

The Banco Compartamos Initial Public Offering

Introduction

On April 19, 2007, Banco Compartamos became the first Latin American microfinance institution (MFI) to offer equity through an Initial Public Offering (IPO). Shareholders in Compartamos, including ACCION International, the International Finance Corporation (IFC), Compartamos NGO, and private Mexican investors sold 29.9 percent of Compartamos' stock in a secondary offering listed on the Mexican Stock Exchange.¹ The total proceeds from this sale were US\$468 million, with purchases by 5,920 institutional and retail investors from Mexico, the United States, Europe and South America.

IPOs are a new phenomenon in microfinance, and the success of the Compartamos issue raises the possibility that other MFIs may contemplate raising equity by public offering. Yet the microfinance industry is only beginning to become involved with IPOs. How exactly does an IPO work? What are the preconditions for considering an IPO? What are the factors that made the Compartamos IPO so successful? Could other MFIs do the same? This *InSight* provides detailed information about the transaction – its rationale, process, results, and key success factors. This information is important for widening the understanding about IPOs in the microfinance community.

More than a new phenomenon, the IPO represents the culmination of an ongoing strategy within microfinance to enlist the private sector in microfinance: the commercial model of microfinance. The success of the IPO has brought an unprecedented level of excitement about microfinance into the investment banking world. It has sent the message that service to the poor and profits can go hand in hand, a message that will undoubtedly attract more private sector players to microfinance and possibly to other market-led approaches to poverty.

More than a new phenomenon, the IPO represents the culmination of an ongoing strategy to enlist the private sector in microfinance.

At the same time, the surprisingly high valuation for Compartamos and hence proceeds from the sale have provoked much debate within the microfinance community on fundamental issues concerning interest rates, the use of profits, what it means to work in the interest of clients, and ownership and governance of regulated MFIs. The questions arise in part because the high profits that were a significant factor in the success of the IPO were made possible in part through high interest rates. This *InSight* is mainly concerned with the why and how of the IPO, but it does make a few preliminary comments to help frame the healthy discussions on interest rates and the commercial model that are sure to continue.

¹ A secondary offering involves sale of existing shares rather than raising fresh equity through issuing new shares.

1. Origins and History of Banco Compartamos

The origins of Compartamos lie in the Mexican youth organization, *Gente Nueva*, founded in 1982 to improve the quality of life of Mexico's marginalized communities through social action, and health and food programs. In 1990, to provide support to establish family microenterprises and other income-generating activities among these communities, Compartamos was launched with a village banking pilot program. In 1995, as the village banking program had expanded and began to achieve operational self-sufficiency, it was separated from the food program.² Throughout the last 17 years, Compartamos, which began its credit operations in the states of Oaxaca and Chiapas, has experienced remarkable expansion and growth while attaining and then maintaining high levels of profitability.³ Today, Compartamos stands out as one of the best performing MFIs in the world and one of the largest in Latin America in number of clients, providing loans to over 630,000 Mexicans as of March 2007. As of the end of 2006, it operated through 187 branches in 29 of the 32 Mexican States (see Table 1). In the view of many, Compartamos has become a world model for other microfinance institutions.

Since its inception, Compartamos has mostly served women entrepreneurs largely in rural settings, with 98 percent female clients. Its clients are involved in a variety of economic activities, such as food trade, handicraft production, and farming. Compartamos started operations by applying the village banking methodology, offering a basic loan termed the Income Generator product which aims to finance working capital. Currently, it offers village bank, solidarity group and individual loans, and has an average loan size of US\$446, which is only 5.8 percent of GNI, suggesting that Compartamos reaches a very low-income segment of the Mexican population.

Table 1: Compartamos at a Glance (December 31, 2006)

Type of Organization	Commercial Bank
Coverage (Number of States)	29
Number of Branches	187
Number of Employees	3,203
Number of Clients	616,528
Percentage of Women Clients	98%
Average Loan Size	US\$446
Average Loan Balance per Borrower/ GNI per Capita (2005)	5.8%
Gross Loan Portfolio	US\$271 million
Portfolio at Risk > 30 Days	1.1%
Return on Equity (ROE)	56%
Return on Assets (ROA)	23%
Effective Interest Rate (Yield on Average Portfolio, excluding VAT)	82%* ⁴
Operating Expense / Loan Portfolio	33.45%

Sources: Compartamos Annual Report, 2006; Credit Suisse "Offering Circular;" and Microfinance Information eXchange, profile of Compartamos (www.mixmarket.org).

² For more information about stages of growth at Compartamos, see Malombe, Joyce. "Community and Development Foundations: Emerging Partnerships," Washington D.C.: World Bank, 2000.

³ For detailed information on Compartamos' financial performance, see ACCION International website's key statistics, financial indicators page (http://www.accion.org/PDF/LAC_06Q4_prog.pdf), the Microfinance Information eXchange's profile of Compartamos (www.mixmarket.org), or Compartamos' Annual Report, 2006, available at www.compartamos.com.

⁴ Carlos Danel Cendoya, Co-Executive Director Compartamos, Interview, June 2007.

*Clients also pay a 15 percent value added tax (VAT) to the Government of Mexico, so the total charge to clients is 97 percent.

Of the four core products Compartamos offers, the Income Generator loan is still the mainstay. It makes up 88 percent of loans (Table 2).

Table 2: Compartamos' Four Core Products (December 31, 2006)

Product	Requirements	No. of Loans	Percent of Loans	Portfolio (US\$)	Percent of Portfolio
Income Generator	- Women - Group of 15 or more - Solidarity Guarantee	570,905	87.7	236,669,027	87.4
Solidarity Group	- Men or Women - Group of 3 to 8 people - Solidarity Guarantee	28,360	4.4	10,572,843	3.9
Individual Credit	- Men or Women - Personal Guarantee	16,646	2.6	17,892,504	6.6
Parallel Credit	- Women - Existing Income Generator Credit	35,142	5.4	5,693,069	2.1
TOTAL		651,053	100%	270,827,443	100%

Source: Banco Compartamos. Annual Report, 2006.

