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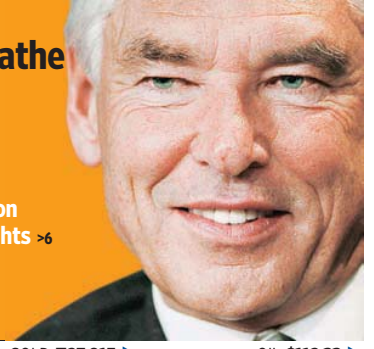
THE WALL STREET JOURNAL

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INDUSTRY CRISIS

Ratings firms liberal with MFIs: M-Cril

Managing director Sinha says other firms give lenders higher ratings without understanding the sector properly

BY DINESH UNNIKRISHNAN
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MUMBAI
Micro-Credit Ratings International Ltd (M-Cril), the largest ratings agency in India's ₹20,000 crore microfinance industry, has alleged that other ratings agencies have been giving higher ratings to microfinance institutions (MFIs) without properly understanding the sector.

"They (other ratings agencies) have been too liberal in the assignment of grades to MFIs by giving one to two notches above from what we assigned," M-Cril managing director Sanjay Sinha told *Mint* in an interview on Friday. "My point is that they do not understand the (microfinance) sector." Sinha did not name any particular agency.

MFIs give tiny loans to poor borrowers, typically at an interest rate of 24%. They mainly source money from commercial banks to do business.

According to Sinha, such higher ratings provided a wrong image to the commercial banks about the creditworthiness of MFIs, prompting them to lend large amounts to them, which in turn resulted in issues such as multiple-lending that eventually led to a crisis in the sector.

"Commercial banks and investors that relied on such ratings were inevitably lulled into a comfort zone resulting in excessive lending at a time when the industry was headed for disaster," Sinha said. "The incursion of the large corporate ratings agencies into the world of microfinance must bear part of the responsibility for the current mess in the Indian microfinance industry."

Major ratings agencies active in the space—Crisil Ltd and Credit Analysis and Research Ltd (CARE)—refuted the allegations and justified their ability to rate MFIs.

"Our experience allows us to compare the business risk of the microfinance sector with that of other financial sector entities so that we can provide a better perspective to the in-

vestors in correctly placing the risk of investing in microfinance," said D.R. Dogra, managing director of CARE. "While our holistic understanding of the financial sector helps in providing a lot of value to the investors, at the same time we understand the unique nature of microfinance activities and have specialized products and a dedicated team for the sector."

Crisil, too, defended its ability to rate MFIs.

"Crisil has an in-depth understanding of the MFI sector. We have been working in this sector for over a decade and have evaluated around 250 MFIs to date, based on a robust evaluation process which includes branch visits and interactions with the borrowers of MFIs," Crisil said in response to an email query. "Further, the risks in the sector are manifested in the Crisil ratings for MFIs. As far back as December 2009, eight out of the nine ratings assigned to MFIs were in rating categories of BBB and below."

Some industry experts, however, did not share this view, saying major ratings agencies have a "shortfall" in terms of understanding the risks in the microfinance sector.

"Ratings agencies have a long way to go to build knowledge as far as working with the poor is concerned," said Mathew Titus, executive director of Sa-Dhan, an association of MFIs.

"They (ratings agencies) have applied similar financial sector ratings to a completely different client set without questioning its relevance. In some sense, ratings agencies definitely have shortfall in terms of recognizing the ill that has plagued the market," he said.

This is the second time in less than a fortnight that a major ratings agency has raised allegations of foul play against competitors.

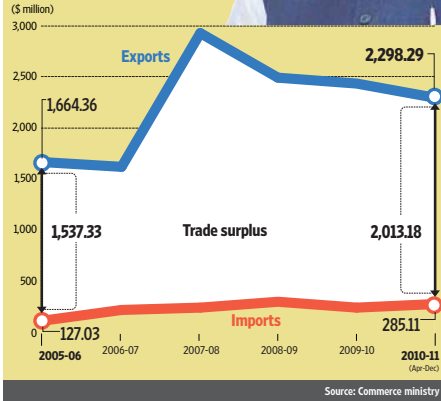
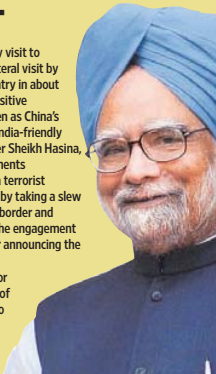
Late August, Ica Ltd, one of the four major ratings agencies in India, had criticized the industry for making compromises to win business, sparking a debate on the credibility of the agencies in the country.

MFIs seek ratings from agencies either for the organization or for any specific instruments. A higher rating enables companies to bargain with banks for a better pricing of loans.

