

Role of foreign investors in the Indian microfinance crisis



with no apologies to Wall St

Savings and Credit Forum

Bern, 11 May 2012

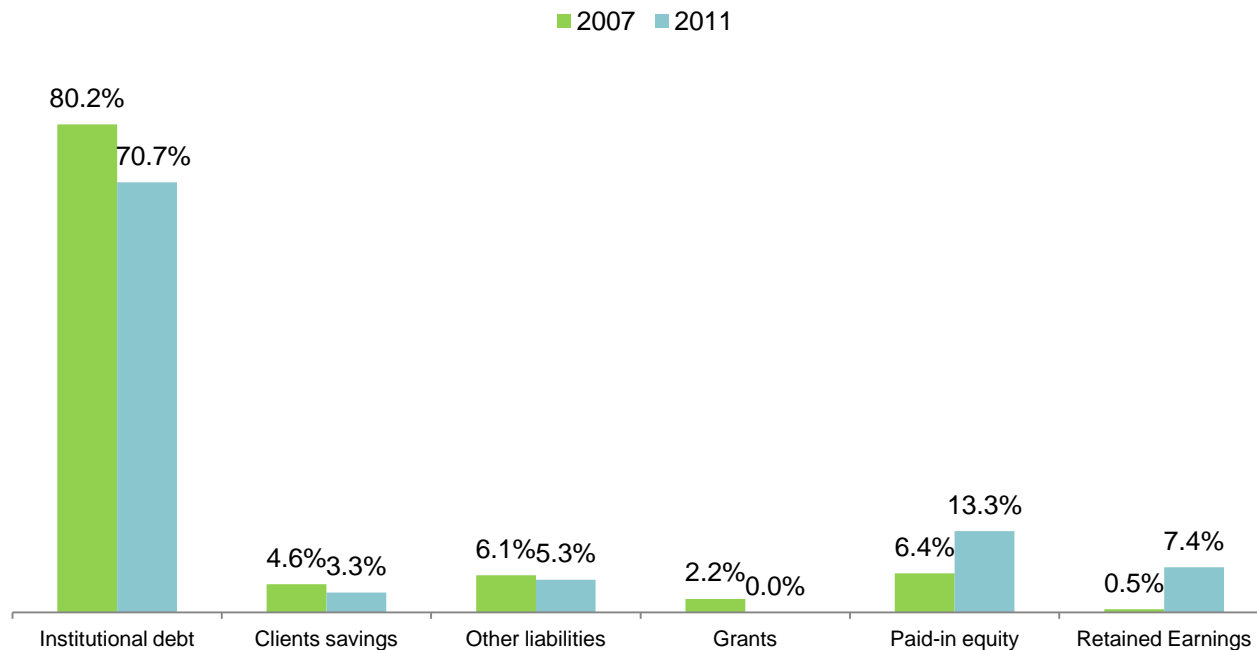
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Foreign investors in Indian microfinance

- Due to limitations on gearing ratios, the need for equity investments in MFIs is apparent
- Indian MFIs did well to generate equity – from \$24m in 2007 to \$778m in 2011 – 32x in 4 years – >80% foreign

