GROUPE
ESC DIJON BOURGOGNE

Cahiers du CEREN 29 (2009)

CEREN
www.escdijon.com

# Interest Rate ethics: an aspect of social performance in microfinance

*Arvind Ashta*[1] [a],

[a] *Professor, Holder of Chair in Microfinance (Burgundy School of Business, CEREN, 29 rue Sambin, 21000 Dijon, France), Tel 333 8072 5966, Fax 333 8072 5999, Arvind.ashta@escdijon.eu*

## I. Introduction

A key question which has been debated in Microfinance in recent years has been interest rate levels. Very often, this question is related to governance. Another major concern has been that the sector is transforming from donor dependence to social investing and the latter group of investors are focusing on a double bottom line. This paper sees how interest rates, specifically, can be included in the social performance metrics.

The plan of this paper is as follows. First we start with a recent case study which has brought the interest rate ethics question to the fore. We then examine related questions of governance to see whether governance is also related to the ethical question. We then look at a related field of transparency of interest rates. We then offer some possible ways for microfinance rating firms to include these issues in their rating criteria. Finally, we offer directions for future research raised by this paper.

## II. The Compartamos Case and the interest rate question

In 2007, Compartamos made an initial public offering which shocked the world in more ways than one. First, its IPO was oversubscribed 13 times and this showed to the world, that commercial investors were really interested in investing in this field. Second, the valuation of the IPO which capitalized the company at 1500 million dollars compared to a book value of 126 million dollars indicated that the company had very high expected growth rates and highlighted that microfinance has been growing at a pace of 30% per year and that commercial operators were growing faster. Thirdly, the book value of 126 million dollars in 2006 compared to a paid-in share capital of 6 million dollars in 2000 when Compartamos was converted to a for-profit company showed a year-by-year doubling of the company, a growth rate made sustainable by high internally generated profits and no dividends in the first few years. This indicated clearly that microfinance company could be managed following private equity holding models, even when the holders of the equity are predominantly NGOs and developmental bodies such as the IFC.

The fourth, perhaps biggest shock, of course, was unfavourable, when it was discovered that the high profits came from high interest rates neighbouring 100% per annum. The world wondered if this was microfinance and if it was ethical (Lewis, 2008; Smith & Epstein, 2007).

Compartamos, the CGAP, related to one of the donors, as well as Accion, another donor came out quickly with well worded defences (Danel & Labarthe, 2008; Rhyne & Guimon, 2007; Rosenberg, 2007). In short, they argued that the

[1] Arvind Ashta would like to thank the Bank Populaire of Bourgogne-Franche Comté for financing the Microfinance Chair of the Burgundy School of Business (Groupe ESC Dijon-Bourgogne) which he is holding and which funds his research. Our thanks to the participants of the 4th African Microfinance Conference in Ouagadougou (July 7th to 10th, 2009); notably to Mrs Anne Bastin of Lux-Development, for their numerous comments and questions which undoubtedly added value to this paper.