Starting operations in 1999, M-Cril has so far rated 900 MFIs as against 250 by India's

CRITICAL VISIT

Prime Minister Manmohan Singh's two-day visit to Bangladesh (6-7 September), the first bilateral visit by an Indian premier to the neighbouring country in about a decade, comes at a time when there is positive momentum in the bilateral relationship even as China's influence on Dhaka continues to grow. An India-friendly regime in Bangladesh, led by Prime Minister Sheikh Hasina, has clamped down on anti-India terror elements in the country by handing over to India Ulfat terrorist Arabinda Rajkhowa. India has reciprocated by taking a slew of measures to facilitate trade and resolve border and water disputes. Singh is expected to take the engagement between the two nations forward by either announcing the scrapping of the tariff quota on imports of readymade garments from Bangladesh or substantially increasing the present quota of 10 million pieces of readymade garments to allow its eastern neighbour reap benefits from India's growth story.



Source: Commerce ministry

AMINO RAZA KHAN/MINT

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Gujarat against raising tariff at Mundra project

BY UTPAL BHASKAR
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NEW DELHI
The Gujarat government has refused to consider any move to allow a higher tariff at Tata Power Co. Ltd's 4,000 megawatt (MW) Mundra power project, two units of which are expected to be commissioned by March next year.

This may affect the financial viability of the project because its fuel costs are set to be higher than seen earlier. While developers factor in risk before placing bids for big power plants such as Mundra that would be fired by imported coal, experts are of the opinion that there will be muted interest in similar projects such as the one proposed in Cheyyur, Tamil Nadu, if developers are not allowed to raise tariff on higher input costs due to a change in overseas law or regulations.

Tata Power, which has been lobbying the Union power ministry in pursuit of a higher tariff, acquired a 30% stake in two coal mining units and a trading company from Indonesia's PT Bumi Resources Tbk for \$1.1 billion in 2007 to source fuel for the Mundra plant. But Indonesia has stipu-

QUICK EDIT Medicines for all

Doubts have been expressed if allowing 100% foreign direct investment (FDI) in the pharmaceutical sector has made for good policy. In recent years, foreign firms have acquired Indian companies in the sector. By itself, this is a normal state of affairs.

So, what is different in this case? It has been pointed out that between 2011 and 2013, a large number of drugs are likely to go "off patent" in the US, making it possible for local firms to produce cheaper generic versions. With foreign ownership of companies, it is feared, this may not happen.

The fears are real: India does depend a lot on generic versions and any sudden change in their availability will have large consequences. But instead of a knee-jerk reaction, it is better to tweak existing policy. Instead of disallowing FDI, foreign firms need to be told why whittling the supply of generics will be unacceptable. Otherwise, they should be welcomed to invest.

Air India cuts losses in US operations

BY P.R. SANJAI
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MUMBAI
The US operations of national flag carrier Air India have come out of losses and posted a small cash profit in July.

The profit on US routes comes when Rohit Nandan, 54, assumed charge as chairman and managing director of the carrier in mid-August, replacing Arvind Jadhav, who had been heading Air India since May 2009.

"Air India has cut its losses on its flights on the US routes in July. This is in sharp contrast to the losses suffered by the airline on these routes when the non-stop flights were initially introduced in August 2007," said an airline executive, requesting anonymity.

"Apart from peak season, introduction of Delhi as a hub and (going for) aircraft with 303 seats instead of 195 helped us to come out of the red. We expect the trend will continue throughout this year, barring September, and help in cutting down the overall losses."

Nandan could not be reached for comment. Some US flights such as



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Lessons in crime

The CBI is letting school students—and us—get a sneak peek at its crime fighting tools and methods. (www.livemint.com/cbileasons.htm)

SLIDESHOW

The world in pictures

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INSIDE MINT TODAY



Demographic dividend turning into a demographic nightmare

Lok Satta Party founder Jayaprakash Narayan on the anti-corruption campaign led by Anna Hazare and issues related to Andhra Pradesh. >P6



Investments in Ethiopia farming face criticism from activists

As Indian businessmen bet on cash crops, it's unclear whether food security issues are being tackled. >P7



Removal of parallel imports clause in copyrights Bill may stir up debate

The provision would have helped students gain access to the latest versions of text books from across the world. >P4



Business of Life: Tilting the scales

With some IIMs attempting to rebalance gender roles, here's a look at women in corporate India, and why a lot more needs to be done. >P13

'Rating firms liberal with MFIs'

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largest rater, Crisil; CARE has graded 75.

These ratings agencies also did not undertake sufficient branch-level investigation and interaction with clients while assigning ratings, Sinha said.

"As a result, these ratings agencies failed to sound the warning bell when the industry was clearly going off the rails from 2008, and especially in 2009," he said. "Unfortunately, the Reserve Bank of India's rules also favour the corporate agencies on the mistaken assumption that mere size rather

than knowledge of and commitment to a specialized activity like microfinance enhances analytical capability."