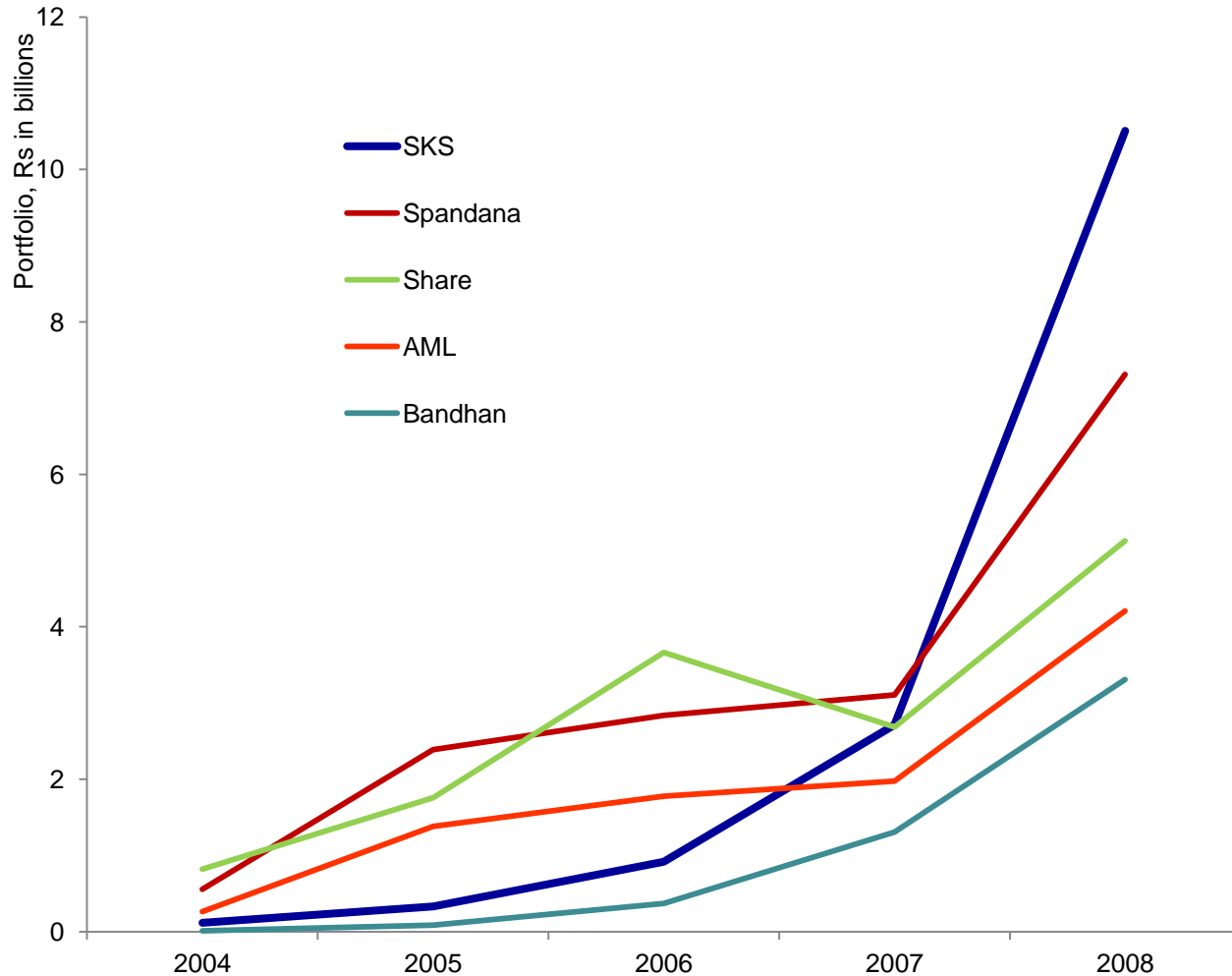


...were bedazzled by zeros

- They were presented with ambitious business plans for a huge apparently untapped market
- MFI promoters with a smooth sales pitch were able to sell the idea that indefinite exponential growth was possible in microfinance where it had failed in internet companies and the US housing market
- Thus they obtained high valuations for sales of shares to foreign private equity and HNIs, and
- The success of the Compartamos IPO became an exemplar that

