**TEAMWORK PAYS:**
M.R. Rao (left), MD & CEO, and
S. Dilli Raj, CFO, SKS Microfinance

# REBOOTING SKS MICROFINANCE

SKS MICROFINANCE UNDER VIKRAM AKULA SCALED DIZZYING HEIGHTS BEFORE CRASHING DOWN. FOR THE COMPANY TO SURVIVE AND THE INDUSTRY TO GROW, HIS SUCCESSORS WANT LESS HIGH JINKS AND MORE MODERATION.

BY **RAJIV BHUVA**

*Photograph by* **RONJOY GOGOI**

**"THE GAME STARTS FROM HERE,"** says S. Dilli Raj, chief financial officer of SKS Microfinance, once the poster child of microfinance. "Our strategy is to get more efficient and then grow." For a company that was perilously close to opting for corporate debt restructuring (CDR) a couple of years ago, that's ambitious. Peers, including Spandana Sphoorty and Share Microfin, had no choice but head the CDR way.

That's history for SKS's honchos—Raj, and CEO and managing director M.R. Rao. The new SKS is no longer about scale and growth; it's all about efficiency and profitability. It's about having a lean team that will service

more customers. It's about operational and financial leverage without spending on additional infrastructure. Most important, it's about the customer. One of the most visible signs is the lower interest rates; SKS and others charged up to 32% a year as interest in 2010-11; that's come down to 25%. Microfinance institutions (MFIs) have traditionally charged higher interest rates, arguing that they had to cover high operating costs, expensive capital (mostly borrowed from banks as they can't take deposits), and the risks that came with the business (microfinance loans are predominantly unsecured).

Nearly all MFIs have slashed interest rates because the norms governing them mandate lower rates. Sanjay Sinha, managing director of M-CRIL, a global leader in the rating of microfinance outfits, says, "The regulation aimed at reducing interest rates and capping margins will change the business dramatically." SKS has a competitive advantage over most others because it did not opt for a CDR, and has a capital cushion from its 2010 IPO, says Puli Kishore Kumar, CEO of a Hyderabad-based MFI, Trident Microfin. Sinha says this translates into a substantial financial advantage.

It is now up to Raj to capitalise on that. "We are in a better position to reap the benefits of consolidation of the sector," he says. The number of players has reduced, regulations are stronger than before, and the demand-supply gap has widened because the competitors are still in poor shape. Demand is not a challenge. Raj claims that it is possible for SKS to grow at 100% or 200% annually. But the plan, he says, is to grow at a more conservative, and sustainable, 60% or so a year. The company will also diversify into non-microfinance businesses, and over time, reduce its earnings from microfinance to 75% from 90% today.

**OR A COMPANY** that is synonymous with microfinance, this is a big step. Equally, it's a pragmatic one. Microfinance is a risky business because it deals with borrowers who have no collateral or, often, jobs. To understand why the recasting of SKS matters, it's important to know its journey.

It all started in 2006, when there was a huge interest in microfinance after Muhammad Yunus and the Grameen Bank were awarded the Nobel Peace Prize "for their efforts to create economic and social development from below". Almost overnight, private equity poured into MFIs in countries where the poor had no access to credit.

Here, Andhra Pradesh emerged as the microfinance hub, with over 2,200 MFI branches by 2010. The rapid rise was largely due to the then chief minister Chandrababu Naidu, who scaled back subsidised rural credit in the late 1990s; MFIs and self-help groups stepped in to fill the credit gap.

Like most MFIs, SKS began as a non-government organisation (NGO) that took money from donors and then lent it to the rural poor. Launched in 1998, the company shot to prominence a few years later when its founder, Vikram Akula, announced that SKS could run as a profitable venture. Akula incorporated SKS as a non-banking finance company (NBFC) in 2005, and by 2009, the company was judged the second-best MFI in the world according to the annual composite ratings done by U.S.-based microfinance data and resource organisation Microfinance Information Exchange. The next year, Akula took the company public.

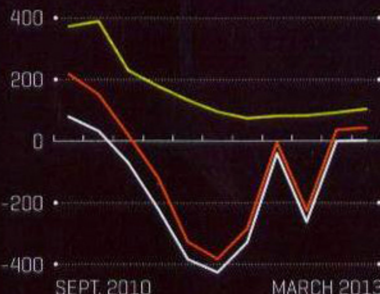
The initial public offering was oversubscribed 13.69 times, and listed at Rs 985. Sceptics waited for a fall, because, many said, a microfinance company was not intended to be a profit-making entity. Sure enough, there was a fall, but not just for SKS. The entire industry was virtually grounded by a new legislation passed by the Andhra Pradesh government.

