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# 6 microfinance crises that the sector does not want to remember

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**Standard**

**Microfinance Focus, April 22, 2011:** Microfinance sector has served as a boon for the rural community providing them financial support to uplift their position in the society. In the process of changing the lives of several thousands of people, the sector has suffered several hardships over the years and faced some severe hurdles. Here is an account of some most important crisis which shaken the microfinance sector.

### 1) Nicaragua Microfinance crisis of 2008:

In the mid 2008, a movement called “Movimiento No Pago” started which initialized the organization of violent protests and ultimately forced the microfinance institution branches to close. The movement has been mostly by farmers who have ties with the left-wing party. The leaders of the Movimiento No Pago from the North and Caribbean regions of Nicaragua have issued warnings that they will lead to mass destruction which includes burning the buildings of MFIs, taking hostage of MFI personnel and increasing the threshold of violence in case their demands for the moratorium law is not met.

#### What caused the crisis?

The microfinance industry in Nicaragua is under siege by a politically motivated group of borrowers who call themselves the No Payment Movement (Movimiento No Pago). The group is led by the former mayor of Jalapa, Omar Vílchez. The movement commenced in Jalapa in the summer of 2008, with the takeover of an MFI and a riot provoked by a protest speech. Recently, the leaders of the movement have demanded that the Congress approve a Moratorium Law to give debtors a 10 year amortization period with interest rates that do not exceed 8 percent APR in order to put a stop to the harassment faced by the micro-finance industry.

#### Impact on mf sector and concerns:

The Nicaraguan microfinance industry suffered a profound crisis in 2009 and 2010 as a result of both the international financial downturn and the domestic No Pago (No Payment) Movement. Heightened by political interference, these events took a toll on Nicaraguan MFIs and left them both illiquid and unpopular. As reported by La Prensa, more than 100,000 clients have stopped receiving credit. The industry served some 324,000 clients before the crisis, while today it serves an estimated 225,000. Total portfolio dropped from US\$420 million in 2008 to US\$170 million at present. Despite heavy write-offs, members of the Nicaraguan microfinance institution association (known by its Spanish acronym, ASOMIF) have an estimated portfolio at risk of 19 percent.

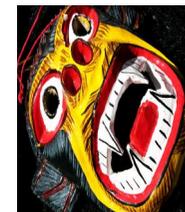
### 2) Kolar Microfinance crisis of 2009:

In 2009 in Kolar, Karnataka ( India) 60-70% of its microfinance clients were Muslims. Most of the practices of microfinance institutes (MFIs) such as having women meet with unrelated men and taking clients out of town for training were considered to be against their religious traditions. The issue grew bigger and bigger and one

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day it reached a tipping point when the local Anjuman Committee issued a 'fatwa' against MFIs operating in the area for demanding the removal of such customs. Communication between the clients and the MFIs to come to a standstill and also affected the process of loan repayments. This led to a lot of disturbance in the MF sector in Kolar and eventually the adjoining areas.

### What caused the crisis?

MFIs promptly blamed the whole issue on religion whereas religion played only a peripheral role in what caused the crisis. The main causes of the crisis in Kolar are believed to be the following:

- Multiple borrowings by clients and in some cases use of phantom customers by fraudsters in order to increase borrowings

Other issues such as gender equations in families, down turn of silk industry, vested business interest and communal organization, also played a major role.

### Impact on the microfinance sector and concerns:

From Kolar, the crisis gave way to similar situations in other parts of the state. Due to the hold of local religious leaders (and their youth committees) over their community, the fire of delinquency spread fast. It was provoked by the overheated lending environment created by competition amongst the many registered MFIs and an unknown number of unregistered lenders. In some slums in Bangalore, the "Kolar trouble" was used almost merrily by local leaders to provoke similar crisis in other critical areas. The crisis in silk industry in Sidlaghatta, the silk industry crisis in Ramanagaram, the religion masks business rivalry, and communal riots, economic distress and delinquency in Mysore were all fuelled by the Kolar crisis.

### 3) Andhra Pradesh Microfinance crisis of 2010:

The microfinance crisis in the southern Indian state of Andhra Pradesh was triggered by astounding number of suicides among over-indebted clients of some of India's biggest microfinance institutions (MFIs). The suicides brought on by explosive growth of microfinance organizations in Andhra Pradesh, led to rising debt stress among thousands of other clients. In the hunger to meet their growth targets, loan officers sold loans to clients already indebted to other organizations. To take charge of the situation, the state Government passed a restrictive ordinance severely curtailing the activities of the MFIs. The crisis threatened microfinance sector not only in Andhra Pradesh, but nationwide.