set the stage for the SKS IPO

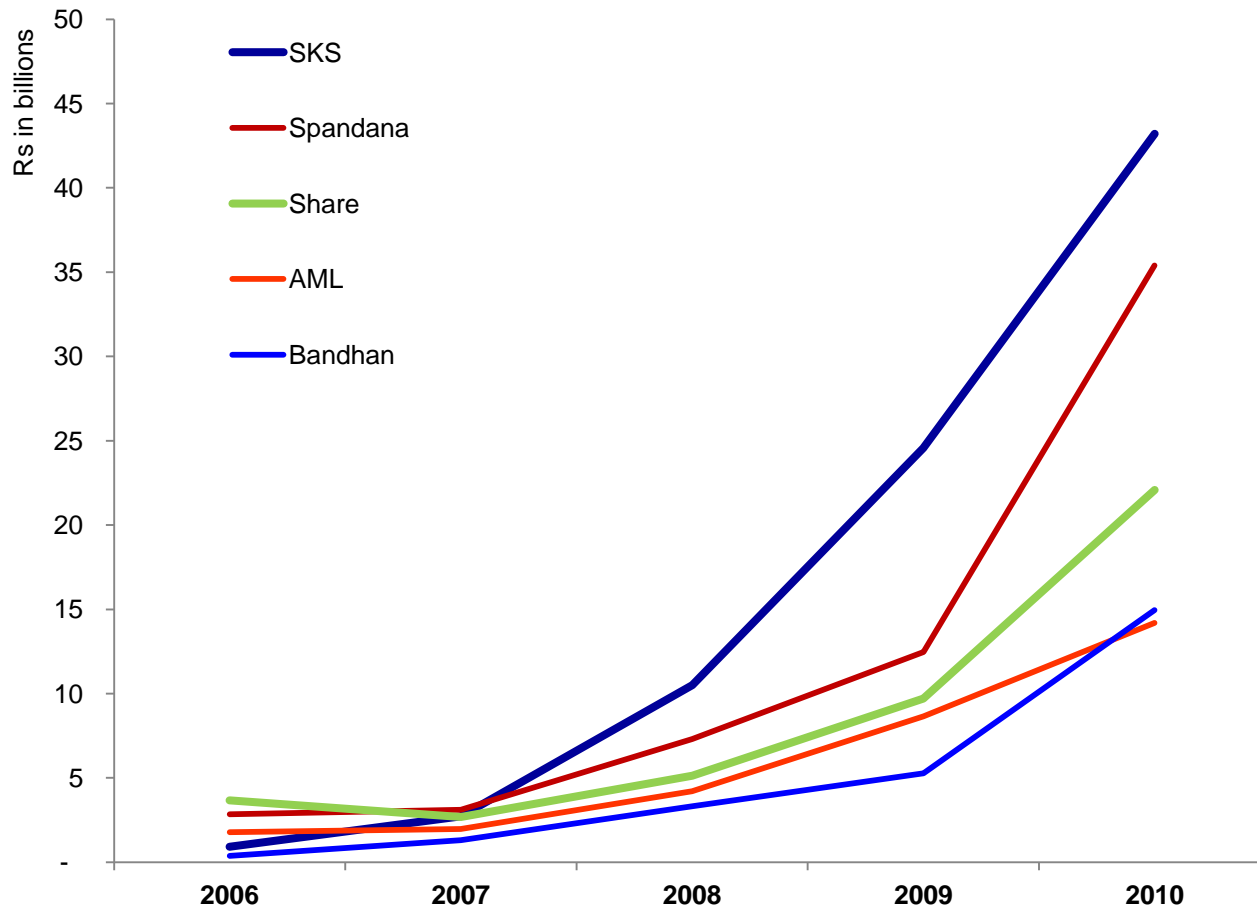
...fuelling a growth spurt by SKS in 2007



Leading to similar actions by others

- Other leading MFIs also sold to private equity at high valuations based on ambitious business plans
- ...obtaining high valuations by **promising** continued high growth rates and related high returns
- Once SKS plans for an IPO became known, others started to dream equally big