In addition to these products, all clients are covered by life insurance. Compartamos and Banamex Seguros recently won a “Sustainable Banker of the Year” award given by the *Financial Times* for their design of this insurance product, which combines free life insurance coverage (with cash benefit) and voluntary additional coverage. Compartamos is piloting a range of other products including: home improvement loans (with approximately 1,000 clients in the pilot stage), preferred customer loans, and an emergency loan program for hurricane victims. Products in the design and evaluation stage include a remittances product, a fast cash product and a savings account.⁵

After achieving financial self-sufficiency in 1997, Compartamos began the process of launching a regulated financial institution – a SOFOL (*Sociedad Financiera de Objeto Limitado*) – with a legal charter to provide working capital loans. The regulatory category of SOFOL was born in 1993 partly as a result of NAFTA. SOFOLs are specialized financial institutions that grant working capital, mortgage, agriculture and other types of loans in Mexico.⁶ This transformation would help the organization achieve faster and more sustainable growth, especially by allowing it to access commercial capital. In 2000, the NGO’s microfinance operations, personnel and loan portfolio were transferred to *Financiera Compartamos S.A de C.V.*, which began life with US\$6 million in equity investments from IFC, ACCION Gateway Fund, Profund, Compartamos A.C. (the founding NGO) and other Mexican private investors.

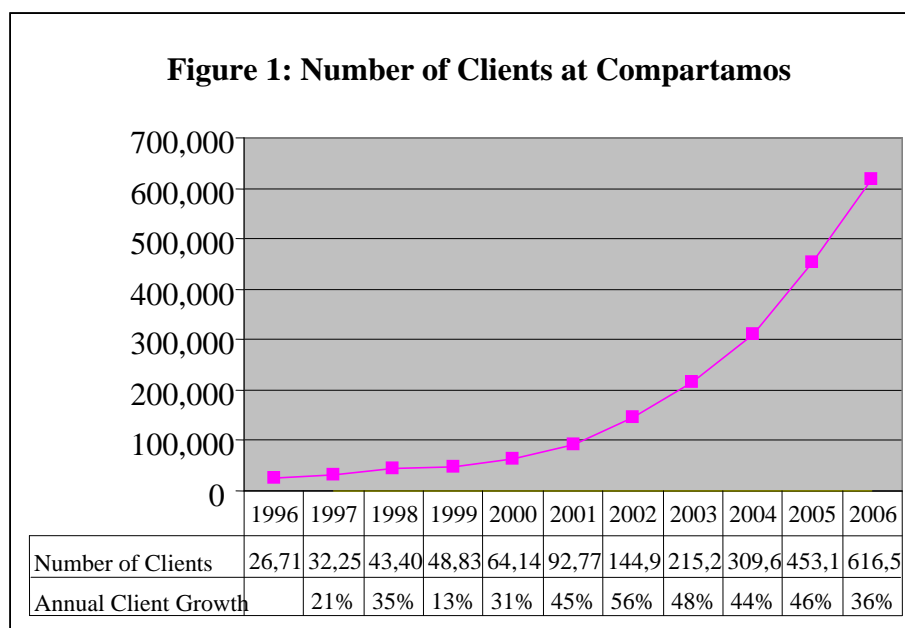
⁵ Monica Brand, project manager for Compartamos at ACCION International. Interview, June 2007.

⁶ Manuel Campos Spoor, “The Expansion and Future of Sofols in Mexico,” presentation to Housing Finance Systems in Emerging Economies, World Bank Group Conference. March 15, 2007.

In the six years since becoming a SOFOL, the institution’s outreach, growth and financial performance have been extraordinary (Figure 1). It grew even faster in percentage terms than it had during the 1990s, a remarkable achievement, given that Compartamos already had a large client base. (Usually the rate of client growth slows as institutions expand.) In absolute terms, Compartamos added clients at a pace unmatched by any MFI in the Americas: more than 100,000 net new clients in both 2005 and 2006. Its compound annual growth rates were 46 percent in terms of clients and 60 percent in terms of portfolio between 2001 and 2006⁷.

By 2006, the gross loan portfolio stood at US\$271 million, with a portfolio at risk rate over 30 days of 1.1 percent.

Throughout the 2000-2006 period, return on equity averaged 52 percent. This rapid growth and strong profitability allowed Compartamos to begin accessing the capital markets, and in 2002, *Financiera Compartamos* issued its first US\$20 million bond on the Mexican Stock Exchange.⁸ During the next several years, Compartamos raised approximately US\$70 million on the bond market, gradually improving the terms and conditions of the offer (including some credit enhancement from IFC) while attracting investors from increasingly mainstream institutions in Mexico. All of Compartamos’ bond issues were underpinned by strong ratings from Standard and Poor’s and Fitch. As of 2006, Banco Compartamos maintained ratings of MXA+ from Standard and Poor’s and MXA+ from Fitch.⁹



Source: Microfinance Information eXchange.

⁷Banco Compartamos. Annual Report 2006.

⁸For more information on Compartamos bond issues see: Cesar Lopez, “Microfinance Approaches the Bond Market: The Cases of Mibanco and Compartamos,” *Small Enterprise Development*, Volume 16 No. 1. ITDG Publishing: Rugby, U.K.: March 2005.

⁹Credit Suisse. BANCO COMPARTAMOS S.A., INSTITUCION DE BANCA MULTIPLE (COMPART). Oferta Pública Secundaria de Acciones. (Offering Circular) 23-Abril 2007. Versión Definitiva.

The SOFOL legal structure did not allow Compartamos to offer a wide range of financial products. Most notably, it did not permit the capture of savings, which Compartamos believed to be important both for customer service and as a potential funding source. The decision was made to pursue a banking license to better diversify its offer to clients. In June 2006, *Financiera Compartamos* received a commercial bank license from the Mexican Ministry of Finance and Public Credit and changed its name to *Banco Compartamos S.A., Institución de Banca Múltiple*. Commercial bank status allows Compartamos to expand its product offering, including savings accounts and insurance products. This new status better allows Compartamos to achieve its ambitious outreach objective of a million clients by 2008.¹⁰

2. Why did Compartamos do an IPO?

The initial impetus behind the Compartamos IPO came from a normal process of ownership evolution. A sale of a portion of total shares held would allow the shareholders to redeploy capital that was otherwise tied up. Some of the original investors in *Financiera Compartamos*, such as ProFund, had already exited. Other investors, notably ACCION International and IFC, had delayed selling shares until after the banking license was finalized to assure the banking authorities of their confidence in and commitment to the license application. Each shareholder had its own reasons to sell shares.

