THE HINDU

Today's Paper

Published: February 26, 2012 00:00 IST | Updated: February 26, 2012 04:30 IST

Small loans add up to lethal debts

Erika Kinetz

The microfinance industry pursued a path of rapid business growth inrecent years; two investigations now link it to debtor suicides

DEBT AND DEATH:Family members with a photograph of Hari Prasad, who took his own life in August 2010 by consuming pesticide in their home in Kadiri in Anantapur district of Andhra Pradesh. He had run up debts with a microfinance company. In the photograph taken last week are Sunita, the widow, 22, along with her daughter Shwetha, 5, and son Kiran, 16 months.— PHOTO: AP

First they were stripped of their utensils, furniture, mobile phones, television sets, ration cards and heirloom gold jewellery. Then, some of them drank pesticide. One woman threw herself into a pond. Another jumped into a well with her children.

Sometimes, the debt collectors watched nearby.

More than 200 poor, debt-ridden residents of Andhra Pradesh killed themselves in late 2010, according to media reports compiled by the State government. The State blamed microfinance companies which give small loans intended to lift up the very poor for fuelling a frenzy of over-indebtedness, and then pressuring borrowers so relentlessly that some took their own lives. The companies, including market leader SKS Microfinance, denied it.

Investigations

An independent investigation commissioned by the company, however, linked SKS employees to at least seven of the deaths. A second investigation commissioned by an industry umbrella group that probed the role of many microfinance companies, did not draw conclusions but pointed to SKS' involvement in two more cases that ended in suicide. Neither study has been made public.

Both reports said SKS employees had verbally harassed over-indebted borrowers, forced them to pawn valuable items, incited other borrowers to humiliate them and orchestrated sit-ins outside their homes to publicly shame them. In some cases, SKS staff physically harassed defaulters, according to the report commissioned by the company. Only in death would the debts be forgiven.

The videos and reports tell stark stories:

One woman drank pesticide and died a day after an SKS loan agent told her to prostitute her daughters to pay off her debt. She had been given Rs. 1.5 lakh in loans but only made Rs. 600 a week.

Another SKS debt collector told a delinquent borrower to drown herself in a pond if she wanted her loan waived. The next day, she did. She left behind four children.

One agent blocked a woman from bringing her young son, weak with diarrhoea, to the hospital, demanding payment first. Other borrowers, who could not get any new loans until she paid, told her that if she wanted to die, they would bring her pesticide. An SKS staff member was there when she drank the poison. She survived.

An 18-year-old girl, pressured until she handed over Rs. 150 meant for a school examination fee, also drank pesticide. She left a suicide note: “Work hard and earn money. Do not take loans.”

In all these cases, the report commissioned by SKS concluded that the company's staff members were directly or indirectly responsible. — AP

THE HINDU

Today's Paper » NATIONAL

Published: February 26, 2012 00:00 IST | Updated: February 26, 2012 04:30 IST

... Small loans add up to lethal debts

Developed as a non-profit effort to lift the downtrodden, microfinance has increasingly become a for-profit enterprise

FINAL PAYMENT:The parents of 18-year-old Lalitha, from Godhumaguda village in Ranga Reddy district of Andhra Pradesh last week, with a picture of their daughter. She took her life by consuming pesticide after being pressured by the agents of a microfinance company to hand over Rs. 150 she had kept aside to pay her school examination fee, towards clearing the family's outstandings.Her suicide note read: "Work hard and earn money. Do not take loans."— PHOTO: AP

Continued from Page 1

Caught in the despair of poverty, tens of thousands of impoverished Indians kill themselves every year, often because of insurmountable debt. The supportive structure of the microfinance companies was supposed to change that.

But Davuluri Venkateswarlu, director of Glocal Research in Hyderabad, which conducted the industry-wide investigation, said in an interview that he told SKS executives there was "clear involvement of SKS personnel" in some suicides.

SKS continues to deny all responsibility for the deaths, and says it never commissioned an independent inquiry. SKS spokesman J.S. Sai, who flew to Mumbai from the company's Hyderabad headquarters to discuss the AP's findings, said the company stands by its September 2011 affidavit before the Supreme Court. In that affidavit, chief executive M.R. Rao says SKS "is neither the cause of nor responsible for any suicides in the State of Andhra Pradesh."

The deaths came after a period of hyper-growth leading up to the company's hugely successful August 2010 initial public offering.