...fuelling a more generalised growth spurt

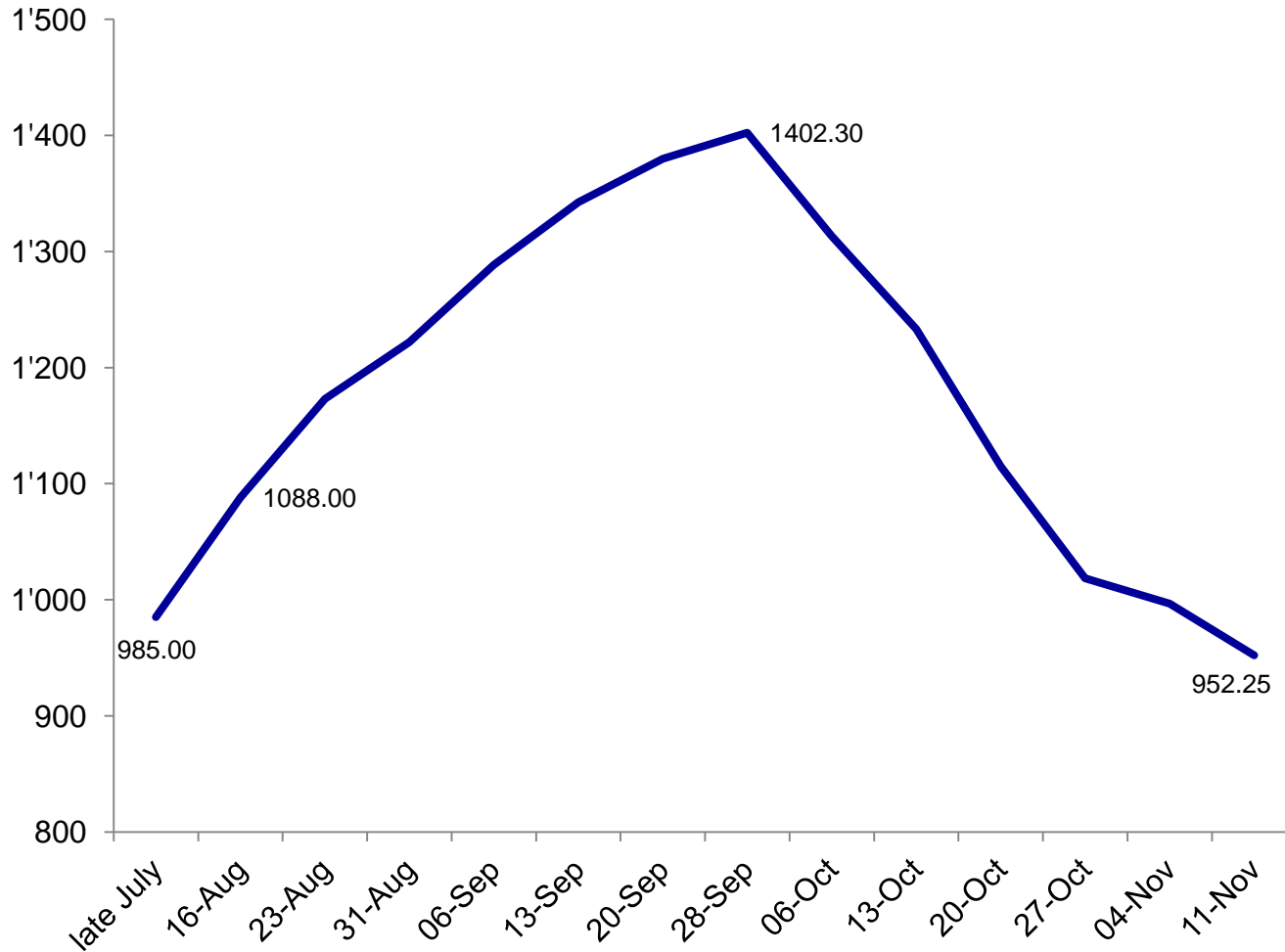


...and all the ills of an over-heated industry

- New NBFCs springing up in every corner of the country – all with ambitious business plans and seeking high equity valuations
- ...a “get rich quick” rush that led to competition for “the low hanging fruit” amongst microfinance customers
- Resulting in multiple lending, a decline in customer service, emergence of over-indebtedness
- Pressure on managements to control operations, train new staff and foster the organisational culture, and
- Pressure on staff to achieve targets, earn incentives and maintain portfolio quality ratios
- Incidents of client coercion cannot be ruled out