- ACCION had very little wholly-owned capital for making equity investments in microfinance, even as it was developing new projects in other regions. It was strongly argued inside ACCION that since Compartamos was now very attractive to a range of investors, ACCION should sell some of its shares, allowing more commercial investors to come in, and at the same time freeing capital that could be invested in riskier, earlier stage microfinance projects. Such a move would serve the dual objective of moving microfinance into the mainstream capital markets and allowing ACCION to stay at the riskier edge where as a non-profit its mission lies. Hopefully, ACCION could use the funds to help develop Compartamos-caliber institutions in other locations. From a slightly different (and somewhat opposite) perspective, the large value of ACCION's total investment portfolio represented by Compartamos constituted a concentration risk, and to improve funds management, ACCION was advised to diversify.
- Similarly, Compartamos A.C., the original NGO, and IFC had their own internal policies and plans for sale and use of proceeds. Moreover, local and international private investors signaled their keen interest in purchasing shares, demonstrating the ready market potential of a sale.

Given the shareholders' interest in selling part of their holdings, Compartamos requested that all shareholders act in unison, allowing the bank to select the best method of providing liquidity. A variety of possible means were considered. A prime consideration favoring an IPO was the desire to maintain the mission, vision and focus of Compartamos regarding its microfinance operations and clients. A solution, it was believed, should avoid the major disruptions in governance, management, and strategic direction that abrupt ownership changes can bring. Aside from an IPO, direct private sales were a possibility, for example to a strategic investor such as a major international bank or to a group of private equity funds, especially funds devoted to microfinance. All of these types of investors expressed strong interest. Yet, selling a significant part

The multiplicity of small shareholdings means that neither Compartamos' governance structure nor its business approach has changed as a result of the IPO.

¹⁰ See Table 4 for more details on the ownership structure of Banco Compartamos upon its licensing in 2006.

of its capital to a single investor or investor group was not Compartamos' preferred choice as this would have had a dramatic impact on its governance structure and potentially on its social mission as well.¹¹ An IPO would provide a more diversified ownership base.

To ensure governance stability, Compartamos set a 30 percent limit on the amount of shares offered through the IPO. The amount any one investor could buy in the IPO was also limited, to no more than 10 percent of the offer or about 3 percent of the bank. In the actual event, the maximum allotted to any one investor was far lower.¹² The multiplicity of small shareholdings means that neither Compartamos' governance structure nor its business approach has changed as a result of the IPO.

An additional attraction of an IPO was, according to Alvaro Rodriguez, ACCION's Chair and representative on the Compartamos board, the desire to "...show the world that investing in the poor was a profitable venture, and that with a successful IPO we would attract funding from commercial sources to help the fight against poverty."¹³ For years, Compartamos and its principal shareholders have worked to integrate microfinance into the traditional financial sector and attract private investment. Since its first transformation in 2000, Compartamos has aimed to promote microfinance as an asset class that provides investors both social and financial returns. The series of bond issues mentioned above were a major step along that path; the IPO would represent another.

Unlike many IPOs, Compartamos did not raise funds for its own operations or expansion through the IPO. It was a secondary, not a primary, sale – i.e. no fresh capital came into Compartamos as a result of the sale. In fact, Compartamos did not need to raise new equity in early 2007. It has other means of financing growth.

As a newly-licensed Mexican bank, Compartamos is under-leveraged relative to other banks (40 percent capital adequacy ratio versus 16 percent for Mexican banks on average),¹⁴ This gives it room to grow from its existing equity base through borrowing and deposits. Moreover, equity can continue to grow through retained earnings, as it has in the past.

3. The IPO Process

An IPO is not easy. It requires a tremendous amount of effort in terms of transparency and good governance starting long before the IPO process, and nearly full-time attention from management during the IPO itself. The work ranges from filing the necessary documentation with the regulatory bodies and writing a prospectus for potential investors to devising and implementing a marketing campaign for the sale of the initial shares. Banco Compartamos followed a standard IPO process in which a variety of activities were carried out.¹⁵

A. Selection of Underwriter: Credit Suisse. The first step was the selection of the underwriter. An underwriter, in consultation with the company, decides on the basic terms and structure of the offering well before trading starts, including the percentage of shares allotted to institutions and

¹¹ Ibid. Note that no investor received more than 1 percent of the bank's total capital in the final allocation. This is discussed further below.

¹² Lauren Burnhill, ACCION International representative on Compartamos Board. Interview, June 2007.

¹³ Alvaro Rodriguez, ACCION International representative on Compartamos Board Interview, June 2007.

¹⁴ Juan José Guitierrez, "Compartamos IPO Presentation," Presented at the ACCION Network Directors Meeting in Grenada, Nicaragua, May 2007.

¹⁵ Most of the information about the IPO process comes from Guitierrez, "Compartamos IPO Presentation".

to individual investors. Six investment banks with IPO experience in international capital markets were invited to present their IPO and strategic sale proposals to Banco Compartamos. The proposals consisted of a work plan with recommendations about who to sell to (e.g. IPO vs. strategic investors), how the two alternatives should be structured, views on market expectations, and proposed valuation of the company. Following the bank's decision to do an IPO, the criteria for selecting the underwriter were based on the investment bank's experience issuing IPOs, its valuation and sale structure approach, its knowledge and experience in the microfinance industry, and the quality of its IPO team. Credit Suisse First Boston (CS) was selected with strong endorsement from the board's selection committee. While CS was responsible for the overall underwriting of the IPO, it entered into sub-agreements with local Mexican underwriters to handle the IPO's Mexican tranche. These underwriters were Banamex (ACCIVAL) and Banorte.

B. Working Groups. Five special working groups participated in the IPO process: a) the internal working group at Compartamos, formed by the Bank's CEO, CFO, legal counsel and strategy director; b) an external legal team with extensive IPO experience, knowledge of Compartamos' operations, and established relationships with the Mexican authorities; c) external auditors, responsible for validating Compartamos' financial statements according to legal requirements; d) experienced local underwriters with deep knowledge of the Mexican market and good relationships with local investors; and e) a Board level committee overseeing, among other things, revisions to the shareholders agreement.

