bank and Microcredit Fund Germany.

Microfinance forum  
(Berlin 2012)



DMI JASMINE training "Marketing and Sales", April 2013, Offenbach



BeuteFuchs, client of  
MFI KIZ, DMI's member



#### Financial Achievements (data refers to DMI members)

	Dec 10	Dec 11	Dec 12
Portfolio at Risk <sup>(1)</sup>	9%	9%	10.5%
Write-off Ratio	2.7%	2%	4.2%
Portfolio Yield	n.a.	35.4%	n.a.
Debt to Equity Ratio	1.6	1.33	n.a.
Operating Expense Ratio	n.a.	57%	n.a.
Cost per Borrower <sup>(2)</sup>	€934	€934	€934
Staff Productivity <sup>(3)</sup>	60	90	120
Return on Equity <sup>(4)</sup>	226.5%	101.3%	n.a.
Return on Assets	54.5%	21.9%	n.a.
Operational Self-Sufficiency	41.1%	69.7%	n.a.

<sup>(1)</sup> PAR15

<sup>(2)</sup> Average amounts based on a study by DMI on processing cost of MFIs per loan product

<sup>(3)</sup> Assessed value

<sup>(4)</sup> ROE before donations

- Public relations: DMI acts as a contact partner for media, organises conferences, initiates working groups and regularly takes part in European, national and federal state level events.

#### Adopted Approach

At its September 2011 General Assembly, DMI members adopted a Code of Conduct based on the standards provided by the European Microfinance Network (EMN). The Code points out the main principles for its members' actions such as client protection, transparency, adapted complaint mechanisms, ethical working methods, non-discrimination and data protection. Moreover, DMI is a member of the European pilot group for implementation of the "European Code of Good Conduct for Microcredit Providers".

#### Funding sources

DMI finances itself by means of membership fees (about 25%) as well as fees for service delivery for MFIs (about 10%) or for third parties (about 65%). This is complemented by voluntary commitment, without which the association would not exist today.

#### Outreach Achievements (data refers to DMI members)

	Dec 10	Dec 11	Dec 12
Active Borrowers	652	3,627	7,954
Women	34%	33%	33%
Migrants	40%	41%	41%
Youth <sup>(1)</sup>	39.6%	38.9%	39.1%
Rural Clients	n.a.	n.a.	n.a.
Clients Below Poverty Line <sup>(2)</sup>	66%	66%	66%
Active Savers	n.a.	n.a.	n.a.
Loan Portfolio	€1,001,659.96	€10,380,604.76	29,133,427.67
Average Loan Amount Disbursed	€5,712.11	€6,050.06	€5,895.13
Number of accredited MFIs	41	57	64
Number of Branches	45	65	77
Number of Staff	80	108	114
Number of Credit Officers	64	86	91
Client Drop-out Ratio	n.a.	n.a.	n.a.

<sup>(1)</sup> Below 30 years old

<sup>(2)</sup> Data based on a non-representative sample of 15 German MFIs