The above mentioned cases tensed the already critical situation in AP. The microfinance crisis in the state was attributed to usurious interest rates charged by the MFIs, stringent recovery measures of MFIs, limitations of on-lending, continued misery of the rural population, competitive politics that made sustainable

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interest rates unsustainable and State-civil society conflicts.

#### **Impact on the microfinance sector and concerns:**

In October 2010, keeping in view a series of suicides of borrowers of microcredit (over 53 suicides in less than 8 months), the state government of Andhra Pradesh passed an Ordinance to regulate working of microfinance institutions. The ordinance was passed to stop alleged abusive practices like higher interest rates and unlawful collection mechanism undertaken by a few microfinance institutions.

#### **What caused the crisis?**

With more than 40 MFIs clustered in the state, an unprecedented level of competition has made multiple borrowing a commonplace phenomenon.

In the year 2006, Andhra Pradesh was faced with a similar problem – The Krishna Crisis. In the Krishna district, multiple borrowing combined with repayment difficulties, coercive recovery practices of MFIs and clashes with the state-run Velugu SHG programme led to a government clamp down on the MFIs, which sparked a repayment crisis and large scale defaults by MFI clients.

Further, the unabating number chase by microfinance institutions has given quite a stressful job to their loan officers. The average loan portfolio per credit or loan officer has reached to Rs 20 lakhs and can even escalate up to Rs. 50 lakhs for larger MFIs. A loan officer on average serves 380 borrowers and this number goes up to 500 in the larger MFIs. To achieve these unrealistic targets loan officers resort to coercive lending and recovery methods.

According to a report prepared by the Gender Unit of SERP which listed 54 microfinance related suicide cases in Andhra Pradesh, unbearable harassments by loan officers of some of the largest MFIs were reported to have driven poor borrowers to death. The report has even alleged that MFIs abetted borrowers to commit suicides. Moreover, out of the 123 cases of harassments which the report lists, there were 47 cases of multiple borrowings, with borrowers being chased by many MFIs for loan recovery.

#### **Impact on the microfinance sector and concerns:**

As per the ordinance, no MFI was allowed to carry out its operations until they registered with the government. Thus, all existing operations were halted. Borrowers began to lose their discipline and even took advantage of the situation by refusing to repay the loan. Many were also instigated by local politicians to refuse repayments. With this becoming a phenomenon across the state, default rates soared for the first time ever. The obvious result of it was a reduction in cash flow and fresh capital from financial institutions drying up. There was a lot of chaos in the MF sector and regulation went for a toss.

While many microfinance institutions have suffered losses and still continue to face uncertainty, the real people who will be impacted are none other than the borrowers. There is a real danger that, borrowers, especially in Andhra Pradesh may face a hard time in getting access to credit for years to come.

#### **4) The 2010 Pakistan floods:**

The 2010 Pakistan floods began in late July 2010, , resulting from heavy monsoon rains in the Khyber, Pakhtunkhwa, Sindh , Punjab and Balochistan regions of Pakistan and affected the Indus River basin. Approximately one-fifth of Pakistan's total land area was underwater. In a country that already battled poverty, people had lost everything: homes, crops, and livestock – any hope of a livelihood. The poverty stricken rural sector was unable to repay the existing loans and due to future uncertainty of repayments people were not in a position to borrow more from the MFIs. As a result, the microfinance sector suffered great losses and is still reviving with the help of different international agencies.

#### **What caused the crisis?**

At their peak, the Pakistan floods last summer submerged almost one-fifth of the country's total land mass destroying 21% of the crop areas, killing or injuring thousands, destroying homes, businesses, schools, and health facilities, and bringing widespread outbreaks of disease. Women across the board, whether they were contributing to share farming, family owned crops or caring for livestock, had no means of survival. Women who used other skills like sewing and crafts to generate some income had also lost their tools, raw materials, work-spaces and clients. Basically, the borrowers, most of them being women, lost all means of repayment of their existing loans as they lost their means of livelihood. At the time when they needed the micro-credits from the MFIs, the institutions were in no position to lend more as the previous debts had not been cleared. This led to severe microfinance crisis in Pakistan.

#### **Impact on the microfinance sector and concerns**

The wide-scale damage to infrastructure, and particularly to agriculture, dealt a massive blow to the already struggling economy. The flood cost microfinance institutions over \$125 million in losses. MFI's branches had been destroyed, livestock of clients had drowned, and small-scale industries funded by MFIs had been damaged. Preliminary estimates suggested losses of nearly PKR 2.0 billion out of a total portfolio of PKR 7.1 billion in the flood-affected districts. Additionally, 86 branches belonging to microfinance providers had been damaged.