C. Documentation and Registration. These working groups produced the following documents: an International Offering Circular with key information about the international private offering; a prospectus detailing the features of the Mexican public offer; Compartamos' audited financial statements; the underwriter's contract; and the share purchase agreement.¹⁶ These documents had to be authorized by the Mexican Banking and Securities Exchange Commission (CNBV) with a favorable recommendation from the Mexican Stock Exchange. Following the authorization, the offer had to be registered in the Mexican Securities Registry (INDEVAL).

D. Preliminary Marketing. Before structuring the offer in both local and international tranches, preliminary meetings were held in the United States and Europe to assess international demand for shares of Banco Compartamos. The meetings also provided an opportunity to maximize investor interest in the IPO and to reach a broad pool of international investment funds. Given the novelty of the Compartamos issue in many respects, there was little basis for guessing in advance how the market would respond. During the meetings, Compartamos management presented the history, mission and objectives of Compartamos and CS discussed market dynamics for public offerings in emerging markets, especially for financial institutions. At the end of this process the underwriters estimated the number of potential buyers and the scale of their appetite for shares, and from these estimates they set an initial price.

E. Sale. The final part of the process was the actual sale of the offering. A ten-day road show was organized in which 54 one-to-one meetings, ten conference calls, and eight open meetings were carried out in the U.S., Europe and Latin America. Throughout a road show, the underwriter receives final purchase orders from previously targeted investors who want to participate in the offering. The orders specify the amount of shares desired and the price the

¹⁶ The share purchase agreement (SPA) enables the underwriter to acquire shares and distribute them to qualified purchasing investors. SPAs typically make arrangements for settlement, custody and reporting, among other things.

investor is willing to pay, which are quoted in reference to a suggested price. The process of assembling all orders is known as building the offer book. Because expressions of interest received were so much above initial expectations, the initial estimated price was increased. During the marketing period, the estimates of Compartamos' implicit market valuation were revised upward several times.

When all the orders were in, they amounted 13 times the number of shares available for purchase. The orders might have been even higher, had the number of shares that any one buyer could obtain not been capped at 10 percent of the offer.

The underwriters then allocated shares across those who made offers, taking into consideration the need to both build a suitable ownership mix and maximize the proceeds of the sale. As a result of this process, the final price was determined to be MXN 40 per share, as a result of this process. Bidders were informed of their receipt of shares at the end of the day on April 19, 2007, and when markets opened on April 20, 2007, trading of the Compartamos shares began on the Mexican Stock Exchange.

4. The Results

The final offer consisted of shares sold publicly to Mexican individuals and institutions (18 percent of the total) and to institutional investors through U.S. SEC Rule 144A, for U.S. investors and Reg S, for international investors (82 percent of the total, discussed further below). The shares are only listed on the Mexican Stock Exchange.

Table 3: Outcome of the Compartamos IPO

Listing	First Bank IPO in Mexico in recent years
Time to Completion	17 weeks
Demand	13 times oversubscribed
Percent of Total Capital Floated	29.9%
Total Number of Shares Sold	128,308,412
Opening Price per Share	MXN 40/ US\$3.65
Opening Price/Book Value ratio ¹⁷	12.8
Opening Price/Earnings ratio (April 19, 2007, based on 2006 earnings) ¹⁸	24.2
Offer Value	US\$468,325,703
Tranches	18% Mexican; 82% International

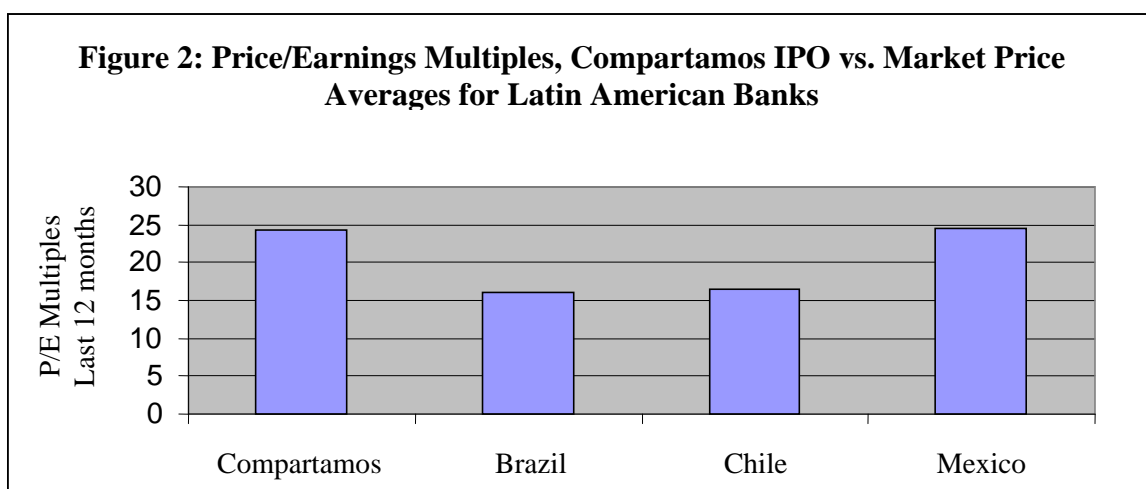
Sources: Burnhill, Lauren: "Information about the Compartamos IPO", *Bolsa Mexicana de Valores, Compartamos' Presentation 2007*. Gutierrez, Juan José, "Compartamos IPO Presentation."

A. Pricing. Although the size of the offering (30 percent of capital) did not change from initial road show to execution, the terms of the offering where changed to account for the strong demand. Initial pricing estimates were at a range of MXN 28-35 (Mexican Pesos) per share. Credit Suisse recommended increasing the price to the MXN 36 to 40 range. The final price was set at MXN 40 (US\$3.65). The total number of shares offered was 128,308,412. At US\$3.65, the final offer had a total value of US\$468,325,703. This implied a market valuation of Compartamos of roughly US\$1.56 billion as of the April 2007 offer date.

¹⁷ Credit Suisse, "Banco Compartamos Transaction Summary" Presentation, June 15, 2007.

