The author, center, in India.

Business Basics at the Base of the Pyramid

Why should business among the very poor be different than it is anywhere else? Listen to customers, standardize processes, and don't be afraid to make a profit.

IT'S NOT EVERY day that a fellow who runs a $250 million financial services firm has a fatwa, or Islamic religious ruling, issued against him. But that's what happened four years ago when my then $7.3 million company, SKS Microfinance, started doing business in Nizamabad, India. Armed with broken bottles and machetes, a gang of local thugs intimidated, attacked, and stole cash from some of our loan officers. They tried to extort money from us in exchange for permitting SKS to operate safely in the region. When we refused to pay, they spread rumors that we were trying to convert people to Christianity. The fatwa, handed down by local clerics, said it was a sin to borrow from us.

We knew if we became complicit with a culture of extortion, our customers would be the ones to suffer. They barely had enough money to meet basic needs, never mind pay off bad guys. So we walked away from our $285,000 portfolio in Nizamabad. By not giving in to the thugs, however, we won some respect in that town and in other villages where we were doing business.

Many companies say they protect the interests of their customers. Very few actually sit in the dirt with them, using stones, flowers, sticks, and chalk powder to figure out if they'll be able to repay a $20 loan at $1 a month. With this approach, we've created our own loyal "gang" of over 2 million customers.

SKS is like any other healthy high-growth business, except that our customers have almost no money. Consider the plight of Saryamma: She and her husband were landless laborers who earned about $1 a day. Persistent drought often made work and food scarce. Saryamma's husband entered into bonded labor, a form of indentured servitude that still exists in India, just so the family would have enough money for grain. Her oldest son was forced to seek work rather than attend school.

In 2002, Saryamma joined our program and recruited four other women from her village who wanted loans. In line with our group-lending model, each loan was linked to the others: If one woman couldn't pay her small weekly installment, the rest of the women chipped in; if she refused to pay, the others pressured her into meeting her obligation. Saryamma initially borrowed $200 to buy a buffalo so she could sell the milk. She took one year to repay, in weekly increments of $4.50. In subsequent years, she took out other capital loans, eventually adding three more buffalo, a cow, two acres of land, and a pair of bulls to her portfolio. Her family's net income has increased to $10 a day, propelling her firmly into India's lower middle class. Her husband is now free from bonded labor, and Saryamma's youngest children are the first in the family to attend school.

Saryamma's story illustrates that providing loans to women is a sure way of making microfinance work. Studies have shown that women are more likely than men to reinvest profits in the household and to support others in their borrowing group. That's why we lend only to women.

How do we manage to help women like Saryamma on such a large scale? From the beginning, SKS's deliberate strategy has been to bypass the usual conventions of poverty-eradication programs. By reenvisioning microfinance, we have achieved excellent customer and business relationships throughout India.

ARTICLE AT A GLANCE

- **Vikram Akula's $250 million firm applies for-profit principles to the world of microfinance - accessing commercial capital, standardizing products and processes, and embracing new technology.**
- **The company unfailingly does what's best for customers, even if that undermines the firm's short-term interests.**
- **The result: a rapidly growing customer base, now over 2 million strong, and a solid brand to leverage with partners.**

Rethinking Microfinance

A fatwa is hardly the only scary thing my company has encountered on its path toward rapid growth. Much more worrisome is the slow rate at which our industry has been able to gain traction and deliver broadly on its promise.

Microfinance is often lauded as the solution to poverty. Borrowers include agricultural laborers, mom-and-pop entrepreneurs, street vendors, home-based artisans, and small-scale producers, each living on less than $2 a day. They are quintessential base-of-the-pyramid customers - the potentially lucrative market segment that University of Michigan professor C.K. Prahalad has so famously drawn attention to and that many companies have had trouble reaching. (See his and Allen Hammond's "Serving the World's Poor, Profitably," HBR September 2002.) The simple notion of microfinance - providing business loans of as little as $100 or $200 to the poor - was pioneered in 1976 by Muhammad Yunus, who founded Grameen Bank, won the Nobel Peace Prize, and is a personal hero of mine. No doubt, microfinance has benefited people like Saryamma tremendously, but the model just hasn't managed to scale to large numbers.

Most microfinance institutions worldwide are small nonprofits; about 80% serve fewer than 10,000 customers. While the industry celebrates having reached about 140 million people, roughly 3 billion (or 750 million households) still live on $2 a day or less. In terms of households, that's only a 19% market penetration - a sure sign of underperformance in any other industry.