Whereupon the success of the IPO

Indian rupees

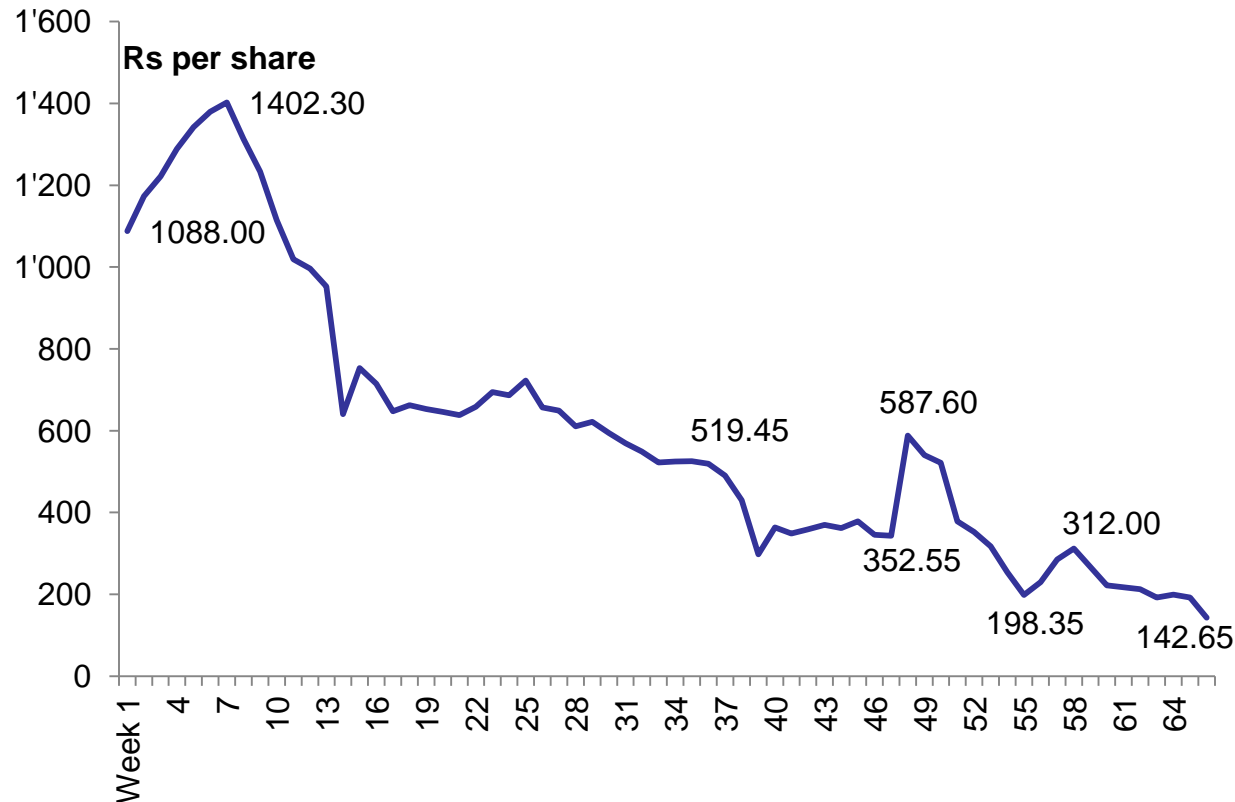


Has the makings of its own failure

- As SKS first seeks media attention before the IPO
- Sending hacks trawling the countryside for microfinance stories fair or foul
- ...finding out about the strengths of microfinance but also exposing its weaknesses and revealing instances of over-indebtedness
- And with the well publicised success of the IPO, generating envy amongst politicians, bureaucrats & others
- ...while exposing its own raw nerve soon after by sacking its CEO
- Which drew media attention back to microfinance during the annual period of farmer suicides

