

# Microfinance Funds Continue to Grow Despite the Crisis

So far, microfinance funds have been relatively unscathed by the financial crisis that has wreaked havoc on most asset classes around the world. While emerging market funds have experienced a 20 percent sell-off (Anderson 2009), assets of the top 10 microfinance investment funds grew by 32 percent in 2008. Microfinance is one of the few asset classes with a positive return in 2008. The average net return for Euro-denominated microfinance fixed-income funds reached 5.5 percent in 2008. This is the best performance since the creation of the Symbiotics Microfinance Index EUR (SMX EUR),<sup>1</sup> in stark contrast to the 12 percent drop for fixed-income corporate indices in emerging markets (Emerging Markets Bond Index Plus [EMBI+]).<sup>2</sup>

According to recent CGAP research, as of December 2008, there were 104 active microfinance investment funds with total estimated assets under management of US\$6.5 billion. These investment vehicles encompass a broad range of institutions and instruments, including structured finance vehicles, private equity funds, holdings of microfinance banks, and fixed income funds. However, the industry is very concentrated: the top 10 funds (all European except for the Omidyar Tufts Fund) hold about 60 percent of the asset base. See Table 1.

Eleven new microfinance funds were created in 2008, including seven funds since the Lehman Brothers bankruptcy in September 2008. Most of the funds are invested in fixed-income instruments (close to 80 percent), but investors are now showing interest in microfinance equity.<sup>3</sup> Triodos Bank and Development World Markets (DWM)<sup>4</sup> announced two new equity funds in March 2009; several others are in the pipeline. The DWM Microfinance Equity Fund I closed with US\$82 million commitments from four large institutional investors.

## Growth is fueled by double-bottom-line investors

Microfinance funds have attracted a large pool of socially oriented investors, including public, institutional, and retail investors. Development investors, such as IFC (the private-sector arm of the World Bank Group), are very active in the microfinance market and are ramping up their microfinance portfolios in response to the global credit squeeze. Large pension funds, such as APB and TIAA-CREF, have maintained their microfinance allocation as part of their socially responsible investment strategy, although very few new investments have been announced in the past six months. Finally, retail investors have continued to fuel the growth of microfinance funds in 2008. In the context of the crisis, they are making new allocations to support microentrepreneurs in emerging markets, and redemptions are still low. The ResponsAbility Global Microfinance Fund, a retail-oriented fund, has grown by 96 percent in 2008 and 17 percent since September 2008.

1 SMX EUR, created in 2004, tracks the performance of six microfinance funds. For more information, see [http://www.symbiotics.ch/en/smx\\_eur](http://www.symbiotics.ch/en/smx_eur).

2 EMBI+, which tracks total returns for traded external debt instruments in the emerging markets, dropped by 12 percent in 2008.

3 For more information see O'Donohoe, et al. (2009).

4 DWM is one of the leading asset managers in microfinance.

**Table 1. Top 10 microfinance investment vehicles (MIVs), as of December 2008**

Rank	MIV	Assets under management (2008 US\$)	Assets under management (2007 US\$)	Description
1	ProCredit Holding AG	1,019	800	Holding company based in Germany with majority stake in 22 microfinance banks
2	European Fund for Southeast Europe	745	587	Investment company (SIF) registered in Luxembourg
3	Oikocredit	632	569	Financial cooperative registered in the Netherlands
4	Dexia Microcredit Fund	429	298	Regulated mutual fund registered in Luxembourg
5	responsAbility Global Microfinance Fund	378	193	Regulated mutual fund registered in Luxembourg
6	SNS Institutional Microfinance Fund	243	117	Nonregulated fund registered in the Netherlands
7	responsAbility SICAV (Lux) Microfinance Leaders Fund	201	160	Regulated mutual fund registered in Luxembourg
8	ASN-Novib Fund	122	120	Mutual fund registered in the Netherlands
9	Dual Return Fund, Vision Microfinance Subfund	116	55	Regulated mutual fund registered in Luxembourg
10	Omidyar/Tufts Fund	114	116	University endowment fund registered in the United States
	Total	3,998	3,015	

Source: Phone calls/emails/reports, CGAP and Symbiotic research.

Notes: Exchange rate December 2008 EUR/US\$: 1.40974; December 2007 EUR/US\$: 1.47285.

An MIV is an independent investment entity with at least 50 percent of its assets invested in microfinance.

## Steady return for microfinance funds in 2008

Figure 1 shows the historic performance of euro denominated funds.<sup>5</sup> Net return peaked in 2008, with average fixed-income funds reaching 5.5 percent net returns. Three main factors contributed to the good performance of fixed-income funds in 2008:

1. Increase in credit premium.<sup>6</sup> Microfinance funds have increased their risk premium significantly (200–400 basis points) since