¹⁸ Author calculations

The success of the sale can be gauged by a look at two critical ratios. The price/earnings ratio of Compartamos at the time of initial offer was 24.2 (based on 2006 earnings) and the multiple of book value represented by the sale price was 12.8. Besides representing the highest multiples paid for a microfinance institution, the price/earnings ratio is comparable to or exceeds multiples commanded by Latin American banks in Brazil, Mexico and Chile (Figure 2). The average price/earnings multiple for Brazilian banks, based on prior twelve months earnings was 16, for Chilean banks 15.6 and for Mexican banks 24.5 (Figure 2).¹⁹



Source: Credit Suisse calculations and (for Compartamos) author calculations. Compartamos figure based upon 2006 earnings.

Compartamos' share performance shortly after the IPO was strong. The price rose 32.3 percent on the first day of trading,²⁰ and after two weeks it reached MXN 59.93 (approximately US\$5.50) – a premium of 49.8 percent above the offering price. As of June 26, 2007, the price was MXN 63.5,²¹ giving Compartamos an implied market valuation over US\$2.24 billion.

B. Sellers and Restrictions. All pre-IPO shareholders in Compartamos sold part of their holdings through the IPO. The largest single seller was ACCION International with 9.025 percent of shares sold, followed by Compartamos A.C. (the Compartamos NGO) and the IFC with 8.2 and 2.6 percent respectively.

Table 4: Compartamos: Ownership Structure Before and After the IPO

Shareholders	% Held Before IPO	% Sold in IPO	% Held after IPO	Number of shares (sold)/purchased
Compartamos A.C.	39.2	7.4	31.8	(25,159,212)
ACCION	18.1	9.0	9.0	(38,613,240)
IFC	10.6	2.7	7.9	(11,302,644)
Individual Investors	32.2	11.0	21.2	(36,497,448)
New Investors			29.9	128,308,412
Total Shares Traded				128,308,412

Source: Credit Suisse. Offering Circular.

¹⁹ Credit Suisse, "Banco Compartamos Transaction Summary" Presentation, June 15, 2007.

²⁰ Randewich, Noel. "Mexican microlending bank surges in market debut." *Reuters*. April 20, 2007

²¹ Yahoo Finance Mexico, Accessed June 20, 2007 <http://finance.yahoo.com/q?s=COMPARTO.MX>

Specific selling restrictions apply to all original shareholders under Mexican securities regulations. This six month post-sale restriction (through October 20, 2007) is referred to as the lock-up period. Additionally, as a part of the shareholders agreement completed in March, 2007,²² restrictions also apply to the maximum percentage of shares that each shareholder can sell during the eighteen months following the lock-up period. One of the primary purposes of these restrictions is to insure continuity in the governance of the company, as well as to signal the commitment of the selling shareholders to the ongoing health and development of the bank.

As a requirement of its licensing, Banco Compartamos is not permitted to pay dividends during the first three fiscal years of operation as a bank, and it must contribute all net income from such operations to net capital reserves. Dividends will not be available for shareholders until 2010 (from net income generated for the year ending December 31st 2009).

C. Buyers.²³ Given the strong international demand for share in Banco Compartamos, the IPO was structured in two tranches: one Mexican and another U.S/International. All the shares are listed on the Mexican Stock Exchange (ticker symbol COMPART.O) and are available to the public. The shares are not listed on any U.S. national securities exchange or quoted in any automated interdealer quotation system, neither in the U.S. nor elsewhere outside Mexico. Shares traded outside Mexico can only be purchased by and traded among qualified institutional buyers (QIBs) who have investable assets in excess of \$100 million, under Securities and Exchange Commission (SEC) Rule 144A.²⁴ In general, international investors purchased shares under Rule 144A or Reg S. In the final allocation of the offering between the local and the international tranche, the Mexican investors received 18 percent of the offering while 82 percent went to the US/international tranche.

A total of 5,920 investors bought shares in Compartamos, including 158 institutional investors. Among the institutional investors were some of the leading investment companies in the U.S., U.K., and elsewhere, all of whom look across the entire capital market spectrum to select their investments from among thousands of choices. Of the institutional investors who purchased shares, 58 percent were hedge funds and 42 percent traditional institutional investors. The geographic breakdown of the institutional investors was 52 percent United States, 33 percent Europe, 5 percent Mexico, and 10 percent other Latin American countries. In fact, the offer had an extremely high “hit rate,” i.e., a high percentage percent of all investors who attended the road shows made purchase offers. In addition, the purchase offers were all substantial. Of the 158 institutional investors, 72 requested the maximum 10 percent of offering allowable (equivalent to roughly 3 percent of the bank’s capital). The average order requested was 6.5 percent of the offering. Demand was so high, however, that the average order filled was only 0.6 percent of the offering, or about 0.2 percent of the bank.

D. New Ownership Structure. The ownership structure of Compartamos Bank has changed following the IPO, although the key shareholders continue to play an important role (Table 4). The NGO Compartamos A.C. remains the largest shareholder of the Bank, holding 31 percent.

²² Burnhill, Lauren, “Information about the Compartamos IPO.” Internal Memo to Senior Management: ACCION International, May 4, 2007.

²³ Most of the information on buyers comes from the Burnhill, op cit.

²⁴ Rule 144A provides foreign companies with a process for selling securities to large institutional investors (QIBs) which is less onerous than the SEC registration needed for listing on a U.S. stock exchange. Rule 144A was developed to induce foreign companies to sell securities in the U.S. capital markets and to increase the opportunity of U.S. institutional investors to acquire securities of foreign companies.

ACCION International is the second largest shareholder. It sold 9.025 percent of the 18 percent held before the offering, receiving net proceeds (after fees) of US\$134,965,740, and remaining with 9.025 percent of total equity.

Of the 32.2 percent of Compartamos shares held pre-IPO by individuals; most were held by Compartamos directors and managers. The acquisition of these shares dates to the formation of the SOFOL in 2000. At that time, individual investors in Compartamos were mostly private individuals including founders and managers who put their own money into the new *financiera*. These investments were risky, given that Compartamos was still a relatively young organization just emerging from NGO status. The individual shareholders sold approximately one-third of their total holdings, remaining with 22 percent of the shares under the new structure.