Microfinance firms haven't succeeded in helping as many customers as they would like for several reasons: their lack of access to commercial funds, the high cost of handling millions of microtransactions, and an inability to create scalable operating systems. I first learned about these limitations in 1995, when, after graduating from Yale with a master's degree in international relations, I became a loan officer for the Deccan Development Society (DDS), an NGO that extends microfinance loans in India. One day, in the course of my normal rounds, an impoverished woman from Kusunoor, a remote village DDS wasn't serving, asked me, "Can you offer loans in my area?" I passed her inquiry on to the NGO's directors. Their response was both a refusal and an excuse: The grant cycle was ending, and DDS could not expand beyond the 100 villages it was then serving. I shared that with the woman, and I will never forget her reply: "Am I not poor, too? Do I not deserve a chance to get my family out of poverty?" I realized then that to truly use microfinance to help eradicate poverty, we would need a new model, one that would allow microfinance organizations to scale up quickly so that we'd never have to turn any poor person away.

I launched SKS in 1998 to build that next-generation microfinance company. I remember early on walking down a dusty road in a remote drought-prone region of India, looking for potential customers. I turned a corner and came upon a group of women in bright-colored saris sitting in front of thatched mud huts. I approached and explained that I was starting a microfinance program and could bring collateral-free loans right to their doorstep. "You can start small businesses and get out of poverty," I said. The women met my pitch

with silence and probably some skepticism, but one had a sparkle in her eye. That woman was Saryamma.

The Scale Is the Thing

SKS's business strategy is based on three entrepreneurial principles borrowed from fast-scaling consumer businesses like Starbucks and McDonald's. These principles can help guide any multinational or NGO that wants to sell - profitably - to the hundreds of millions of people at the base of the economic pyramid.

Adopt a profit-oriented approach in order to access commercial capital. When I started SKS 10 years ago, I had no money of my own and no interested investors, so I established it as a nonprofit with lots of small donations from friends and relatives. I had certainly admired Grameen Bank's group-lending model, but I wasn't a big fan of Yunus's theory that microfinance firms should be merely self-sustaining companies - what he calls "social businesses." I felt that if the industry were going to provide the estimated $300 billion of credit needed by the poor, it would have to tap larger, commercial capital markets-and that meant structuring our businesses so that investors could expect significant returns.

To attract the kind of bigwigs that any Silicon Valley start-up might, I made the following pitch: "There's an entrepreneurial spirit among the poor, who earn extraordinarily high returns from their small businesses. You invest in us, we invest in them - and fortunes will come to both of you." As a first step, right after SKS broke even, I converted it to for-profit status and was able to get philanthropist Ravi Reddy to be a founding investor. Then I secured money from parties such as Unitus, a Seattle-based NGO that helps promote microfinance; the Small Industries Development Bank of India; and technology entrepreneur Vinod Khosla. Later, we landed Sequoia, a premier venture capital firm that was an early investor in Google. With our performance strong and these power players on board, SKS was able to attract multimillion-dollar lines of credit from Citibank, ABN Amro, and others.

Standardize products, training, and other processes in order to boost capacity. Taking a cue from giants like Starbucks and McDonald's, SKS standardized its products and frontline processes. Instead of getting, say, 23 rupees from one villager and 27 from another, all in coins, our loan officers collected standard repayments in round numbers of 25 or 30 rupees. Internally, we adopted the factory-style training models that had helped the corporate giants scale up so rapidly - and thereby boosted our own workforce capabilities and growth. To this day, we walk our employees (all of whom come from poor villages themselves) through a series of highly simplified and experiential learning modules. We enroll about 500 new loan officers every month. They participate in theory classes on Saturdays and practice what they've learned in the field during the week. At most microfinance organizations, it takes four to six months of training for a loan officer to become productive; we have shortened that to two months and hope to cut it to one.

Use technology to reduce costs and limit errors. Most microfinance organizations record all their transactions on paper, in three separate locations: passbooks, collection sheets, and back-office ledgers. A loan officer who has 450 customers with two products each must make 2,700 manual entries a week or more than 140,000 a year. Imagine how many missed zeroes and transposed digits there might be, particularly with a low-skilled workforce?

