

No Limits to Trust

Celebrating Sitaram Rao

First Inaugural V. Sitaram Rao Memorial Lecture

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Microfinance institutions are in the business of lending, let me start with this utterly obvious statement that we can all agree on. We also know that lending involves trust. Indeed, the Latin word for lending, extending credit, is 'credere,' which means 'to believe,' to be credible or trustworthy.

I start with this observation because ultimately the reason we are gathered here to honor Sitaram Rao is that he embodied trust, in a variety of ways. I must clarify that I never got to know Sitaram, to my regret. I met him the day I joined the SKS board as an independent director, I remember going through an induction ceremony of sorts, where there was an exchange of information between the existing board and senior management, and myself, and then I had to step out of the room while a vote was taken. Sitaram was gracious in receiving me, and what strikes me the most about that time was the deference with which he was treated in the room. Alas, that is the extent of my personal interaction with him.

I say alas because, in preparing for these comments, I did my research, as a credible academic might. It's clear that Sitaram nurtured relationships and enhanced trust. I am sure I would have benefited enormously from being around him.

First, Sitaram embodied trust by personal example. Of course, the glowing testimonials that poured out on Sitaram's passing are testimony to this. There were a couple of sentiments, expressed by many, that have stuck with me. Several said that Sitaram built a "scalable mentoring model". That sounds like business-jargon, but really all it is saying is that thousands of people trusted him as a mentor. Others said that curiosity animated him. He was perpetually a student, music to the ears of an academic of course. An accomplished person cannot mentor people without also learning from them, it is inevitable. At a company like General Electric, people would "invert the organizational pyramid" so that those at the top of whatever hierarchy there was could learn from those below. Mentors become mentees, and vice versa, so that everyone is learning from each other. And I can envision Sitaram's abiding curiosity to invest in these mutual trust-based relationships.

For example, Sitaram used to always say that SKS field staff, people like Nirmala and Sandhya, were his teachers, that is was those individuals who taught him microfinance. And he would encourage new recruits, even those from the best MBA schools, to go spend time with the field staff because, he said, they would learn most from them.

Second, MFIs add another dimension of trust to the normal arms-length lending decision. Trust among MFI members is central to the collective lending model. The trust among the borrowers is what allows them to credibly represent each others' credit-worthiness to the microfinance lender, especially valuable when there is no other mechanism to access such information. Of course, collective liability of the group reinforces this, and also cannot work without a high degree of trust in the borrowing group. In

all countries where I have watched MFIs work their magic, there is a fairly high degree of policing of the group to ensure that this trust is nurtured, usually in quite subtle ways sensitive to maintaining the community fabric.

This community trust must be actively reinforced by the MFI. Here Sitaram's basic but powerful admonition to all of us is worth restating, that as long as the client, the borrower, remains the center of attention of any growth path that MFIs embark on, ultimately things will be fine. As MFIs learn and improve their operating models, some of these efficiency gains must be shared back with borrowers. Most likely this comes through falling real interest rates charged to the borrower. The better MFIs will be able to accomplish this more surely and consistently. I believe SKS has remained true to this. Further, as the industry matures, competition will play its magic role, ensuring that there is a balance between returning moneys to the borrower (through lower interest rates) and reinvesting in the MFI business model.

It is always tricky to be a for-profit company while doing this. In most societies' perceptions, making money is not synonymous with doing good. Think of the provenance of the phrase, 'filthy lucre,' in English, going back to a writer in Middle English translating 'shameful gain' in the Bible using the Latin word 'lucrum,' or profit. In Aramaic, the language around the time of Christ, debt and sin were indistinguishable; today's concept of 'odious' or evil debt, imposing costs unfairly on borrowers in indebted countries, harkens back to traditions in Christianity and Judaism, and of course, Islam's prohibition on interest has given rise to the Islamic finance industry today.

Making money has been abused in society, many times. Look for example at my adopted home in the United States, wracked in suspicion about the enterprise of making money on Wall Street today, where the great-and-good of the business world have participated in a spectacular financial collapse. Thus, it is fair to say that broad-based societal suspicion is empirically oriented.

