Berrett–Koehler Publishers

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For release July 2, 2012

Confessions of a Microfinance Heretic

How Microlending Lost Its Way and Betrayed the Poor

By Hugh Sinclair

"An arresting exposé on the microfinance industry… told with almost cinematic flair."
-- *Publishers Weekly*, May 2012

"Hugh Sinclair is a brave and persistent guy… [who] knows his stuff. Channeling Michael Lewis sets a pretty high bar, and the attempt makes *Microfinance Heretic* more fun to read than most financial books." -- *New York Journal of Books*

San Francisco, CA -- This is the true story of a young IESE Business School grad who joined the burgeoning microfinance industry in the early 2000s with the intention of doing good in the world. Over the course of the following decade, he would discover vast global networks of corruption, cover-ups, and countless betrayals of the poor in what had grown into a $70 billion sector. His attempts at exposing wrongdoing would result in death threats, aggressive and personal retaliations, and legal action -- after all, the first rule of microfinance is *don't criticize microfinance.* Part memoir, part financial detective story, and part exposé, these are the **Confessions of a Microfinance Heretic** (Berrett-Koehler, July 2012, hardcover, $27.95).

Hugh Sinclair traveled to several continents while working for numerous banks, agencies, and institutions and saw microfinance from the ground up. He soon realized that the heart-warming stories presented on sites like Kiva and Grameen Foundation were anything but commonplace in microfinance sectors. When his efforts to bring his findings to senior executives were thwarted, Sinclair became an anonymous source for *The New York Times*, providing information for a story that covered a wide scope of microfinance misdeeds (http://nyti.ms/N43qNl).

But such reports only scratch the surface. In this book, Sinclair reveals the devastating dark side of this feel-good industry: rampant corruption, exorbitant interest rates, and microloans leading to fraud, child labor, prostitution, and even suicide. Much of the book centers on the scandal Sinclair uncovered involving the Nigerian nonprofit **LAPO** and its dealings with industry darlings **Kiva, Grameen Foundation** and **Triple Jump**.

However, other key players such as **Deutsche Bank, Citibank, SKS, ACCION, Grameen Bank**, **Blue Orchard, Calvert Foundation,** and **Compartamos** make appearances. There are many people who do not want this story told – some of them have already intimated as much in no uncertain terms to the author.

Sinclair doesn't just criticize and expose the industry but recommends how to fix it -- because he has seen that microfinance *can* work and so lays out the conditions necessary for its success. The question is: will anyone listen?

Hugh Sinclair has worked in microfinance with numerous global organizations, banks and funds for over a decade. He currently consults on microfinance strategy and portfolio management. Previously, he worked in traditional finance at ING Barings, CDC Capital Partners, and BZW Securities -- now Barclays Capital. Hugh holds a Master's degree in International and Corporate Finance from the University of Durham and an MBA from IESE Business School.

Among his accomplishments are being the first to deliver a Harvard Business case study in Mongolian and achieving the Guinness World Record for the fastest motorcycle tour from Prudhoe Bay, Alaska to the tip of South America. He speaks frequently at business schools and microfinance conferences.

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Berrett-Koehler Publishers
hardcover; $27.95; 264 pages
978-1-60994-518-3
July 2012

Author Tour for Hugh Sinclair

July 9, 2012
New York - Housing Works Bookstore - Conversation with David Roodman (author of *Due Diligence*) - Moderated by *WSJ* columnist Simon Constable

July 13, 2012
Washington, DC - Politics and Prose

July 20, 2012
Mountain View, CA - Google HQ - Author Talks @Google - Private Event

July 24, 2012
Berkeley, CA - Berkeley Arts and Letters - Conversation with Rose Aguilar, Host of "Your Call" on KALW-FM

About Hugh Sinclair

Author of Confessions of a Microfinance Heretic

Hugh Sinclair spent his first 18 years living in London, before his lifelong passion for travelling and exploring took over. No longer satisfied selling cheese in a UK department store, he managed to find a job as a messenger in Toronto for a large bank. He managed to gradually work his way up to a junior job on the Toronto Stock Exchange, where his interest in finance was cemented. Economics seemed the obvious choice for a university degree, so he went to the very north of England to study, while working in Toronto and then London in the holidays.

Upon graduation the prospect of a full-time job seemed premature, so Hugh packed his bags and went to South America for a year, where he learned Spanish, worked on a series of voluntary projects, and read all the economics books he had failed to read at university. He returned to Barclays, who sponsored him to do a masters in finance and econometrics, so Hugh returned to Durham University to study yet more maths and economics, and also did some teaching to undergraduate economists.