Originally developed as a non-profit effort to lift society's most downtrodden, microfinance has increasingly become a for-profit enterprise that serves investors as well as the poor. As India's market leader, SKS has pioneered a business model that many others hoped to emulate.

But the story of what went wrong at SKS has led current and former employees and even some major shareholders to question that strategy, and raises fundamental questions for the multibillion-dollar global microfinance industry.

Meanwhile, whistleblowers at SKS say they have been targeted for retaliation and that the company has failed to correct structural flaws that contributed to the suicides.

"At the end of it," said Alok Prasad, chief executive of the Microfinance Institutions Network, the industry group that commissioned the Glocal report, "you come down to a handful of cases where some things went wrong. Is that indicative of the model being bad or very rapid expansion leading to a loss of control?"

Beginnings in Bangladesh

Microfinance was born in desperation. Amid the 1970s famine in Bangladesh, Muhammad Yunus began giving small loans to poor women with his own money. Despite the predictions of bankers, the women paid him back.

The core idea of Professor Yunus' Grameen Bank was the borrower group. Five women from a village determine how large a loan each member gets and act as guarantors. If even one member is delinquent, no new loans are issued. Group members apply pressure and support that has kept repayment rates near 100 per cent.

Professor Yunus' innovation won him the Nobel Peace Prize in 2006.

In 1997, Professor Yunus' acolyte, Vikram Akula, founded his own microcredit organisation, Swayam Krishi Sangham, which stands for "self-help society." In 2005, SKS started operating as a for-profit company and Mr. Akula began chasing private investment to achieve the massive scale required to dent global poverty.

Public issue

In August 2010, SKS Microfinance, then India's largest microlender, went public. Exuberant investors oversubscribed the Rs. 1,715- crore offering by nearly 14 times. The stock surged more than 10 per cent on its first day. In celebration, the company handed out 21,000 watches to employees.

Then media reports began to surface that over-indebted borrowers were killing themselves.

In October 2010, a mob of 150 people surrounded SKS' Hyderabad headquarters, protesting the suicide of a borrower's husband. They threatened to drag the corpse inside and demanded Rs. 9.8 lakh.

It was one of dozens of deaths the Government of Andhra Pradesh blamed on aggressive tactics by microfinance companies. The police jailed microfinance employees, including dozens from SKS. Among the charges was abetment to suicide, essentially driving people to kill themselves. Authorities investigated 76 cases in which employees from SKS and other microfinance companies were blamed for driving borrowers to take their own lives. The State passed a law designed to clamp down on abuses with new restrictions on loan disbursement and collection and onerous registration requirements on the companies. Microlending in India's largest microcredit market was effectively shut down.

Charges denied

Microfinance officials fought the new law and denied the charges, accusing the State government of trying to gain traction with voters and punish companies for capturing valuable market share from state-run lending groups.

Established microlenders such as SKS said loan sharks operating under the guise of microfinance were behind the excesses. SKS and other companies asked a court to stop the arrest of their employees. The court issued a stay on new arrests. Today, no one is in jail.

In a November 2010 letter to the Union Finance Minister, Mr. Akula defended his company and included supportive articles from *The Wall Street Journal* and the *Financial Times* .

At the same time, the industry group Microfinance Institutions Network hired Glocal to investigate 44 deaths among debtors of microfinance companies, including SKS.

Mr. Venkateswarlu, the Glocal director, presented the findings to executives at three lenders. In January 2011, he delivered startling news to Mr. Akula and Mr. Rao — SKS employees had clear involvement in the suicide of four borrowers, meaning that their actions appeared strongly linked to the subsequent deaths, according to their investigation.

The AP obtained a four-page section of the Glocal report that deals with the SKS case studies. It related the financial history of borrowers, the loans obtained, the nature of pressure or harassment for repayment, and the microfinance company involved. Mr. Venkateswarlu verified that it was indeed the material he presented to Mr. Akula and Mr. Rao.

“They said they'd look into the issue and take some appropriate action,” Mr. Venkateswarlu said.

SKS sent internal audit teams to the field. Their reports exonerated the company.

Inquiry initiated

Unable to reconcile the two sets of findings, SKS hired Guardian's Human & Civil Rights Forum and Third Eye, a private investigative agency, to do a more thorough, independent inquiry, according to Ramesh Vautrey, head of administration at SKS, who oversaw the investigation, and Rajender Khanna, the president of Guardian's.