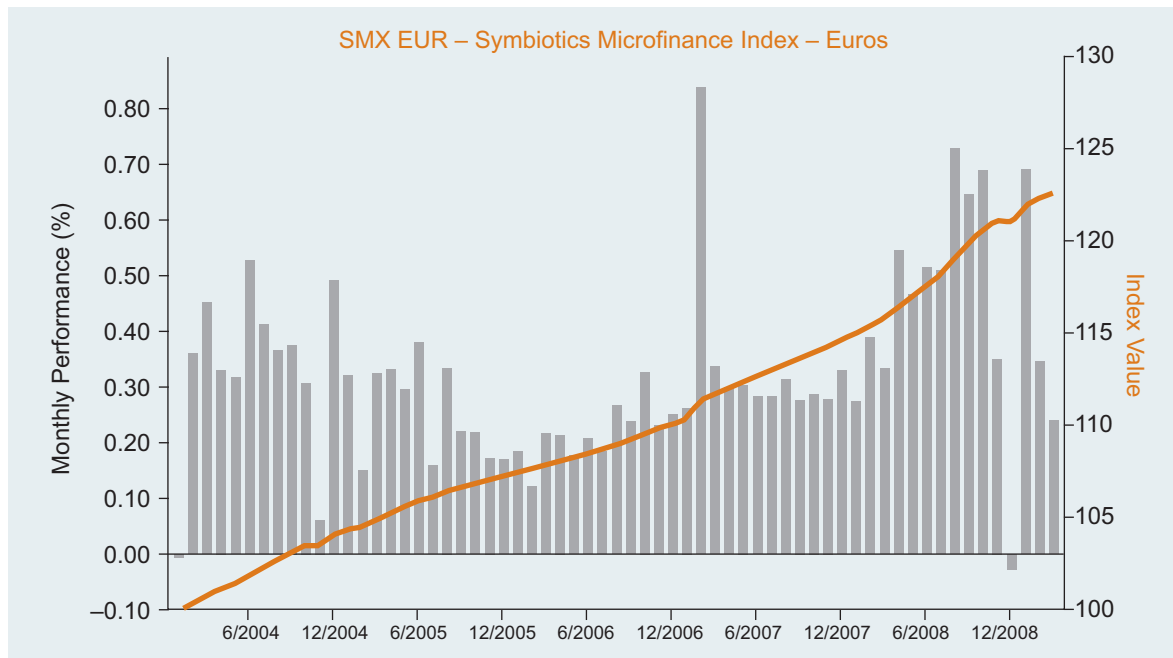
summer 2008. Symbiotics, a microfinance investment adviser, reports that average credit premium for the portfolio it advises is now close to 700 basis points.

2. Fixed-income funds are invested mostly in hard currency and are not impacted by emerging market currency dislocations (although this entails passing the currency risk to the investee).
3. Microfinance loan portfolios have proven resilient to the crisis so far, with no significant

5 The following funds are currently part of the index: Dual Return Fund Vision Microfinance EUR Cap, ResponsAbility Global Microfinance Fund HC Cap, Dexia Micro-Credit Fd Sicav BlueOrchard Debt EUR Cap, ST Honoré Microfinance A EUR Cap, BBVA Codespa Microfinanzaz, Fil (included in January 2008), and Wallberg Global Microfinance Fund (included in March 2009). Index volatility is calculated as the annualized monthly standard deviation of the index rate of return, using data since the index inception. The SMX Euro index is available on line at [http://www.symbiotics.ch/en/smx\\_eur](http://www.symbiotics.ch/en/smx_eur).

6 Credit premium=spread charged by asset manager to cover risks.

**Figure 1. Historic performance of euro-denominated funds:  
The Symbiotics Microfinance Index EUR**



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increase in nonperforming loans until December 2008. Liquidity shortages, rather than credit risk, have been the major source of concern in 2008.

### Projection for 2009: Treading difficult waters

We expect continued but slower growth of microfinance fund assets in 2009. We do not foresee major redemptions from institutional investors because of their long-term time horizon and double bottom line perspective. Public development investors will gain importance and continue to increase their microfinance portfolio: KfW and IFC announced a US\$500 million Emergency Liquidity Facility for microfinance in

December 2008, with US\$250 million available in 2009. We also expect continued support from socially oriented retail investors. Therefore, we foresee microfinance funds' assets under management growing 10–35 percent in 2009.

The full effect of the global crisis and its triple shocks—economic contraction, currency depreciation, and scarcity of credit—will play out more fully in emerging markets in the second half of 2009. Microfinance institutions' (MFIs') portfolio-at-risk ratios have already increased in the first quarter of 2009;<sup>7</sup> some microfinance funds are building loan loss provisions to reflect rising MFI credit risk. Asset managers are increasing their level of cash to improve liquidity and manage redemptions.<sup>8</sup> The cost

<sup>7</sup> Although portfolio at risk remains below 5 percent for most leading MFIs.

<sup>8</sup> The average microfinance fund cash position (for Luxembourg-based funds) is reaching around 16 percent of AUM, a high level by any industry standard.

of hedging foreign exchange exposure is also increasing because of higher currency volatility. As a result, we project lower absolute returns for fixed-income funds. We foresee below 3.5 percent average net return for fixed-income funds denominated in euros.

It is likely that 2009 will be a challenging year for microfinance, and the crisis will test the assumption that microfinance is resilient to economic shocks and can maintain high asset quality in times of turmoil. Nevertheless, we believe the fundamentals of the sector remain strong.

## References

Anderson, Jonathan. 2009. "Chart of the Day: How Much Money Has Left?" Emerging Economic Comment, UBS Investment Research, March.

O'Donohoe, et al. 2009. "Shedding Light on Microfinance Equity Valuations: Past and Present." Occasional Paper 14. Washington, D.C.: CGAP and J.P. Morgan, January.

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