



Microfinance : Microcredit

Microfinance: The Micro-Credit Crunch?

Microfinance institutions have lent billions to poor people worldwide. Now the global credit crunch has made lending money more expensive. But has it also affected the microfinance sector?



Traders watch falling prices in the Karachi Stock Exchange, Pakistan. Will the financial markets that has hit developed countries spread to emerging markets where microfinance has its strongest hold? (Photo: Reuters)

Is the world running out of poor people? Someone who has visited Kiva.org lately might get that impression. The popular micro-lending website asks for patience, as it struggles to find loan-seeking entrepreneurs fast enough to match a growing number of potential lenders.

This illustrates a broader recent trend in microfinance – the influx of money from private investors and equity funds, and not enough capacity to invest it. Konrad Ellsäßer, managing director of Fides Group, which develops rural microfinance institutions, recalls meeting fund managers who “had gathered billions of dollars and were desperately looking for ways to invest.”

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But can this microfinance boom weather the storm that has battered the global financial sector? Camilla Nestor, head of the Grameen Foundation’s Capital Management Advisory Center, thinks so. “We have not seen any diminishment in the appetite of local financial markets appetite for lending to microfinance institutions,” says Nestor. “In fact, many local bankers we speak to express interest in continuing to grow their microfinance exposure.”

More money, more problems

The surge of private investment might be the most notable development in the microfinance sector in recent years. Forty specialized microfinance investment funds have been established in the past three years alone.

International retail and investment banks, pension funds, and private equity funds all channel capital into microfinance. Deutsche Bank estimates the global microfinance loan volume at 25 billion dollars, with 1.5 billion dollars of new capital channeled into the market each year. The global market is expected to increase tenfold by 2015. But with Big Finance's money, comes exposure to Big Finance's problems.

Since the "explosion" of microfinance in 2005-06, something more resembling an implosion has occurred in mainstream finance. Triggered by the subprime loan crisis in 2007, major banking companies all over the world have lost billions. A

s a result, cash is becoming more expensive on international credit markets. American subprime borrowers will probably default on 200 to 300 billion dollars, estimates The Economist. This means that banks, hedge funds, and professional investors will have less money to spend and lend.

A few years ago, a global crisis like this probably would not have mattered much to microfinance institutions, but the influx of foreign investment has created new dependency. Karsten Löffler, a finance expert at Allianz Climate Solutions who has worked with microfinance, says that the microfinance market is still very diversified. Some institutions like the Dutch Oikocredit fund rely entirely on own capital. "Up to now, they are not affected by what is happening in the credit markets," Löffler says.

Most microfinance institutions in the developing world, however, get their money from investors in the form of credit or equity. Depending on the nature of these investors, higher costs for credits on international markets will be felt by microfinance institutions. The very big players that rely on more sophisticated financial instruments, however, will feel the heat. "These debt instruments don't work anymore or at very bad rates," Löffler says, "because the market just doesn't work anymore."

But the credit crunch could even be a blessing for the microfinance sector, according to Ivan Mortimer-Schutts, a financial sector development specialist at Science Po in Paris. "You can learn from other people's problems with risk, and if microfinance institutions can learn from the subprime crisis, then that's a good thing." And while the Microfinance sector displays little correlation with industrialized countries' financial trends, the subprime crisis could increase investors appetite for areas in which to diversify.

The subprime or mortgage crisis, Mortimer-Schutts says, was partly the result of a credit process of lending to borrowers with little or poor credit histories, often through independent mortgage brokers. Features similar to the microfinance sector. "That has encouraged the risk taking, at least in the American property market," says Mortimer-Schutts describing the mechanisms that led to bad loans.

There are potential parallels, albeit imperfect, with microfinance: when

large international institutions get involved in microfinance they almost never make the loans directly to the people or small corporations that represent the final risk. They are financing a new style of financial institutions about which they often have little practical experience. "They are not in the front seat with regard to evaluating risk," says Mortimer-Schutts. "They are at least a couple of seats back."

If the financial sector learns from the subprime crisis, the microfinance industry might benefit from improved risk awareness, Mortimer-Schutts thinks. But he warns against drawing too many parallels between microfinance and the financial mainstream. "With microfinance, we are still talking in relative terms about really small amounts," he says. "If you look at what was lost in the financial sector over the last few months, it is several times more than what has been invested in microfinance over the course of years."

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