Nonetheless, I believe there are dozens of enterprises that combine doing well with doing good, so to speak. Globally, MTV International dedicates a lot of its prime TV time airing public health messages to its fanatically musically-aligned, young customer base. It believes this is good for its young audience, and good for its own brand with them. Even locally, in India, there are several great examples. The Bangalore based surgeon, Devi Shetty, in effect is building an organization to facilitate health inclusion, just like the microfinance sector is interested in financial inclusion. Two young engineers, one from MIT and one from IIT, started AspiringMinds, an entity dedicated to talent inclusion, that is, helping educated but under-employed youth in India find productive, often highly paid employment. They do this by using technology-based assessment tests to dramatically lower the costs for major corporations in India to access talent pools not from the conventional few colleges each company might normally hire from, but from several hundreds, and ultimately several thousands of colleges off the beaten path. All these inclusion-based businesses are making money, and doing good in a concrete measurable way. Thus, my own pragmatic response to the admonition inherent in the idea of filthy lucre is that a measure of balance and old-fashioned common sense is needed to avoid getting carried away.

Don't underestimate the 'getting carried away' part! I have been watching the evolution of Banco Compartamos in Mexico, their leading microfinance firm and among the first worldwide to do an IPO which resulted in great wealth for some of the founders. It is fair to say that several sections of Mexican society are uneasy about the distribution of gains from Compartamos' microfinance efforts, even though I believe that overall good has been created. All this is ironic given that Compartamos comes from the root meaning 'to share.'

SKS should learn from Compartamos' experience. Stepping away from the rhetoric and sometimes passionate debate, is there a sense in which idealistic people would stay away from SKS in the future? Academic economists, using data from the United States and France, have demonstrated that there is evidence of 'sorting' in the labor market. (American) football players tend to be large, musicians tend not to be tone-deaf. Extroverted individuals tend to gravitate to jobs that allow them much interaction with their co-workers, and much customer interaction. This should not be surprising, but it is reassuring to find statistical confirmatory evidence. What does this mean for altruism in the SKS workplace, as the company goes through an IPO? I believe SKS' ongoing success depends on maintaining a continually-reexamined balance between profit-making and altruism, and that this is something to which we must continue to pay attention during the transition to being a public company.

Third, Sitaram played the role of an institution builder in the microfinance sector. These institutions are what we need to ensure that the trust I have been talking about outlasts not just Sitaram but every one of us in this audience.

Let me elaborate a bit. In my recent work, I build on a long tradition of scholarship, including that of some celebrated winners of Nobel Prizes for economics and peace, to identify the classes of barriers that prevent commerce from kicking in speedily enough to alleviate poverty in developing countries. MFIs are in the business of alleviating exactly one such barrier, that of access to credit. But societies have to allow individuals' demand for all sorts of useful things to be consummated – not just credit – for example, access to educational services, water, food, indeed even political representation.

Every access to some such 'thing' is underpinned by societal reassurances, as it were. As a buyer of something, you want to be sure that you have good information about it, that no one misrepresents the products or services they are selling you, and that there are consequences for them if they do. You also want to be sure that you have the right to hang on to what you buy, that vested interests or powerful entities don't muscle in and deprive you of what you buy.

How are these reassurances delivered in the MFI sector in India? Consider Saadhan, which Sitaram was an integral part of, and its promotion of a code of conduct for MFIs that stresses ethical treatment of the client. Likewise newsletters like Microfinance Focus in India disseminate useful information about the microfinance sector. Credible information is the lifeblood of a sector based on trust. I learned that Sitaram worked with the chartered accountancy profession to focus on specifying norms for the sector; in this, he did us all a great service.

I'd like also to focus on Unitus, the international NGO that has done so much to reduce global poverty and had an instrumental role in the development not just of SKS but of the microfinance sector in India, Africa and elsewhere. Companies like SKS exist in a web of institutions, that includes several like Unitus, dedicated to injecting capital, and to my mind, more importantly, expertise, to help scale up existing nascent poverty-reduction initiatives. Sitaram's even-handedness, and recognition of the value of Unitus' services, catalyzed its partnership with SKS.

Make no mistake, while personal mentoring is vital, and Sitaram's role in propelling SKS' early growth is monumental, his lasting contribution will be in helping along the development of this web of institutions. We talk about roads and highways and electric power, the hard infrastructure that we in India have to catalyze. As important is the soft infrastructure that underpins the free flow of

information and contractual sanctity, promises that are made to be kept, and these come from this web of trust-building institutions.

There are no limits to this trust.

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