Tired of maths, and unable to postpone full-time employment any longer, Hugh joined the corporate finance department of ING Barings. Once the student loans were repaid he realised that sitting in a stuffy office for 15 hour stretches was not actually particularly pleasant. With experience in only two sectors, finance and cheese, he had no idea what to do next, so decided to do an MBA in Barcelona, during which time he hatched a ridiculous plan to satisfy a childhood ambition – to get into the Guinness Book of Records. Only one potential employer was impressed with this plan, and agreed to sponsor the expedition and postpone his start date – Enron. Thus Hugh and a friend from ING Barings drove two motorcycles from Prudhoe Bay, Alaska, to Ushuaia, Argentina, blissfully unaware of the events taking place in Houston. With the record under his belt, Enron and then Argentina collapsed, and Hugh returned to the drawing board. It was time to try something else.

He worked initially in Mexico, at two microfinance institutions (MFIs), and then moved to Mozambique with his girlfriend, now wife, to work on an ailing MFI. After some rather unpleasant discoveries in Africa, they returned to Europe, where Hugh began working for the Dutch microfinance fund Triple Jump, and Jessica began working at a women's rights fund. Hugh's ability to sniff out problems was put to good use in his new job, until he sniffed a little too much in the head office, and discovered some more disturbing events occurring in the heart of Holland, far from Africa and Latin America where most of his work took place. Frustrated by what he perceived as utter disregard for the poor, he confronted management, and eventually won a court case against them – leading once again to unemployment.

He has worked as a microfinance consultant ever since, working across the broad range of the sector, visiting and living in some 53 countries. His work has involved some of the largest banks and investment funds in the sector; the rating agencies; peer-to-peer organisations; consulting boutiques; private investors; foundations; large microfinance networks; and countless MFIs. But during this decade he grew increasingly concerned about the actual impact of microfinance upon the lives of the poor. As avoidable and predictable crises began to spread across the sector, and as academic research began to suggest that the impact of microfinance fell somewhat short of its miraculous claims, Hugh began to observe a more pervasive phenomenon: the entire microfinance sector had been discreetly hijacked. It was time to satisfy another childhood ambition, and write a book.

Hugh and Jessica married in 2007 and their daughter was born in 2010. They now live in a remote corner of South America far from the antics of the microfinance sector, in one of the last remaining locations without a single MFI, and no one appears to upset about this. He continues working as a consultant for a select group of clients who genuinely strive to provide ethical, beneficial microfinance to the poor, Jessica continues working for the women's rights movement.

Hugh remains optimistic about the potential for microfinance, and is quietly optimistic about some subtle changes that are happening already, but his days of flying around the world trying to fix MFIs are over. He now works about 50% of the year in microfinance, and the rest of the year in the renewable energy sector and assisting small companies to grow. He remains passionate about economics, and will one day satisfy a third lifelong ambition to do a PhD, but in the meantime is working on some innovative projects to improve the effectiveness of lending and investing in the poor entrepreneurs of the world.

To set up an interview with the author, contact Cynthia Shannon, 415-743-6469 or cshannon@bkpub.com

How Can We Fix Microfinance?

Hugh Sinclair, author of *Confessions of a Microfinance Heretic (*Berrett-Koehler, July 2012) offers suggestions on how to improve a corrupted industry

For people interested in making small loans:

- In a Peer-to-Peer network (like Kiva, MicroPlace, or MyC4), **ensure you can track the actual flow of money from your account to the poor person's wallet and back.** Fancy photos and heart-warming stories are nice (and important marketing materials for the platforms), but also look for hard data. Can the platform confirm the actual interest rate being charged, for example? If they can't provide this one piece of critical data, demand a good explanation.
- **Read rating reports.** Ask the fund if they have at least read the ratings for their MFI's, if they exist. If they are investing in MFI's that do not have ratings, and the fund is unwilling to insist upon a rating, take caution.
- **Ask for social performance data.** There is no point knowing about a few micro-entrepreneurs' success stories if you don't know how many failures there were and how many showed no notable growth or loss.
- Ensure you **know who is actually deciding which investments to make** and what their due diligence and monitoring processes actually are. Ask probing questions and treat evasive answers with suspicion.
- **Check where your pension fund invests**. Private pension funds have invested billions of dollars in microfinance, usually through investment companies like Blue Orchard, and consider them "socially responsible." Ask for and critically check their investment criteria and processes, and complain if you suspect that your money is being invested in unsavory activities.

