



## **Government Development Institutions Undermine Microfinance Sector Maturation**

*MicroVest supports a MicroRate study showing International Finance Institutions are preventing private lenders from financing poor micro-entrepreneurs*

Bethesda, MD February 12, 2007—This year's Nobel Peace prize recognized microfinance as a unique development tool that does not require government subsidies to grow to scale. The private sector is able to step in and dramatically impact poverty reduction at the grassroots level by lending to microfinance institutions (MFIs) who then make small loans to the working poor. For many years, the roles played by government donor agencies—or International Financial Institutions (IFIs)—and private lenders complemented each other in the microfinance sector: IFIs supported newer, riskier MFIs until they grew stable enough for private funding to participate. Today, this delicate balance between the two major groups of microfinance lenders is faltering.

Recent research shows that IFIs are abandoning their traditional, mission-driven role and instead concentrating their subsidized loans on the top-tier MFIs, thereby forcing private commercial lenders to work with less credit-worthy borrowers at distorted rates. The effectiveness of IFIs' strategy to continue offering subsidized loans to the best credit risks in this nascent capital market has been under increasing scrutiny. Many are questioning the IFIs' motivation to continue lending to the largest commercial MFIs and whether the government money could be better spent on increasing the creditworthiness of riskier MFIs.

[MicroRate](#), the first rating agency specialized in evaluating MFIs, received a grant from [Calmeadow](#) to study microfinance funding patterns. In the study's report, Julie Abrams of Microfinance Analytics and Damian von Stauffenberg of MicroRate write, "Research confirmed what [MicroRate observed in its] ratings: IFIs are not complementing private lenders; they are crowding them out of the most attractive parts of the MFI market." Commercial lenders cannot offer less credit worthy MFIs the rates necessary to adjust for the increased risk because these MFIs are becoming used to subsidized IFI rates.

Abrams and von Stauffenberg present evidence proving that, "Development institutions (IFIs) are concentrating their loans in the strongest MFIs, leaving private lenders to look for opportunities among smaller, riskier borrowers." They argue that in recent years, as microfinance has gained such a positive reputation, IFI's increased exposure in MFIs is a way to fulfill their commitment to international development—a target area set by their Board of Directors or top managers. "If a budget has been allocated to microfinance, that budget must be spent—and spending it on a few, large loans to top MFIs is far quicker, cheaper, and less risky than lending to, and nurturing immature institutions."

Gil Crawford, General Manager of [MicroVest Capital Management](#), fully supports the findings of this report and says, "it is, if anything, understated." He explains how many commercial microfinance lenders feel that IFIs are effectively squeezing 1.5% to 2.0% out of the market. There is strong evidence that commercial investors are ready and willing to efficiently finance the leading MFIs with amounts equal to and even larger than the IFIs but they are finding the IFIs take the best transactions with their subsidized funds.

Mr. Crawford continues, "This study shows that tax payers' money is being used in an area where the private sector can and does operate efficiently." MicroVest agrees with MicroRate's recommendations that call upon the senior decision-makers of IFIs, "to refocus on how to complement and attract the private sector instead of preempting it and competing with it as they are now often doing."

The full MicroRate study can be found at: [www.microrate.com](http://www.microrate.com)

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#### About MicroRate:

MicroRate is the first rating agency specializing in the evaluation of microfinance institutions (MFIs). Its objective is to link MFIs with funding sources and in particular with international capital markets. MicroRate evaluations allow lenders and investors to measure risk and they thereby help to create the transparency without which financial markets cannot work. Over the past decade, MicroRate has analyzed over 300 MFIs in Latin America and Africa and other developing regions. This provides a unique basis of practical experience and of performance data – captured in an industry database- which MicroRate uses to determine trends and performance benchmarks.

#### About MicroVest:

MicroVest Capital Management (MicroVest) manages MicroVest I, LP, a \$25 million private equity fund providing debt and equity capital to microfinance institutions in emerging markets. As the first private microfinance investment fund in the United States, MicroVest's goal is to link capital markets to the entrepreneurial poor by expanding the capacity of profitable MFIs throughout the world. MicroVest is based in Bethesda, Maryland and was founded by CARE, MEDA, and the Seed Capital Development Fund—three non-profit organizations with longstanding credibility and investments in the microfinance industry.