...providing much ammunition to detractors

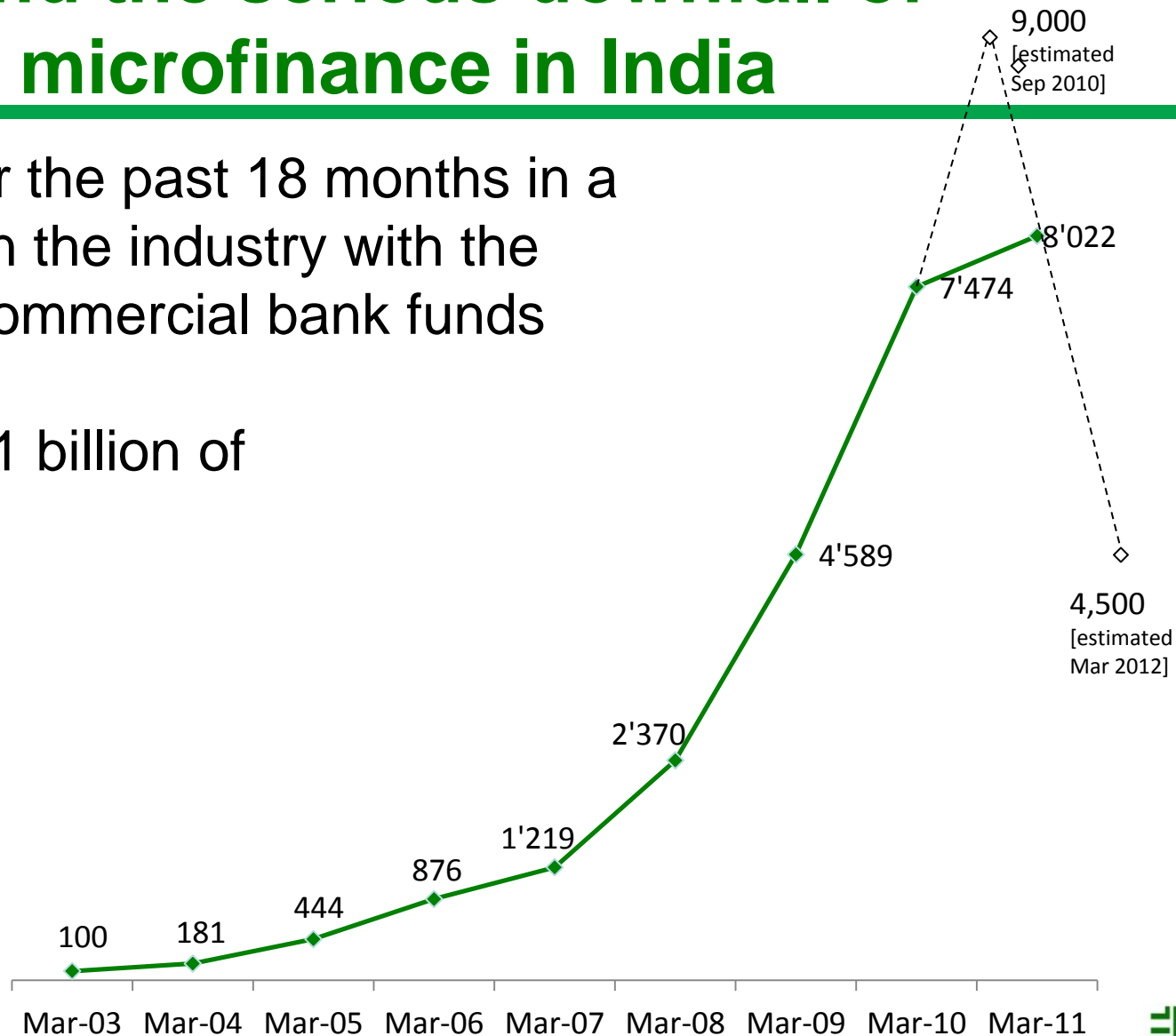
- And leading to the state government's action
- The rest is history



...and the serious downfall of microfinance in India

Resulting over the past 18 months in a 50% decline in the industry with the drying up of commercial bank funds

And around \$1 billion of portfolio default by clients.



CRILEX: M-CRIL's Index of MFI growth



But equity investors and IPOs can have a positive impact

- Provided we do not get carried away with the rhetoric of the market and try to push for valuations we know to be outrageous, and
- Maintain our balance and sensitivity as people with a commitment to development
- Client needs as the centre of attention combined with sober projections of growth

**We need not be pessimistic in the long run,
just realistic,**
and learn some lessons from what has happened.