An official with a Hyderabad-based micro lender, who used to approach M-Cril for ratings till a few years ago, said most MFIs stopped using M-Cril ratings as commercial banks started insisting for ratings from bigger ratings firms while sanctioning loans.

"Everybody used to get rated by M-Cril. The problem we faced is that when we attained a definite size, lenders and investors wanted us to get rated by major ratings agencies," the

Sinha says sufficient branch-level investigation and interaction with clients weren't done

official said, requesting anonymity.

India has four major ratings agencies Crisil, CARE, Fitch Ratings and Icra. Brickwork Ratings India Pvt. Ltd, another rater, is a relatively recent en-

trant to this space. Also, SME Rating Agency of India Ltd is active in the industry, but is largely limited to rating of small and medium enterprises.

Global ratings agency Standard and Poor's holds a 51% stake in Crisil, Moody's is the single largest shareholder in Icra with a 28.51% stake, while Fitch is unlisted. CARE, set up in 1993 and the only one controlled by local promoters, plans a listing this fiscal.

Andhra Pradesh, India's fifth largest state and accounting for more than a quarter of the micro lending industry, promulgated a law in October to

control microlenders. This was after a series of reported suicides due to alleged coercive recovery practices adopted by some of them.

The law restricted MFIs from collecting weekly repayments, and made it mandatory that government approval be obtained if a borrower takes more than one loan.

While the repayment rate dropped to 5-10% following the state law, commercial banks, which typically provide 80% of the funds to the industry, stopped lending.

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To read our 22 August story 'Icra takes on competitors over ratings', go to www.livemint.com/ratings.htm

Gujarat against raising tariff at Mundra project

FROM PAGE 1

lated that starting 23 September, the coal that the country produces will be pegged at prevailing international prices.

"They (Tata Power) have written a letter to the Union power minister to call a meeting for discussion on the issue," said Saurabh Patel, Gujarat's energy minister. "The centre then wrote a letter to the Gujarat government to call a meeting of all procurer state governments since we are the major procurer of power (1,900MW). We have flatly refused it. Tata Power had asked for fuel increase as a pass through."

The other states that will buy power from the plant are Maharashtra (800MW), Punjab (500MW), Haryana (400MW)

and Rajasthan (400MW). Mint could not contact the power ministers of these states by the time of going to press.

"The financial position of the Mundra projects was done on the basis of certain assumption of coal prices. A new regulation in Indonesia...makes it mandatory for all the coal companies in the island nation to sell coal at prevailing international (benchmark) prices. This move will impact the margins of power generation due to the fuel being secured from Indonesia," said an external spokesperson for Tata Power.

The chief executive officer of Coastal Gujarat Power Ltd, a special purpose vehicle (SPV) of Tata Power, has kept the Union government and the concerned state governments aware of the changed situa-

tion, the spokesperson added.

The progress till the end of March 2011 was approximately 77%, with total capital commitments of 100% of total equipment ordering and a total actual expenditure of ₹13,166 crore. The total estimated cost of the project is ₹17,500 crore.

The debt-equity ratio is 3:1 (75%-25%).

The financing comprises equity of ₹4,250 crore, external commercial borrowings of up to \$1.8 billion, and rupee loans of up to ₹5,550 crore, according to the external spokesperson.

The states are to buy power at ₹2.26 per unit, according to the power purchase agreements that have been signed.

"We have written to the centre. Why should the state get

involved? UMPP (ultra-mega power project) is the centre's project and they have bid it out," Patel said. "If imported coal is the issue, then the government of India should take the issue up with the Indonesian government."

Tata Power may struggle to keep the project viable given the volatility of the market, said two industry experts, on condition of anonymity.

UMPPs follow a competitive tariff-based bidding process in which an SPV

is set up to reduce risk perceptions and increase investor confidence. The SPV takes care of regulatory requirements such as land acquisition and environmental clearances, and transfers these to the winning

bidder.

The Union government has distanced itself from the issue.

"It is between the developer and the procurers and has got nothing to do with us. We had advised the developer to take up the issue with the procurers," said a top power ministry official, who did not want to be identified.

A top executive of Power Finance Corp. Ltd, the nodal agency appointed for the award of such large projects, said: "Our job was to bid out the SPV, which we have done. Beyond that it is between the developers and the procurers."

The UMPP programme has had its share of problems, with ecological concerns and local resistance. The government wants to set up 16 UMPPs to meet the needs of the world's second-fastest growing major economy after China. Of these, four have been already awarded. India has a power generation capacity of 180,000MW and expects to add 62,374MW by 2012.

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Corrections & Clarifications

feedback@livemint.com

A sentence in the 3 September obituary of Jehangir Sabavala should have read: "...he was part of 'no isms'...no groups, when it came to his work."

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