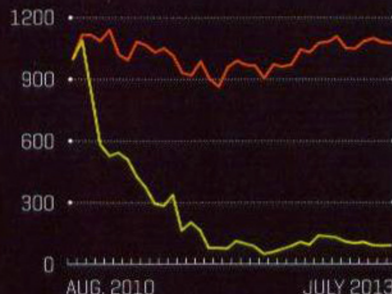
In the early days, borrowers maintained enough fiscal discipline to repay their loans on time, giving MFIs the confidence to continue and grow. But as the overall economy got worse, borrowers couldn't pay back, and as they began to default, the MFIs came under repayment pressure. By 2010, there were 9.2 million MFI defaulters in Andhra Pradesh alone. On their part, not sure how to meet their growing debts, MFIs began charging even higher interest rates on new loans, and began coercive recovery practices. It became a vicious cycle. News reports emerged of recovery agents obstructing funerals of borrowers who had committed suicide.

Alarmed, the Andhra Pradesh government stepped in to curb what it called usurious lending. In 2010, it issued a set of stifling regulations that prohibited MFIs from visiting prospective borrowers at home and made it mandatory for an MFI to get government approval before giving a second loan to a borrower. Effectively, this stopped all microfinance activity in the state; only recently did the Supreme Court allow SKS to start operations in Andhra again. With MFIs on a tight leash, borrowers saw no reason to repay existing loans, putting even more pressure on the lenders.

The following months were tough for SKS, which posted a cumulative loss of Rs 1,733 crore over seven quarters until September 2012. By October 2010, Akula realised the extent of trouble SKS was in; that month, he asked Raj and Rao if the company was going to be able to pay its staff. Reports say Akula was under pressure

## WHAT THE NUMBERS SAY

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from the SKS board to resign, and he finally did so in November 2011. From being a poster child, SKS had become a virtual outcaste.

**BUT, SAYS RAO,** "if 2010 had not happened, we would have been in an even worse condition". Alok Prasad, CEO of Micro Finance Institutions Network (MFIN), an association of NBFC-MFIs, adds: "It is critical to have a framework of clear rules and regulations which take away uncertainties." Despite cash flow problems in late 2010, Raj was confident because he was clear that the crisis was external and not internal.

The SKS board, however, was worried, and considered various options, including a CDR scheme, which others had opted for. Raj was never happy with the idea, he says, because SKS defined the industry, and a CDR could well have killed microfinance here. Also, since the company was publicly listed, such a scheme would have destroyed shareholder value. Luckily, the company had a way out: Its bankers came to its aid. "They made available credit limits, provided the company did not opt for the CDR route," says Raj. Yes Bank sanctioned Rs 250 crore and IDBI Bank Rs 200 crore. "It was an endorsement that the crisis was an external event," he adds. Despite this, the SKS share price fell from Rs 1,212 on Oct. 14, 2010 to Rs 345 on June 30, 2011. It has continued to fall, and today trades at around Rs 115.

Meanwhile, Raj and Rao cut operating costs by reducing staff strength and branches. Between December 2010 and June 2013, SKS reduced its headcount from 25,735 to 9,959. That cut personnel costs by 53%. More than 1,000 branches were shuttered, and that reduced other operating expenses to Rs 18 crore from Rs 51 crore.

These steps have worked: In the last three quarters, SKS has emerged from the red with a net profit of Rs 1.2 crore, Rs 2.7 crore, and Rs 5 crore in December 2012, March 2013, and June 2013, respectively.

For the sector at large, the colour of funds has changed and development finance institutions are willing to accept lenders who earn 2% return on assets instead of 4% earlier. "Caps on profit margin and loan pricing will reduce the upside for MFIs," says Vishal Mehta, co-founder and partner at Lok Capital, a New Delhi-based social impact venture capital investor.

SKS has seen increased confidence from its lenders in terms of higher sanctions and reversal to market interest rates. "Non-performing loans are near all-time lows at SKS," says Paresh Patel, CEO of Sandstone Capital and a board member. "The loan book is growing quickly enough, so SKS will continue to grow its operating footprint without much additional investment on capital and operating expenses."

Also, says Raj, investors are still bullish. Last June, SKS raised Rs 230 crore through a qualified institutional placement, which was oversubscribed by 100%. He says new investors came in because they believe that the SKS story today "holds tighter than at the time of the IPO".

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