

# Banks get a lesson in lending

By Mike Foster

**W**ealthy philanthropists striving to boost the fortunes of the poor may have inadvertently provided a template for rebuilding the banking sector.

Their mission concerns microfinance: lending tiny sums to the needy, often in the third world, to enable them to start small businesses. Wealthy backers include technology industry luminaries Bill Gates, Pierre Omidyar and Vinod Khosla, founders of Microsoft, eBay and Sun Microsystems, respectively.

Muhammad Yunus, founder of not-for-profit Grameen Bank of Bangladesh, says microfinance principles can create a string of successful social businesses, from which revenues can recycle donations worth billions. If successful, *microfinance can become self-funding*.

Roughly \$40bn (€32bn) has been advanced with the help of the microfinance movement. It's an impressive sum in philanthropy terms but in this era of multi-billion dollar bank bailouts it seems paltry. "It's peanuts," concedes Jacques Attali, president of microfinancier PlaNet Finance and a former head of the European Bank for Reconstruction and Development.

Attali, an adviser to French President Nicolas Sarkozy, reckons microfinance can revolutionise the way the world does banking business. PlaNet is using microfinance to fund businesses in the impoverished suburbs of Paris as well as in emerging economies. "It's about putting ethics back into finance. It's not about making financiers rich," he says.

## SUB-PRIME

Paradoxically, the US sub-prime mortgage business, whose spiralling defaults triggered the banking crisis, could be seen as a form of microfinance, says Attali. "It was bad, not good, microfinance. The difference between

the two is how you lend the money."

Due diligence on sub-prime issuance during the boom was poor because agents wanted to meet sales targets. The repackaging, leveraging and sale of the loans to the wholesale markets magnified the pain of defaults.

The sums involved in emerging markets microfinance tend to be far smaller, with lot sizes as small as \$100. Loan officers keep a close eye on their clients. This is partly a by-product of the expectations of donors, keen to ensure

**"ITS ABOUT PUTTING ETHICS BACK INTO FINANCE. IT'S NOT ABOUT MAKING FINANCIERS RICH"**

their money is being spent wisely. It also forms part of the ethos of the movement, determined to improve societies and economies.

Robert Annibale, global director of microfinance at Citigroup, says: "The sector takes a granular approach to lending. You can get repayment periods as often as once a week."

The businesses funded by the loans are basic trading operations which deliver high profit margins, making it easy to cover interest rates as high as 16% to 24%. Defaults are remarkably rare. The not-for-profit MicroLoan Foundation, where Bob Geldoff is patron, enjoys a 99% repayment rate, for example.

## COMMERCIAL

Unsurprisingly, such success has caught the eye of commercial operators. So-called social banks have sprung up, mimicking the microfinance approach but with profits as the goal. Microfinance charity Accion is working with commercial banks to establish microfinance operations in the US.

As with sub-prime mortgages,

microfinance loans are being resold or bundled together and sold as funds or securities by companies including BlueOrchard Finance and SKS Microfinance. Last year's annual returns from Luxembourg-listed funds Dexia Micro-Credit and responsAbility Global Microfinance were 5.62% and 6.88% respectively. Mexico's Compartamos Banco and Equity Bank of Kenya have secured share listings to raise funds for their microfinance operations. Analysts at Deutsche Bank have argued that microfinance loans could make perfect collateral for asset-backed bonds and JP Morgan is enthusiastic about the sector. The investment banks' interest is not just altruistic – they spy an opportunity to sell their services to the movement as it grows. At crisis-hit Citigroup, Annibale's unit is a rare growth story.

But Yunus, who won a Nobel prize for his work at Grameen Bank, sees the commercialisation of microfinance as worrying. He has debated the issue with Omidyar, who argued commercial microfinance can bring relief to the poor more quickly than charities. Yunus was not convinced: "When they have enough flesh and blood in their bodies, go and suck them, no problem. But until then, don't do that," he retorted.

Attali is agnostic. He reckons the resale of loans or market listings are fine if new owners have the right ethos. He says: "Shareholders need to take a long-term view. You need rules to stop standards slipping."

## BACK TO BASICS

Arguably, microfinance is back-to-basics lending in which institutions take greater care to assess and monitor borrowers. Annibale draws a comparison with community banks in the US and mutually owned building societies in the UK which dominated lending before the big banks moved in. Profits are rising fast at UK-listed Provident Financial, which offers a doorstep lending service to

the poor.

The success of online, peer-to-peer lending service Zopa provides more evidence that institutions other than banks might be better positioned to offer loans at the lower end of the market. The website, which matches borrowers and lenders and operates in

Italy, Japan, the UK and US, has seen a surge in business. With minimum loan sizes of £10 or €10, Zopa operates a microfinance model in which individual lenders make credit decisions. It claims bad debt levels in the UK of just 0.3%.

The big question for the microfinance sector is how well it will handle a global recession. Food price inflation and competition between lenders has triggered a rise in delinquencies. Attali recently came across a deterioration of repayments in Morocco to below 95%.

He says: "People are borrowing from more than one bank. You need loans registered centrally to deal with that kind of problem."

Standard & Poor's, a credit rating agency, has warned of "the increasing debt burden in this niche" and there is concern about wholesale funds for microfinance institutions drying up. To help fill the gap, the World Bank and German development bank KfW are backing the launch of a \$500m microfinance fund. **WB**