5. Why was the IPO so successful?

The success of the Banco Compartamos IPO cannot be explained by a single factor. A variety of favorable conditions at the MFI, country, and international level contributed to the offering's success:

A. Banco Compartamos. Compartamos stands out as one of the fastest growing MFIs in the region. Its history combines sustained growth, very low portfolio at risk, high profitability, and excellent management with a socially valuable operation, serving primarily poor rural women. Its outstanding performance over time has sent a positive signal to commercial investors. Compartamos has gained public recognition through a number of high-visibility awards (two from the *Financial Times*, IDB's outstanding MFI award, listing as one of the "Best Places to Work in Latin America," and the CGAP Transparency Award). In addition, the banking license that Compartamos has held since June 2006, gives it substantial additional earning power (e.g. deposit and fee-based activities) that has not been reflected in past returns. With the assistance of Credit Suisse, the Compartamos management team made an excellent impression to investors during the road show process.

Table 5: Compartamos IPO: Success Factors

Factor	Conducive Conditions
Compartamos Bank	<ul style="list-style-type: none"> - Excellent track record of profitability and growth - Excellent future growth potential - Superior management - Social value of its operations - Earnings potential resulting from banking license - Relationships with huge numbers of clients
Mexican Microfinance Market	<ul style="list-style-type: none"> - Mostly untapped - Competition in its early stages - High earnings expected in the market as whole
Mexican Financial Market	<ul style="list-style-type: none"> - Well developed stock market - Conducive regulatory environment - Lack of other banking IPOs - Low number of IPOs in Mexico - Strong trading of securities in financial services - Solid Mexican Peso
Mexican Environment	<ul style="list-style-type: none"> - Positive reaction by market to new President - Good market conditions

Global Factors	<ul style="list-style-type: none"> - High liquidity levels in global capital markets - Global IPO market recovery - Financial services as "hot" sector for EU/US investors - Microfinance gaining recognition among investors - Mexico's magnetism as an investment destination
The IPO Process	<ul style="list-style-type: none"> - Excellent commitment and execution from Credit Suisse, Banamex and Banorte - Ability to tap both Mexican and international markets - Effective presentations by Compartamos road show team

B. The Mexican Market. The microfinance market in which Compartamos operates remains substantially untapped. Competition, though growing, is still in its early stages, promising continued strong earnings for the next few years. In addition, the Mexican financial market is sound and liquid. Mexico has a well developed stock market where trading is solid. A strong peso further contributes to the country's sound financial development. Also, the markets have responded well to the policies proposed by the new Mexican President, Felipe Calderón. The low number of IPOs carried out in Mexico (only three in 2006) worked in favor of the Compartamos IPO, increasing demand for its shares, which, in turn, contributed to increases in the share price.

C. Global Factors. Global factors also contributed to the IPO's success. The most significant of these are the high liquidity levels of capital markets globally; the gradual recovery of IPO markets worldwide; the fact that financial services are considered one of the hottest sectors for investment by U.S. and E.U. investors; Mexico as an attractive country for investment; and the increasing understanding of and interest in the microfinance industry among investors in recent years.

6. Implications of the IPO for ACCION International

The initial \$1 million investment ACCION International made in Compartamos in 2000, through its Gateway Fund,²⁵ has yielded a return far beyond the most optimistic expectations (Table 6). ACCION International is cognizant of its responsibility to use the proceeds of the sale to further the microfinance industry's aims of addressing poverty through financial services and is embarking on a daring but thorough strategic planning exercise to define how best to leverage these new resources. The scale of the proceeds (US\$134,965,740 net of fees) will allow ACCION to pursue new equity investments, work in additional countries and regions, develop creative initiatives, and strengthen itself to be able to carry out its mission even more effectively.

Table 6: Details of ACCION's Participation in the Compartamos IPO

Amount in:	Mexican Pesos	US Dollars
Gross IPO Proceeds	1,544,529,600	\$ 140,956,386
Financial Fees	65,642,508	\$ 5,990,646
Net IPO Proceeds	1,478,887,092	\$ 134,965,740
Shares sold	38,613,240 shares	9.025 % of total equity
Shares retained	38,613,240 shares	9.025 % of total equity

Source: Burnhill, Lauren, "Information about the Compartamos IPO."

²⁵ Gateway was originally established in 1997 with donations from USAID and CGAP, which recognized both the need for and scarcity of equity investors in microfinance. It is important to remember that BancoSol, the first commercial MFI in existence, was less than six years old at the time of the Compartamos conversion to a SOFOL, meaning that for many potential investors, the "commercial microfinance" model had not yet been fully tested.

The bulk of the IPO resources will be maintained as strategic reserves, which will assist in covering a share of ACCION’s operating budget. The remainder of ACCION’s budget will come from consultancy fees, dividend income, and fundraising. Grants from private and public sector donors will continue to be crucial, as the challenges of addressing poverty through financial services remain much greater than the resources at hand. Grants will be applied to less proven, riskier ventures with high potential for impact.

7. Implications of the IPO for Microfinance

The Compartamos IPO is a significant milestone in the evolution of microfinance, marking a new level of recognition of microfinance by the mainstream financial markets. Participants in the microfinance industry will examine the IPO and its implications for some time to come. In this paper, we briefly address some of the deeper questions that the IPO poses for the field as a whole. The comments that follow are far too preliminary to be the last word on any of these subjects. Rather they offer an invitation for continued discussion of these important issues.

A. Will there be more MFI IPOs? Compartamos is not the first microfinance institution to issue shares on a public stock exchange. Bank Rakyat Indonesia (2003, listed on the Jakarta, Singapore and others stock exchanges) and Equity Bank (2006, on the Nairobi Stock Exchange) preceded it.²⁶ Both were very successful, but did not yield as high a return to investors as the Compartamos issue.²⁷ Of the three institutions, only Compartamos originated as an MFI. While all these microfinance institutions and their circumstances are significantly different from Compartamos, their listings are relevant for the microfinance industry. A full comparative analysis of these three IPOs would be useful. This *InSight* makes only a few comments.

BRI’s IPO for 40 percent of its capital involved both the sale of existing shares (secondary issue) and new shares (primary issue). Like the Compartamos IPO, BRI’s also had local and international tranches. The offer was 15 times oversubscribed and totaled US\$480 million.