A January 17, 2011, letter from SKS, signed and stamped by Mr. Vautrey, asked Mr. Khanna to “carry out a fact-finding enquiry on the causes of suicide and complicity of our field staffs without any prejudice,” according to a copy of the letter obtained by AP. The AP was shown invoice numbers for SKS payments to Third Eye and e-mails indicating the findings were sent to top management.

P.H. Ravikumar, who became interim chairman of the SKS board last November, said neither management nor the board had authorised an independent inquiry into borrower-deaths.

“Our enquiries from 2009 to 2011 have revealed that neither SKS nor its employees have been the cause for any of the suicides in the state of Andhra Pradesh,” the company said in a statement. The company also said SKS employees have been acquitted in two borrower suicide cases in Andhra Pradesh and that only one criminal case remains outstanding.

Mr. Khanna sent teams to speak with families of the dead, village leaders, neighbours and loan agents, videotaping the interviews. Their report said SKS employees bore direct or indirect responsibility for at least seven suicides, including two that overlapped with the Glocal findings.

The interview videos were shown to the AP by Uma Maheshwari, who said she was present during one set of recordings and visited several of the families personally. She left SKS in July.

In one video, the daughter of borrower Dhake Lakshmi Rajyam cries, gasping as she talks to an investigator in Tadepalligudem, Andhra Pradesh.

Rajyam was unable to pay off Rs. 1.18 lakh owed to eight different companies. Employees of microfinance companies, including SKS, urged other borrowers to seize the family's chairs, utensils and wardrobe and pawn them to make loan payments, her family told investigators. Unable to bear the insults and pressure of the crowd of borrowers who sat outside her home for hours to shame her, Rajyam drank pesticide on September 16, 2010, and died, the family says.

“We've lost my mother,” her daughter says. “Nobody will support us.”

The investigator's conclusions lay the blame on SKS employees, saying they failed to comply with company policies “and even basic moral rights.”

Mr. Vautrey said he sent the case studies to three top managers, including Mr. Rao. E-mails obtained by AP indicate that summary reports were e-mailed to the managers.

Mr. Rao did not respond to multiple requests from AP seeking comment.

Mr. Vautrey went to Mr. Akula's office one night and told him what they were doing was bad *karma* . “I don't want to be part of a team abetting suicides,” Mr. Vautrey said in an interview. “It is systemic failure. We have no right to kill anybody for our own business. Let's close down our business if we can't do it right.”

Profound shift

A profound shift in values and incentives at SKS began in 2008.

In October, Boston-based Sandstone Capital, now SKS' largest investor, made a major investment. It joined U.S. private equity firm Sequoia Capital, which funded Google and Apple and is SKS' largest shareholder, on the board of directors.

Mr. Akula, who had been chief executive in the company's early days, stepped down in December 2008 but stayed on as chairman. The company brought in new top executives from the worlds of finance and insurance.

SKS also began transferring more loans off its books, selling highly rated pools of loans to banks, which then assumed most of the associated risk of borrower default. That freed SKS to push out more and bigger loans.

In December 2009, SKS launched a massive sales drive. The “Incentives Galore” programme ran through February 2010, just one month before the company filed its IPO prospectus.

Agents won prizes worth up to 10 times their average monthly salary for signing huge numbers of new borrowers. Mr. Vautrey said he coordinated the shipment of 8,800 television sets, refrigerators, gold coins, mixers, washing machines and DVDs as rewards for more than 3,000 districts nationwide.

One loan officer signed up 273 groups in a month. Under training protocols, the ideal number of groups formed per month is 12, the maximum is 36, according to field agents and reports written by Mr. Akula.

“The focus is only on targets,” said Ramulu Sirgapur, who spent a decade at SKS before he left in December. “Even if we've given feedback, there might be recovery or repayment issues. That's OK. Just concentrate on growth.”

The result: Management had a great set of numbers to show investors as it shopped the IPO. In a month, SKS could add 400,000 borrowers and 100 branches, and train more than 1,000 new loan officers. SKS had 6.8 million borrowers and had disbursed Rs. 15,680 crore in loans. India was pimpled with SKS branches, which bloomed in nearly 100,000 villages. SKS said it was the fastest growing microfinance company in the world.

What was overlooked

But basic principles of lending were overlooked, according to interviews with current and former employees, as well as correspondence and internal PowerPoint presentations by Mr. Akula.

Six current and former SKS staffers with experience in the field told the AP they no longer had time to check a borrower's assets or follow up and make sure a loan was put to productive use. They said they were pressured to push more debt onto people than they could handle, and that the number of days devoted to borrower training was cut in half.