For the microfinance funds:

- **Formal and professional regulation.** The sector needs specific, dedicated, qualified regulators who understand the microfinance sector in particular. There are none currently.
- **Conduct due diligence on-site with an auditor;** take an IT expert to sniff around in the MFI's back office; do background checks on managers and look for conflicts of interest within the MFI. Don't sub-contract due diligence to another fund, especially one that has already invested in the same MFI.
- **Verify the actual interest rates charged by personally visiting their clients** and asking them how much they actually pay, and ensure this corresponds with all accounts, ratings, and other documents.
- **Hire staff with actual microfinance field experience.**

For the management of an exploitative MFI:

- **Quit.**

For the management of an ethical MFI:

- **Pick your investors carefully** as they can have a surprising influence on your operations and missions -- and not always for the benefit of the poor.
- **Beware of "free" technical assistance from a microfinance fund.** They are invariably trying to sniff you out, or secure a deal for themselves. Exploit such offers by all means, but do not consider them "free". What assurance do you have that information will not discreetly benefit a competitor if the fund has other investments in the region? Many funds have technical assistance arms which they claim are separate, independent entities. Dream on.
- **Review your mission statement,** and re-phrase it if necessary in a measurable, explicit way. Then do it.
- **Spend time in the field visiting clients, on your own.** This reinforces the idea that management is aware of the field operations and is pro-active. Chat informally with junior staff about their working conditions. Time simply sitting in a branch will provide the best sense of the actual customer experience at your MFI.
- **Know who you are actually lending to.** Capture more data on clients. This will help you to understand which clients are likely to benefit and repay a loan, and which are not. It's a service to you, and a service to the client. The IT staff are not "geeks", they are the guardians of some of the most critical information within the entire MFI. Get to know them.

For potential regulators:

- You have a massive, miserable job ahead of you; you are going to discover endless problems and will face huge resistance. A disturbing number of the funds or MFIs you are regulating will fall way short of even modest regulatory requirements. When you ask funds detailed questions about their investments and they eventually reply "no idea", they are probably telling the truth.
- **Consider hiring a bodyguard.**

For the poor:

- The moment you have to get a loan from MFI A to repay MFI B, you already have a problem. Stop immediately – things will only get worse.
- If you are ill-treated or threatened, don't commit suicide **– complain directly to the MFI, investigate if there is a local regulator, or go to the local press.** Journalists love pictures of loan officers harassing poor clients, do not hesitate to use this mechanism as a last resort.
- If you suspect that such practices are common, and can find enough other victims or sympathizers, you may be able to collectively have enough negotiating power to simply refuse to repay your loans. Individually you are weak, but if you can gather hundreds or thousands of clients together, you will get media coverage more easily, and can genuinely threaten the bank with widespread defaults and contagion to other regions.

For microfinance whistleblowers:

- If you are working in an MFI and perceive injustices or are obliged to perform unsavory acts to "problem clients", go on-line and **anonymously blog** about this almost anywhere. There are enough people now aware of the problems that someone will eventually pick up the thread. Be very careful to protect your identity. Consider contacting the regulator if appropriate. If the MFI is rated, contact the rating agencies as to "areas they may wish to investigate in more detail" – they will not publish anything unless they can back it up, but they may consider such advice. It's worth a try.
- **Never reveal all your information.** Keep something up your sleeve, so if the MFI or fund attempts to attack you, you still have something additional to leak. For as long as they don't know how much you know, they will tread carefully. By formally attacking you they risk full disclosure of all documents, at which point you can have a field-day.
- **Be bold. A simple photograph, with supporting evidence, can have a huge impact.**

Suggested Interview Questions for Hugh Sinclair, author of Confessions of a Microfinance Heretic (Berrett-Koehler, July 2012)

To set up an interview please contact Cynthia Shannon at cshannon@bkpub.com or 415-743-6469

How did you get involved in microfinance?

Explain how microfinance works, both in theory and in practice.

Microfinance has some very prominent endorsers, including the Clintons, Queen Rania, and Natalie Portman. Why do you think microfinance appeals to so many people?

What are some of the common misconceptions that people in developed countries have about microfinance and what it does to help the poor?

When did you first discover something was awry? What did you do about it? How did your managers react when you presented them with your findings?