Table 7. Bank Rakyat Indonesia IPO

Type of Offer	Primary and Secondary
Exchange	Singapore, Jakarta and others
Capital Sold (percent of total capital)	40%*
Price (November 10, 2003 FX rate)	US\$ 0.10 (Rp875)**
Price/Earnings Ratio in 2003	11.14**
Book Value Multiple at sale	1.4*
Times oversubscribed	15*
Value of shares issued and sold	US\$ 480 million***

Source: Bank Rakyat Indonesia, June 6, 2007; Jakarta Stock Exchange and the MicroCapital Monitor, May 2007, p. 8.

Equity Bank’s listing in August 2006 was smaller in total scale. It was enthusiastically received on the Nairobi Stock Exchange, and in trading during the few months immediately following the IPO, the price of shares increased greatly.

²⁶ MicroCapital Monitor May 2007

²⁷ Network Microfinance Bank in Pakistan, a much smaller organization, also undertook an IPO.

Table 8. Equity Bank (Kenya) Stock, at Initial Listing and After

Type of Offer	Primary and Secondary
Exchange	Nairobi
Introduction Price per share	US\$1.0
Opening Price per share (August 2006 – at sale)	US\$2.5
Recent Price per share (March 2007)	US\$3.4
Price/Earnings Ratio (Last twelve months)	15.9
Market Capitalization, Introduction	US\$88 million
Market Capitalization, March 2007	US\$169 million

Source: Mwangi, James. “Initial Public Offer: Equity Bank’s Experience” *Proceedings of the second annual Cracking the Capital Markets Conference*, New York, Presentation March 19, 2007 and Credit Suisse Transaction Summary, June 15, 2007.

In all three cases, the valuations implied by the pricing, oversubscription, and subsequent price movements are well above the valuations recorded for most of the private equity sales for MFIs that have been reported to the Council of Microfinance Equity Funds valuation database project. These high valuations tend to suggest that privately sold equity shares have been heavily discounted for lack of liquidity. The liquidity discount is far less relevant for publicly traded shares.

The process explained above shows that many factors came together to make the Compartamos IPO successful, and it is clear that the foundation was the scale, soundness and financial performance of Compartamos itself. While Compartamos, BRI and Equity Bank are all industry leaders, an increasing number of MFIs show scale, growth and profitability sufficient to begin to consider an IPO. In addition, MFIs interested in conducting IPOs will need to invest considerable time and energy in developing consistent and transparent reporting practices as well as state-of-the-art governance. It is now possible to identify 20 shareholder-owned MFIs (as opposed to NGO MFIs or cooperatives) with total loan portfolios in excess of \$100 million.²⁸ For an IPO to be successful, these MFIs must additionally be located in a country with an active stock market, or be able to access an international stock market. While other MFIs may gain access to public exchanges, it should be recognized that the favorable conditions in the environment and timing that prevailed for the Compartamos offering, which added considerably to the returns, may not coincide so well in future offerings. Nevertheless, each new entry of an MFI into the market brings microfinance to the attention of more investors, and interest grows in microfinance as an emerging asset class. We can expect to see more investor interest in the range of vehicles for putting debt and equity into MFIs, including IPOs.

B. Interest Rates, Value Creation and the Success of the IPO. The tremendous success of the Compartamos IPO has provoked debate and reflection about the commercial model of microfinance. Some observers, and ACCION is in this group, see the IPO as the culmination of a long process of preparing microfinance to move into the mainstream financial sector. At the other extreme, some observers have seen the IPO as troubling because it allowed investors to reap extraordinary returns made possible in part by high interest rates. This paper offers a few comments on the broader issues that have been raised, first on the interest rate and second on the implications of the IPO for the commercial model of microfinance. It does not offer a point-by-

²⁸ Elisabeth Rhyne and Brian Busch, “The Growth of Commercial Microfinance: 2004-2006,” Council of Microfinance Equity Funds, September 2006.

point analysis of the interest rate. Readers are referred to the CGAP Focus Note prepared by Richard Rosenberg for detailed information on pricing alternatives.²⁹

The following observations help frame the discussion on Compartamos' interest rate policy to date:

- *Rates of Competitors.* In the Mexican market in which Compartamos operates, Compartamos' rates are clearly within the market range for microfinance. For example, three MFIs – FINCOMUN, FINCA and FINSOL – charge interest rates ranging from 81 percent to 103 percent, compared to 82 percent at Compartamos. Compartamos is more profitable than the others because it is more efficient. There is a case to be made that Compartamos' interest rates will begin to fall as it attracts further competition (especially as it now has a very wide range of financing options).
- *Client Response.* The clients of Compartamos have been willing to pay the rates charged, as attested by low delinquency, continued high demand, and the fact that interest rates have not surfaced as a lead issue in customer feedback. On the other hand, clients have not had many alternative sources of formal finance.
- *How Much "Too High?"* According to Rosenberg's analysis, Compartamos could have reduced its interest rate to the range of 65 to 70 percent while maintaining a level of profitability in keeping with other banks (e.g., return on equity of 15 percent). The costs Compartamos faces, which are detailed in the CGAP paper, mean that rates could not be reduced much farther than this without sacrificing the ability to attract risk capital in the future, even from socially-motivated sources. This observation is important because it allows us to quantify what "too high" might mean.
- *Use of Profits for Growth.* Compartamos kept the vast majority of the profits generated by the high interest rates as retained earnings and used them to finance rapid expansion.³⁰ Retained earnings were quickly lent out to new clients. Compartamos used this strategy to reach over 550,000 net new clients since 2000.
- *Use of Profits for Building Financial Strength.* High profits have given Compartamos a wide range of options for growing and expanding its range of services, as it is now planning to do. Compartamos' strong equity base, built from retained earnings, as well as its profitability, were undoubtedly factors in the decision of the Mexican government to authorize the banking license.

These factors also enable Compartamos to gain advantageous access to capital markets for borrowing and raising additional equity.

In short, Compartamos might have reduced interest rates somewhat, but instead used profits to achieve unprecedented outreach and to position itself for even greater outreach in the future.