“You have a [borrower group], and a loan officer goes out and trains them, educates them, then they give the loan. That's the SKS I'd seen in 1999. That was the whole model on which microfinance is supposed to work. In the quest for growth, a lot of these things got neglected,” said Ankur Sarin, director of the SKS trusts, which are the fourth largest shareholder in the company and tasked with looking out for borrower interests.

As the relationships between heavily indebted borrowers and loan agents broke down, it became harder to collect. Frustrated agents began working together and going door to door to collect, rather than taking payments only in public, a company rule that had been designed to limit coercion. They began using other borrowers to pressure defaulters into repaying.

“The growth was very rapid. That growth led to some suboptimal outcomes,” said Ashish Lakhanpal, managing director of Kismet Capital, one of SKS' largest shareholders, who was on the SKS board until October 2010. “Were there lapses? Absolutely.”

While the board was concerned about fast credit growth, the company never believed it was harming borrowers, Mr. Lakhanpal said. “Mistakes were made, but I find it difficult to believe there was anything people did at a managerial level to encourage field officers to do that,” he said.

Plan that never made it

In the spring of 2011, Mr. Akula began circulating a plan to spend Rs. 49 crore to train financial counsellors, who would make sure clients were not getting into too much debt and used their loans productively, according to Mr. Sarin, Mr. Vautrey and others with firsthand knowledge of the proposal.

But the plan was never adopted. Publicly, Mr. Akula continued to deny that SKS bore any responsibility for suicides. “Whatever happened was due to external factors and was not reflective of any fundamental flaw in our model,” he told *Business Today* .

Privately, Mr. Akula prepared a 55-page presentation for the board that detailed the seven suicides that SKS' outside investigation had blamed on the company. The presentation showed how the pre-IPO push for growth led to a systemic breakdown, and again urged core reforms to restore training and lending discipline.

Board members received copies of Mr. Akula's presentation at a July 26, 2011, meeting, said a former employee who helped prepare the material.

The minutes of the meeting, however, make no mention of the report.

“As per my notes, this was not part of the board proceedings,” company secretary Sudershan Pallap wrote in a September 26 e-mail to Mr. Akula, who had complained of the omission.

Mr. Ravikumar, who would become interim chairman when Mr. Akula resigned, said the board was never informed that SKS employees were implicated in any suicides, and denied Mr. Akula presented any such findings to the board. “There was no presentation from Vikram Akula at that board meeting. This will be reflected in the minutes, as signed by Vikram Akula,” he said.

Mr. Ravikumar said the board reviewed reports from the Microfinance Institutions Network, but none of them implicated SKS employees.

Complaints

Mr. Akula continued to complain to the board that his presentation had been ignored. He summarised his concerns about the company's direction in e-mails, obtained by the AP, to seven board members, including Sequoia's Sumir Chadha, Sandstone's Paresh Patel and three independent directors — Mr. Ravikumar, Harvard's Tarun Khanna, and Pramod Bhasin, the former chief executive of Genpact.

Mr. Chadha, Mr. Patel and Mr. Khanna did not respond to multiple requests for comment.

Mr. Ravikumar declined to comment on what he said was personal correspondence.

Mr. Bhasin said reports claiming SKS bore responsibility for borrower suicides were “unsubstantiated.” “Any issues raised to the Board at various times were fully investigated by external parties and found to be unsubstantiated or without evidence or actions were taken on them where appropriate,” he wrote in an e-mail.

Rancour within the company was intensifying. Board members felt Mr. Akula was suffering from a bad case of “founder's syndrome,” that he could not stand to share power at a company that had become too big for him to run.

Finally, on November 23, 2011, Mr. Akula resigned.

Mr. Vautrey said he was targeted, and SKS began termination proceedings against him on February 6.

Three members of his staff have been fired and have filed wrongful termination complaints.

On February 6, SKS also sold Rs. 243 crore in securitised loans. The stock price surged 10 per cent. Top executives have been on the road, hoping to raise Rs. 500 crore from international investors.

Mr. Sai, the company spokesman, said SKS has hired an ombudsman, is spending Rs. 14.7 crore to improve its customer grievance programme and has revamped training to ensure that employees comply with current regulations and do not lend to over-indebted borrowers. He said the company would like to reorganise incentives to maintain rapid growth while ensuring loan quality. Those changes have yet to be implemented, he said. — AP