There is a fear that the government may leave microfinance institutions from any settlement deal, as they are not regulated by the central bank. If the government leaves them out then the ultimate effect will be on the balance sheet of commercial banks since MFIs borrow from commercial banks to extend small loans to poor client.

### **5) Liquidity crisis in Nigeria:**

Nigerian microfinance sector has been confronted with several challenges since the launch of the Microfinance Policy Framework in 2005. A large proportion of the current situation must be attributed to the Central Bank of Nigeria (CBN) that awarded hundreds of licenses to banks in attempts to create a large mf sector. Most of these microfinance banks (MFBs) were deficient in their understanding of the microfinance concept and the methodology for delivery of microfinance services to the target groups. Many of them lost focus and began to compete with deposit money banks for customers and deposits, leaving their target market unattended, in spite of efforts of the regulatory authorities to put them back on track. As a result what was created was chaos which led to the liquidity crisis in Nigeria.

#### **What caused the crisis?**

The major factors that contributed to the unsoundness of the MFBs were attributed to high level of non-performing loan resulting in high portfolio at risk which had impaired the capital, gross under-capitalization in relation to level of operations, poor corporate governance and incompetent boards.

Other reasons such as high level of non-performing insider-related credits and other forms of insider abuse, heavy investments in the capital market with the resultant diminution in the value of investments, poor asset-liability management owing to mismatch, heavy investments in fixed assets beyond the maximum limit prescribed also contributed to the situation.

#### **Impact on the microfinance sector and concerns:**

The impact of the global financial crisis on MFBs had been more severe than anticipated. Credit lines dried up, competition became more intense and credit risk increased, as many customers of MFBs were unable to pay back their credit facilities owing to the hostile economic environment. Some major steps taken were:

The operating licenses of the 224 out of 820 MFBs that were found to be 'Terminally Distressed' and 'Technically Insolvent' had been revoked by the CBN. NDIC in line with its statutory responsibility was required to pay up maximum insurance coverage of N100,000 per depositor.

The bank directors and management of the closed banks that have abused their positions were handed over to the Law Enforcement Agencies for investigation and prosecution, and those found culpable were blacklisted.

The liquidity crisis severely weakened the microfinance sector and its ability to achieve the policy objective of economic empowerment at the lower end of the market.

## 6) Bosnia and Herzegovina (BiH) Microfinance crisis of 2009:

BiH microfinance sector experienced rapid growth from 2006 to 2008, but suffered a downfall in 2009 as a result of high indebtedness among clients and the adverse effects of the global financial crisis. The 13 members of the Association of Microfinance Institutions (AMFI), which account for the bulk of the sector, reported a fall in gross loans to EUR0.5bn at end-Q309 from EUR0.6bn at end-2008. The banking sector consisted of 30 banks 2 (21 of which were foreign owned) and reported gross loans of EUR7.4bn at end-H109. Both the MFI and the bank sectors had registered strong growth in their loan books in the years leading up to Q408 (2007 growth of 85% and 28%, respectively), when the financial crisis hit the country.

### What caused the crisis?

MFI growth had been financed by relatively cheap cross-border funding from microfinance investment funds (MIVs), as well as by funding from local commercial banks. Banks, the majority of which are foreign-owned, benefited from funding support from their parents. The availability of funding led to high levels of competition, to which MFIs responded by loosening their underwriting standards (eg increasing maximum loan amounts and widening loan purposes) and introducing new products (eg consumer loans). In the absence of a centralised credit bureau until 2008, this led to relatively high levels of cross- and over-indebtedness among MFI borrowers.

### Impact on micro-finance sector and concerns:

With the onset of the financial and economic crisis, these borrowers started experiencing repayment pressures, as remittances fell, unemployment rose and business turnover fell. Loans in arrears increased sharply: by end-Q309, AMFI members were reporting loans in arrears more than 30 days of 6%, which came as a shock for a sector used to reporting arrears rates of less than 1%.

In parallel, funding became less available and more expensive for MFIs, and they were forced to adjust to a stagnant/low growth scenario, put increased attention on arrears management, and in many cases put on hold plans for transformation to deposit taking structures.

There have been controversies, scandals and accusations over all these issues but the field has revived itself amidst all these difficulties and still is working to re-organise the sector to ensure the faith of hundreds of people across the globe.

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Banco Compartamos and SKS IPO

Submitted by Unregistered User on Mon, 05/02/2011 - 17:52.

What about the listing of these MFIs? They sure created lots of negative image for the MFI's. If one may remember the listing of SKS added fuel to the fire(Andhra Pradesh).

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