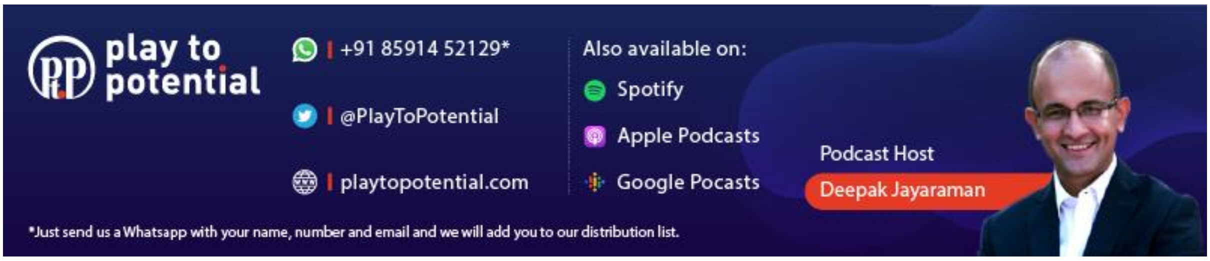

Context to the nugget

Tarun talks about variations in how companies and entrepreneurs think about returning capital to the shareholders and talks about the examples of BFIL (earlier SKS Microfinance) and Banco Compartamos to illustrate how you could have very different approaches but still end up building a successful enterprise over the long run.

Transcription

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Deepak Jayaraman (DJ): The point in the book about how entrepreneurs should think about pricing versus market share and I loved the metaphor of the Titanic, rescuing people on the Titanic of either you take a life boat or you call another ship, talk to us about what's the insight here?

Tarun Khanna (TK): So you are referring to the chapter that I wrote in Trust on microfinance, where I was comparing and contrasting two different micro finance ventures that I know reasonably well, one was what used they call BFIL (Bharat Finance Inclusion Limited) but then was called as SKS Microfinance headquartered in the AP at that time with Banco Compartamos which is Mexican micro finance firm and the unique think about both of these are they are both publicly traded entities and their respective stock markets in Mumbai, in the case of SKS … with the name at the time of vignettes described this in the book and Comport Thomas in Mexico now both these companies are for profit enterprises and they are avowedly and explicitly and unashamedly so, and in both cases I think the logic is very much look we can be a non-profit enterprise in which case we would take any and all economical surplus that we create and distribute it completely to all the stake holders but it will compromise the extent to which where we able to reinvest in the business and grow the system to serve the tens and millions of mostly women, poor women in these countries who desperately need access to cheap credit, now in theory the state should be providing that through subsidies loan and so on and certainly in India we have any number of state-run programs and subsidies credit available from the government the problem is that the market speaks pretty loudly, then when you have a well-functioning micro finance firm competing with the state run self-help groups the poor women choose to go to the well run micro finance firm because there is frankly less corruption involved in the disseminations of funds from there and even though the nominal interest rates seems higher the de-facto interest rate is much lower when you go with a well-run, reliable, professionally run, ethical microfinance firm, whether it's for profit or not is a separate issue, whereas if we go with the state run entity, sometimes the lenders are there sometimes they are not there the side payments demanded, there's other unsavoury action that goes on that I don't want to go into on this podcast and so on. So the women vote with their feet and go to for profit entity but the key point is that both entities Comport Thomas in Mexico and SKS in India both decided that they would prefer to grow overall pie and there is the big distinction there is still a lot of day light between the extreme position that you should give away all the surplus and the proposition that you should revert employees and shareholders also, there's a degree to which you would reward people and here I should say that I have been in independent director for the board of SKS for some time since before it became a public traded enterprise, I am much more comfortable with the SKS approach which is to say let's make sure that we make a healthy return that we return money to the shareholders that we treat the employees really well make sure that they compensated fairly, go out of the way to equip them with the latest technologies in different ways to do their job well so that they can build on the reliability of being there for the poor women when they needed but then make sure that you also consistently and steadily pass on more and more of the gains of continuous improvement and innovation to the poorer women in the form of a lower and lower interest rate and that's what we have delivered year after year other than one or two hiccups recently with demonetization quarters after quarters our interest rates keeps on going down. Compartamos has taken a different approach it said that we want to keep our interest rates pretty high. So our interest rates as SKS is I want to say 19% and change which is probably the lowest of any microfinance firm in the world, that's pretty amazing and it is an explicitly for profit firm so it's able to square the circle much like Devi Shetty can square the circle of saying I want to be a for profit entity but I want to make sure that I serve the poor and ensure that nobody has turned away who had heart disease or tertiary health care needs so also I think the SKS now BFIR is able to square the circle and say there is an intermediate position where you can return capital with shareholders that they keep reinvesting growing the pie and you can keep serving the poor people I have no problem with this Compartamos is to my mind anyway privileging the shareholder much more than I would like to see happen but you know that's between them and their customer and their eco systems I am not in the business of value judgments there and again the market speaks there because they are growing in a very healthy clip and women continue to go to them to borrow money and are quite happy with their services so you know that's the nature of the trade off, on a personal note I am a teacher and an educator and researcher so I take every opportunity to use these materials that I have been studying and working on and bring them into our classroom environments wherever I am teaching around the world and one interesting thing about both these instances of Devi Shetty's heart hospital and from microfinance from around the world, if you post the simple question to let's say a classroom of hundred undergraduates or a hundred CEOs of companies or hundred policy makers in any country and you say how many of you think that it is absolutely and categorically unethical to make money by selling services to the poor that's one extreme position the another extreme position is how of many of you have no problem at all saying that as long as you follow the law and are ethical in all possible respects and letter and spirit if you can make money by selling to the poor, you have no issues with a company being very profitable. So two extreme positions and I tell the students that they cannot hedge their bets, they cannot be both, they cannot be in the middle, they have to choose one or the other this plate is invariably 50-50 invariably, no matter who you pitch this to, it will be 50-50 so it appears that all of us, my hypothesis, as an academic is to say that we appeared to evolved pretty hard wired notions in our heads of what is legitimate and not legitimate to do with catering to the poor bringing the market to serve the poor and again I say my class that it's not for me to make value judgments, I wear my heart my sleeve and my actions tell you where I stand on this debate but if you and your god have a different answer then god be with you go for it.