The fundamental question is whether this strategy works in the best interests of the clients. One way to look at this question is to ask whether Compartamos could have achieved its current outreach and position for future outreach in any other way. Instead of current clients financing growth through reinvestment of profits, perhaps Compartamos could have turned more to investors (by borrowing more or raising more equity). Compartamos' board and management

²⁹ Richard Rosenberg, "CGAP Reflections on the Compartamos Initial Public Offering: A Case Study on Microfinance Interest Rates and Profits." Focus Note No. 42 (draft). Washington D.C.: CGAP, June, 2007.

³⁰ Compartamos paid some of the profits out as dividends in several recent years.

have maintained that the retained earnings strategy was the best option at the time. Until Compartamos built credibility with the capital markets it would have no other strategy. Without retained earnings, growth would have stalled. ACCION, in its role on the board, has supported Compartamos' in pursuing this growth strategy.³¹ Rosenberg, who has advised Compartamos management informally for many years, maintains that this argument has progressively weakened since 2000, as Compartamos has increasingly full access to capital markets. His points are well taken and deserve full consideration by all Compartamos' shareholders and management.

A more philosophical question is whether Compartamos' pricing policy is in accord with the principles of fair pricing. Fair pricing is a hallmark of pro-consumer policy and a value widely espoused in the microfinance industry. It is seen as a key differentiator separating microfinance from predatory practices. But the definition of fair pricing has never been thoroughly debated. Opponents of the commercialization of microfinance might suggest that only cost-recovery pricing is fair. Supporters of commercialization recognize that profits are a necessary part of the equation, but may not agree on whether financing growth is an acceptable rationale for maintaining high profits. One clear lesson from the Compartamos experience is that there is an urgent need for greater discussion and consensus-building among industry participants on the issue of fair pricing as a cornerstone of pro-consumer finance.

The IPO has drawn attention to questions about Compartamos' interest rate policy and growth strategy them, but has not changed the basic issues. However, controversy over pricing has deflected attention from the IPO itself and its significance. It is to this that we now turn.

It is our contention that the IPO was good for all the stakeholders in Compartamos: the clients, the institution, shareholders and the microfinance industry. Here is a summary view of Compartamos and its stakeholders after the IPO:

- Banco Compartamos now has standing and recognition in mainstream financial circles around the world. It will undoubtedly use this standing to access commercial capital from various sources in order to keep growing. The range of possible initiatives Compartamos can undertake has expanded. Compartamos is already considering various possibilities, all in keeping with its social mission.
- The institutional shareholders who sold their shares have resources they can reapply. In the case of the non-profit shareholders, ACCION and Compartamos NGO, the new financial resources open up new possibilities for achieving their mission.
- The individual investors who first capitalized Financiera Compartamos, including the original founders who have been with Compartamos from its origins, have reaped financial rewards well beyond levels that were hoped for when they made their (at the time) risky investments. This outcome raises the issue of the compensation of founders and management for their role in building successful MFIs, especially as non-profits transform into for-profits. A debate on this issue has long been neglected. The Council of Microfinance Equity Funds and the MicroFinance Network, led in particular by Alex Silva, former fund manager of Profund, has begun to examine this important question.

³¹ In policy-setting discussions, the Compartamos board has on many occasions considered interest rate policy, growth strategy and the possible trade-offs between them. ACCION, a minority shareholder, has expressed opinions through its board representatives on these issues, as have all the shareholders represented on the board. The opinions voiced by ACCION representatives or any other board members in internal board discussions are not, however, a matter for public comment.

- The mainstream participants in capital markets who were involved as investors and investment bankers have responded enthusiastically, opening the doors of the capital markets wider to microfinance. “The IPO showed the capital markets that doing business with the poor can be profitable, which opens the way for huge amounts of capital to move into the fight against poverty,” according to Alvaro Rodriguez, Chairman of the Board of ACCION and ACCION’s representative on Compartamos’ board.
- The new investors now have an investment they see as holding its value into the future, based on its past track record, future growth prospects and, according to participants in the process, the belief that Compartamos offers a socially beneficial service. It is important to remember that the premium paid for Compartamos shares came from the new investors, who evaluated Compartamos and were willing to pay a significant price in order to become owners. These shareholders will have an interest in keeping total profits high, which may occur through pricing, growth, diversification of services, leverage or some combination.
- The governance of Compartamos has changed very little, despite substantial ownership change. Compartamos is still governed by social investors for whom the organization’s social mission remains essential.
- The existing and future clients of Compartamos continue to have access to an institution that treats them with respect, provides them all with working capital loans and life insurance, can be counted on to be there into the future, and is working to expand the range of products it offers them. In this context, the prices they pay for these services may be high, but price is only one dimension of the value they derive from their relationship with Compartamos.
- The number of clients reached is set to grow to one million by 2008 and will continue to grow thereafter.

What is striking about this list is the great alignment of interests among stakeholders. The alignment is not perfect, and interest rates are probably the most important dimension in which there is a direct trade-off. However, if one looks at the whole picture of stakeholder interests, it is clear that clients and shareholders value many of the same things in Compartamos. In its everyday operations, Compartamos creates value for shareholders primarily by offering value to clients. The value equation for existing clients involves products that meet their needs, convenience, service quality, respectful treatment, access and reliability, in addition to price. Client value is multiplied by the number of clients – more clients, more client value *and* more shareholder value.

The IPO showed the capital markets that doing business with the poor can be profitable, which opens the way for huge amounts of capital to move into the fight against poverty.

-Alvaro Rodriguez,
ACCION Representative
to the Compartamos Board

Moreover, and this brings us closer to the IPO, because the vast majority of profits have been retained, they have remained at the service of the clients. This in fact creates the double bottom line and is part of the beauty of the commercial model. Clients have an interest in a profitable Compartamos over the longer term because profits support the bank’s continuing availability and future innovation in products and services. Profits left in the company benefit clients and shareholders alike. The IPO did not disturb this dual value creation. Older shareholders took their earnings out without damaging the company (or the clients’ interests). They found other

shareholders eager to take their places. This process is what the microfinance industry has implicitly embraced from the time it first began to work with the commercial model.

The Banco Compartamos IPO is a powerful validation of the commercial model of microfinance, a model that coincides with ACCION's approach to the sector. It is a tenet of those who advocate a commercial approach to microfinance that it is possible for organizations to pursue both financial and social goals. Compartamos stands out as an institution that produces extraordinary value for both shareholders and clients precisely because it has followed a fully commercial model with a double bottom line.

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