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Invisible Hand

Entrepreneur Gets Big Banks To Back Very Small Loans

**Microlending-for-Profit Effort
In India Draws Business
From Citigroup, HSBC**

Ms. Dobbala's Baby Buffalo

By **ERIC BELLMAN**
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SHIVNOOR, India -- Vikram Akula runs a company that doles out loans of \$100 or less to desperately poor villagers so they can buy a water buffalo or a bicycle. But he's hardly a typical do-gooder.

Mr. Akula, the 37-year-old founder of SKS Microfinance Pvt. Ltd., is at the forefront of the latest trend in "microlending," or making tiny loans that help entrepreneurs lift themselves up from the lowest rungs of poverty. Long the province of charitable institutions, microlending is starting to attract the attention of big business. Intrigued by India's red-hot economy and potential market of more than a billion consumers, financial giants such as **Citigroup Inc.**, **ABN Amro Holding NV** and **HSBC Holdings PLC** have already provided millions of dollars for SKS to lend out. SKS, in turn, says it has notched up healthy profits for the past three years.




Vikram Akula

"This can work driven only by greed," says Mr. Akula, a one-time McKinsey & Co. consultant who was born in India and grew up in Schenectady, N.Y. "That's the magic of it."

It's a radical idea in a field that has typically focused more on social goals such as the empowerment of rural women than on profits. Microloans can be a useful tool for alleviating poverty in developing countries where the poor -- who usually don't have access to credit -- use them to start small but profitable businesses. The approach, pioneered in the 1970s by firms like Grameen Bank in Bangladesh, has since spread all over the world. As many as 10,000 microlending institutions now serve more than 100 million small borrowers. India, where more than 300 million people live on less than \$1 a day, is an especially important laboratory for microlending.

The practice isn't entirely altruistic. Default rates on microloans tend to be very low -- under 3%, in many cases. By comparison, U.S. credit-card issuers typically charge off around 5% of outstanding balances. Even so, microlending overhead often gobbles up most of the profit. That's because it can take hundreds or even thousands of loan officers to manage millions of small loans to often-illiterate farmers in remote villages. Transaction costs and paperwork can be overwhelming. Most microlenders live hand-to-mouth, relying on wealthy patrons or development agencies to keep the money flowing.

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People like Mr. Akula see opportunity in making all this more efficient. The son of a physician who moved the family to New York state in the 1970s, Mr. Akula says he was haunted by a memory from a family wedding celebration in his parents' hometown of Hyderabad, India, when he was 10: local boys his age scraping the leftover rice and gravy off abandoned dinner plates. "It was extremely jarring to see this in the summer, then in the fall go back to a suburb in upstate New York," he says.

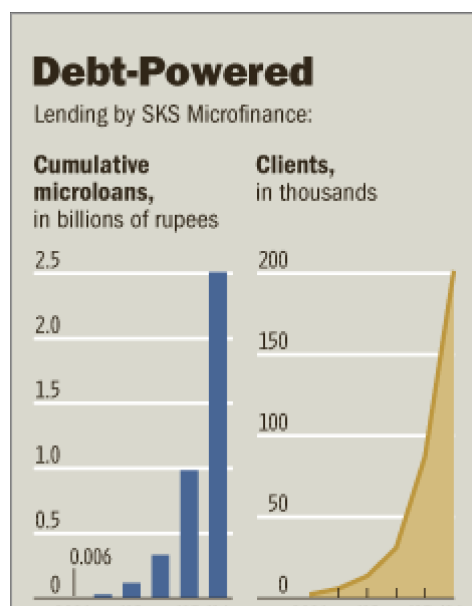
After finishing graduate school at Yale University in 1995, Mr. Akula worked with government- and charity-backed microfinance institutions in India. He saw how powerful a little loan could be in the life of a poor villager. He also saw the limits of the standard model.