DJ: But it's interesting that you say that across different start up it's a

TA: Across cultures across ages across backgrounds its roughly 50-50 give or take and further there's no, I also say in these classes that look my job here given that these attitudes are so ingrained by the time you show up in my classroom in my circle I have no hubris or arrogance that I am going to pursue you to change your mind I just want you to see that there is another side and that there are good people on all sides of this and I think that mutual forbearance and tolerance can go a long way in a civilised discourse.

Reflections from Deepak Jayaraman

DJ: I guess this is such a nuanced topic and I am no expert on it by any means. This conversation reminds me of a conversation I had with Roopa Kudva (RK) who is an MD at Omidyar Network in India. She talks about her dual cheque book model which is based on the belief that the for profit model or non-profit model is contextual and each has a different role in improving lives of the people they are serving.

RK: *"Neither a VC nor a foundation and this unique business module steam from two fundamental beliefs, number one the belief and the power of the business to do good and second the believe and the power of a non-profit to build a strong ecosystem for entrepreneurs whether it be through policy or through market infrastructure and these beliefs are what live to our dual cheque book module, we therefore do both early stage equity investments in for profit start-ups and we also make grants to non-profit and we call this module a flexible capital module, so what's this flexible capital module enables us to do is to actually have a wider tool kit than any VC would have, than any impact investor would have or any foundation would have.*

DJ: And how do you walk that tight rope from a capital allocation perspective, how do you think about how much gets deployed in each bucket?

RK: So what is interesting is that the same investment professional makes investments in for profits as well as the grants to non-profits and we treat our grand dollars as well as our equity dollars equally and is the investment professional who decides, what's the best use of the dollar so typically it's a market innovation of some kind would be a for profit equity investment but if it is to support organizations that work on policy agenda, policy reform or organizations that build sector infrastructure typically these would be non-profits and we would give a grant"

DJ: I guess the questions around how to structure the organization and how much capital to return are reasonably nuanced questions where you could argue on either side? But bringing it back to the entrepreneur, if you are an entrepreneur, it is important to ask the question – which of the two paradigms you would get energy from and where you would think you can add value? I do think the nature of people that flourish in each of these constructs and the skillsets and mind-sets required for success are quite different. I guess in a lot of ways, these choices need to be flow from the values of the entrepreneur and the leadership team than embracing a certain business model or a strategy choice because it is the prudent thing to do.

End of nugget transcription

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Nugget from Roopa Kudva that is referenced: Omidyar Network and innovating for next Half Billion.

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Tarun Khanna - Nuggets

- 38.00 Tarun Khanna - The Full Conversation
- 38.01 Tarun Khanna - Strategy and Careers
- 38.02 Tarun Khanna - Managing time and attention
- 38.03 Tarun Khanna - Creating the conditions to create
- 38.04 Tarun Khanna - Leadership in Emerging Markets
- 38.05 Tarun Khanna - Business model choices
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- 38.07 Tarun Khanna - Measuring Trust

About Deepak Jayaraman

Deepak seeks to unlock human potential of senior executive's / leadership teams by working with them as an Executive Coach / Sounding Board / Transition Advisor. You can know more about his work here.

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