Of the questionable organizations, who are the biggest players and what have they done wrong? How much money is being made at the expense of the poor, not to mention dubious investors?

Tell listeners what happened in Nicaragua, where there was a civil uprising about the loans.

What happened in India with SKS?

What do you think the underlying problem is with microfinance? Will the problems go away if we get regulators to do a better job or if the microfinance funds conduct proper due diligence?

Explain what role Muhammed Yunnus, whom some credit with inventing the industry, plays in your discoveries about LAPO. If he is aware of the high interest being charged to borrowers, why doesn't he condemn the investments?

Reading the book, one could become quite cynical about the entire sector. You mention towards the end of the book that microfinance can work and that eliminating it completely would be to the detriment of many poor people, a la "Don't throw the baby out with the bathwater." Explain this.

Kiva is probably the most popular microlending organization in the U.S. They have invested about $280 million dollar in microfinance - not very much compared to the overall $70 billion industry, but their popularity is growing. You have questioned the effectiveness of Kiva with disappointing results -- can you tell us a little about that?

What advice would you give someone who has invested money in a microfinance fund?

Taking a closer look: The Images of Microfinance

By Hugh Sinclair, author of *Confessions of a Microfinance Heretic* (Berrett-Koehler, July 2012)

The image: a local, smiling woman sitting in her hut with a newly-purchased sewing machine, surrounded by her grateful children and her friendly next-door neighbors.

The description explains that the woman received a group loan with her neighbors and will be able to start an entrepreneurial venture to sell her products at the local market.

Unfortunately this picture is a myth. Here's why:

- Such cases are surprisingly hard to find in practice.
- The clients are not always female, and quite often men deliberately send their wives to get loans because they know they are more likely to be approved.
- Loans are invariably not spent on the productive sewing machine, but on a new TV, repaying another loan to a similar bank, paying other bills, or generally consumed. The microfinance institution does not generally ask what the loan is going to be used for, and even if they do, they don't much care. All they want to know is that it will be repaid. The benefits of the cash quickly disappear, but the debt remains while accumulating interest at an alarming rate, often encouraging the "micro-entrepreneur" to obtain another loan elsewhere to meet the repayments, and often from the very moneylenders the microfinance community claim to replace.
- Interest rates on loans, when all the various hidden charges are considered, are substantially higher than those stated. Interest rates under 30% a year are disappointingly rare, and rates approaching 100% or higher are disappointingly common.
- The small business, if one exists at all, is rarely able to generate sufficiently massive returns over prolonged periods of time to cover all its costs including interest payments. Even if it does offer some genuine improvement to the life of the individual entrepreneur, it is quite possible that this is at the expense of other people in the marketplace. When a superstore opens in a small town in America, many smaller shops are driven out of business. According to the microfinance sector this phenomenon does not occur in developing countries. Microfinance has somehow managed to defy the basic laws of economics.
- The supposedly abundant supply of entrepreneurs in developing countries has not actually been demonstrated. It is assumed that every poor person is a budding Steve Jobs, one business idea away from a big break-through. A quick glance at the overwhelming majority of businesses that receive microloans hardly suggest cutting-edge innovation -- most market traders sell precisely the same trinkets as everyone else in the marketplace, while the number of people buying these trinkets remains unchanged.

- The impact of child labor is a carefully avoided question. The reality is that many micro-enterprises employ their own children, and no one really knows the impact of such labor long-term. As universal education becomes a reality in more and more countries each year, it is likely that some proportion of these children are stacking shelves or selling cellphone credit at the expense of an education. Conveniently, few microfinance banks and only one microfinance fund have policies on child labor. Even the self-regulatory watchdogs avoid discussion of the child labor in their so-called “Client Protection Principles.”
- The majority of the microfinance clients are not at the bottom of the pyramid, or the “extreme poor” as the sector prefers to call it. In fact, quite a few are perhaps best described as lower middle-class, and while it is a pity that their own commercial banks won’t lend them money on reasonable terms, it does not follow that a microfinance bank offering them a loan at 60% interest a year is necessarily contributing to development.
- To a large extent, the clients of most microfinance bankers are not protected by the regulatory protection afforded to people in more developed countries, and are rarely applied even where such regulation does exist.
- By joining groups of borrowers who guarantee one another’s portion of the loan, the defaulting client not only incurs the wrath of the bank, but they also their colleagues, who are obliged to step in and meet the shortfall.

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