The programs were run by well-intentioned people, he recalls, but poorly managed. The way that nonprofit organizations "were doing microfinance was incredibly inefficient and hopelessly unscalable," he says. Mr. Akula decided in 1997 to build his own microfinance company from scratch. His goal: to model a business on McDonald's Corp. or Starbucks Corp., using technology and standardized systems to wring enough efficiency out of each tiny transaction to lower costs.

He didn't initially impress the big microfinance funding organizations with his ideas. After presentations to representatives of the Ford Foundation and the Rockefeller Foundation in New York, he was told he lacked experience in a tough working environment like India. So Mr. Akula raised \$52,000 from more than 300 friends and family members, thanks in part to the tea and samosa parties thrown by his mother.

After six months of waiting for government approvals, SKS launched operations with Mr. Akula and a single employee in Hyderabad in 1998. The first thing they did was put a stopwatch on each step of the loan process. Waste was everywhere. Loan officers had to search for borrowers in fields. Villagers would make payments in unruly piles of sweaty, wadded-up rupees they kept wedged behind blouses and belts. Someone had to count the money and then dole out fistfuls of change.

Mr. Akula made some simple rules. Borrowers have to meet at a certain time. Instead of letting borrowers decide how much to repay each week, they are told to pay the same amount each time in exact change. He set payments in multiples of five rupees to avoid coins (in India the five rupee bill, worth about 11 cents, is the smallest). The bottom line: Fast turnaround means a SKS loan officer can visit three villages a morning instead of one, as is typical, and can handle an average of 50 borrowers in each meeting instead of 20.



Behind the scenes, Mr. Akula cut the time spent on accounting from hours to minutes. He convinced some friends from McKinsey and KPMG LLP to volunteer their time to create simple loan-management software. It is mostly used by loan managers without computer experience.

The software has also helped SKS diversify its risk. A few years ago, SKS saw it was becoming dangerously exposed to buffaloes. With 80% of its loans at some branches going for buffalo purchases, SKS could have faced huge defaults if there was an epidemic that killed off buffalo or a sharp decline in the price of buffalo milk. So it found borrowers in other areas like tractor repair, brick making, tire re-treading and tea shops.

As he perfected his systems, Mr. Akula also launched the other part of his plan: attracting capital from big foreign institutions. Once he had more than 100,000 borrowers, with a default rate of

Source: SKS Microfinance

less than 2%, it wasn't a hard sell. Foreign banks in India face severe limits on the opening of local branches, and yet are under government pressure to make 32% of their loans to what the government labels "priority sectors," including agriculture and rural industry. Mr. Akula's proposition to banks: Pay SKS to find microborrowers and manage loans for you, and you'll get backdoor access to the Indian consumer market. Two years ago, Citigroup became the first international bank to start lending to SKS.

"We are taking microfinance beyond philanthropy," says Robert Annibale, the London-based global director of microfinance at Citigroup. "I may have the smallest business (within Citigroup) but I have the largest potential client group in the world."

While Citigroup won't reveal the size and growth of its microlending business, Mr. Annibale says the bank has helped bring more than \$100 million to microlenders last year through loans, private placements and bond sales -- which is more than three times its business with microlenders a year earlier. Most of Citigroup's business with microlenders has been in Latin America, but it is growing at an even faster pace in India, he says.

ICICI Bank Ltd., India's largest private-sector bank in capital, has gone so far as to give Mr. Akula an open line of credit. The bank says its more than \$10 million in loans to SKS have been low-risk and give it a slightly higher return on capital than it gets from its corporate borrowers. "This could be bigger than any other business that we have got," says Nachiket Mor, executive director at ICICI Bank in Mumbai, the city formerly known as Bombay. ICICI Bank teams up with about 100 microfinance institutions, through which it plans to hand out loans and sell insurance.

Spread across rural India, this approach to tiny transactions plays well into the social agenda of India's left-leaning ruling coalition, which swept to power in 2004 promising to drive India's growth deep into the countryside in a way that sticks. Poor households in India have borrowed \$1.8 billion from microlenders in the past five years. But they could borrow more than 20 times that amount if they had institutions that could bring easy and affordable lending to each village, SKS estimates.