So we digitized the process. Because we couldn't find software that suited us, we enlisted vendors to help us build our own - a suite of simple, user-friendly applications that a computer-illiterate loan officer with a 12th grade education can easily learn. Since the loan repayments are standardized, the fields in the online forms are prepopulated and only the exceptions must be entered. The system is also internet-enabled, so loan officers can send their summary data to the head office within hours after their morning field meetings. (Given that electricity is unreliable in many areas, we've installed car batteries or gas-powered generators as backups.) More recently, we've been experimenting with mobile text-messaging payment applications and biometric authentication technologies. These improvements offer our borrowers the convenience of settling their accounts online and our loan officers a measure of protection from cash-hungry thugs.

Scaling Up Customer Loyalty

Perhaps the most critical factor in our growth (and maybe one not so obvious to most companies that want to do business at the base of the pyramid) has been our extreme focus on the customer. In everything we do, we ask, "Does this work for the borrower?" - even if it means operating against our own short-term interests.

It's hard to identify what's best for the Indian customer without immersing yourself in the rhythms of her village. We've succeeded by engaging poor communities in culturally appropriate ways. When we were first scouting markets and collecting information about potential borrowers, for instance, we relied on some of the visual exercises from my days as a DDS field agent. Instead of asking villagers, who are often illiterate, to describe the seasonal pattern of their cash-flow needs, we had them diagram it with sticks, seeds, and coins. We encouraged them to use colored chalk powder and flowers to map out the village on the ground - indirectly telling us where the poorest people lived, what kind of financial products they needed, which areas were lorded over by which loan sharks, and so on. I personally sat in tea stalls and lunched in roadside diners, talking informally and forging bonds with potential borrowers.

Using this local knowledge, we designed a set of products and a delivery mechanism specifically for our customers. For example, based on what we learned from the visual exercises about how money ebbed and flowed from households - when pay day was, when bills came due, what financial crises families faced - we set people's tiny weekly repayments as low as $1 per week. In the same vein, our health insurance and whole-life insurance premiums are only $10 a year and 25 cents a week, respectively. We also offer interest-free emer-

gency loans. All these products are costly to administer. For example, we are borrowing the funds we use for emergency loans at commercial rates. We do it anyway because the customer needs a safety net when, say, her family's hut catches fire or she can't resume her manual work after complications during childbirth.

Our customer-first philosophy also extends to our processes and systems. The salaries of loan officers, for example, aren't tied to repayment rates or the size of their loan portfolios - something probably unheard of in mainstream financial services. We don't want our loan officers, because of pressure to make their numbers, to collect from a borrower who's in a difficult situation or to try to lend her more than she needs. Instead of having borrowers visit a branch office, our loan officers journey on mopeds to their villages and schedule loan meetings as early as 7:00 **AM SO** that the women don't miss part of the workday. We do this even though the costs of travel are quite high. It's not just the gasoline; our officers brave monsoons, summer heat, and sometimes harrowing driving conditions on rough dirt roads.

Our reward for these efforts? Deep customer loyalty that ultimately results in a 99.5% repayment rate.

Leveraging the SKS Brand

How can razor-thin margins and costly customer relationships lead to high returns? The payoff comes with volume. Over the past 10 years, SKS has provided $725 million in unsecured microloans and insurance products to over 2 million people in 30,000 Indian villages and slums. Because of the changes we've made related to capital, capacity, and costs, we are growing at nearly 200% annually, adding 50 branches and 160,000 new customers a month. The customer growth slope is getting steeper, so we are on track to reach 8 million clients by 2010.

The next step is to leverage our brand to expand an already broad distribution network. With our huge base of borrowers, we can say to makers of soap, clothes, consumer electronics, and other packaged goods, "Source high-quality products to us at the lowest cost available, and we can guarantee you a large market share." We've already done such deals with Indian insurers ICICI Lombard and Bajaj Allianz, and telecom providers Nokia and Airtel. For instance, we supply borrowers with Nokia cell phones and airtime at lower prices than the marketplace offers. We've also been approached by electronics manufacturers, retailers, and others that want to utilize our channel.

The bottom line: Our borrowers get high-quality, low-cost goods. Our suppliers also find new market segments, and SKS and its investors see a small profit margin. Of course, Sequoia is not particularly interested in tiny margins. But when you bundle 15 or 20 products to 8 million customers, with a small profit earned on each, well, that's Google territory.

Our loan officers journey on mopeds to borrowers' villages and schedule loan meetings as early as 7:00 A M .

Vikram Akula *(vikram@sksindia.com) is the founder and CEO of SKS Microfinance, an India-based provider of small business loans and other financial services to poor women.*

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To order, see page 143.

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