India's central bank is so optimistic about the model that it recently changed its regulations to allow small rural organizations to act as agents for banks.

"This is the correct way to go," says Ashok Sharma, a director of the Asian Development Bank in Manila. "After so many years, there is a bit of donor fatigue and everyone wants microfinance institutions to stand up on their own feet."



Laxmi Dobbala of Shivnoor and her husband with her sunflower farm, financed by a microloan

With its client base more than quadrupling in the past year, SKS is the fastest-growing of a group of for-profit microlenders operating in India, including SHARE Microfin Ltd. and Bhartiya Samruddhi Finance Ltd. SKS has handed out \$57 million in loans to more than 200,000 people, many of them repeat borrowers. Mr. Akula won't disclose his salary, but says it is in line with the pay scale for executives in India. He also has a company car and driver and regular home leave to visit his son in Chicago. His most profitable perk may be the stock options he is about to receive, especially if he can take SKS public or attract a big buyer.

The efficiency of his company was on display one recent morning in the village of Shivnoor, 70 miles from Hyderabad. At 9 a.m. sharp, loan officer Chippa Swarnalatha rolled into the village on her moped for her weekly visit. The villagers were already assembled in a circle. Borrowers flattened out their bills

before handing them to her and she slipped them under a board she brings along to keep the bills from being blown away.

When one villager asked why she can't borrow more money, the answer came straight from the SKS training manual: "It is like when a new bride comes into her husband's home. The mother-in-law won't give her all the keys of the house until she trusts her."

Ms. Swarnalatha never went to college or studied accounting. She has never surfed the net or sent an email. A seamstress, she manages the accounting for hundreds of loans worth about \$45,000 in only 30 minutes a day. She's at SKS because it pays around \$90 a month -- a great salary for that region.

"I know sewing and I know the SKS system," says the 26-year-old as she registers payments at the one computer in the regional office. She must work quickly since most outposts like hers get less than three hours of power a day.

More-efficient systems have enabled SKS to drop its annual interest rates to around 24%, from 36% in 1998. That's lower than what most people pay for credit-card debt in the cities. More important, the rate is less than half that charged by many rural loan sharks, who have been blamed in a rash of suicides by farmers who faced ruin in the past year when their crops failed.

Two years ago, SKS's refusal to pay off local goons in the town of Nizamabad led to one of its toughest conflicts, says Mr. Akula. Men with broken bottles and machetes attacked its loan officers and stole their cash satchels. When SKS still refused to pay, the gangsters spread rumors that it was a Christian organization trying to convert people in the largely Muslim area.

When local Muslim clerics heard the rumor, they issued a fatwa, or religious ruling, saying it was a sin to pay SKS loans. SKS had to pull out of the area, losing \$300,000. "Once a fatwa is issued, you are done," says Mr. Akula. Such instances are increasingly rare, however, as SKS grows in popularity. Local bankers who wouldn't give Mr. Akula the time of day five years ago now show up regularly at his Hyderabad headquarters to beg him to let them fund his microlending.

SKS's next step is to bring health and crop insurance to the poor. It hopes to use Visa's card technology to make microloans as simple and inexpensive as getting cash from an ATM.

In the meantime, SKS can tout successes such as Laxmi Dobbala, a 40-something mother of two who lives in Shivnoor. She is using what is left of her third loan to pay for day laborers to help her pick and husk her bumper sunflower-seed crop. Her investment from her first loan two years ago, a buffalo she bought for around \$70, is tied behind her house and continues to produce daily dividends -- more than three pints of milk she sells to the upper-caste landowners in the neighboring village. Recently, a baby buffalo was born. Her investments have left her enough profit to pay for her daughter's wedding and now she plans to diversify into a new business: buffalo rental.

"With my next loan I'm planning to buy two bullocks to help cultivate our crops," she says. "When they are not working in the fields I can rent them out to others."

--Binny Sabharwal contributed to this article.

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