



The Long March of BASIX and the Indian Microfinance Adventure

Minutes of the Savings and Credit Forum on Friday May 11, 2012 at SDC Berne

What were the main causes of the microfinance crisis in India and how did the Indian institution – and long standing SDC partner - BASIX evolve from microfinance to livelihood services, including finance? These topics were discussed by two experts of BASIX and the Indian microfinance sector, **Malcolm Harper**, consultant and previously a professor at Cranfield University, and **Sanjay Sinha**, director of M-CRIL Microcredit Ratings International Ltd. The day was opened by Hansruedi Pfeiffer from SDC who mentioned the recent publication on BASIX by Malcolm Harper et.al. and reminded us of important aspects related to the financial sector: 1. The leading role of Switzerland in microfinance investment funds. 2. The need for strengthening client protection. 3. The challenges of setting the right regulatory framework for banks and microfinance institutions. 4. The significance of the financial sector in economic development.

Malcolm Harper gave a presentation of **BASIX**, a microfinance institution based in Andhra Pradesh, which started operations in 1996 (with support from SDC) and has reached 1.6 million clients in 2011; currently BASIX is facing the consequences of the microfinance crisis and restructuring its portfolio. Based on a 2001 impact study which showed that micro credit alone cannot take people out of poverty, BASIX has **evolved from a micro credit only institution to a livelihood promotion institution**, based on a livelihood concept and the belief that only the “**triad**” – technical advisory services + institution building + finance - can significantly improve poor people’s lives. Nowadays, half of BASIX’ clients are buying non-financial services providing proof that poor people need and want more than credit and are ready to pay for other services if these are of good quality and low cost. Compared with NGOs - which have long standing experience with providing livelihood support to poor households - BASIX is more **client oriented, flexible, innovative and works with clear business approaches**. BASIX does not ask clients to form a group in order to get the services, invests in training of staff and research in order to adapt the offer to the demand, and has an extensive distribution channel.

Based on empirical observations and a thorough analysis of the evolution of India’s microfinance sector, Sanjay Sinha provided us with an insight into the causes of the **microfinance crisis in Andhra Pradesh**. In fact, the microfinance industry was booming in the years 2000 and international investors at least partly misinterpreted the growth potential of the Indian (credit/debt only) market. The MFIs in India, in turn, over exaggerated the growth potential in order to attract more money and focused on regions with easy access and good policies and governance (“low hanging fruits”). Combined with the parallel growth of the Self Help Groups promoted by the government, many poor clients encountered themselves with **multiple loans** and the inability to pay back. In Andhra Pradesh, the number of outstanding loans is four times higher than the number of persons eligible for a loan! The claims and public outcries about the link between over indebtedness and suicides gave the rest! And the State government tightened the legislation by imposing caps on interest rates, loan size and number of loans per household, etc.

Malcolm Harper then took us back to the example of BASIX, who has 35% of its loan portfolio in Andhra Pradesh, and whose repayment rate has decreased from 98% to 84% during the crisis. Nevertheless, at least as detrimental as the crisis, were the **difficulties faced by the management in combining under the same roof the social mission (livelihood development) with its business orientation** (for profit), finding and keeping the right staff, adapting to the increasing competition.

Sanjay then showed the **role of foreign investors in the Indian microfinance crisis**. The IPO (Initial Public Offering) of the microfinance bank Compartamos on the Mexican stock exchange in 2007 raised **many expectations** about the potential of foreign investment in microfinance. Indian MFIs, lead by SKS, presented **over ambitious business plans** to investors and actually managed to mobilize so much money that equity grew 32 times in 4 years in Indian microfinance institutions. This rapid growth resulted in over indebtedness of clients, as mentioned above, but also in **pressure on management** to control



operations, train new staff, and foster the organizational culture, pressure on staff to achieve targets, earn incentives and maintain portfolio quality. In 2010, SKS had 20'000 staff, which made it impossible to rule out client coercion ("force" clients to take up a loan). SKS's IPO in July 2010 was a success, but soon after, the sacking of its CEO and the State government's intervention in the financial sector regulation made the share come down from Rs 1402 in September 2010 to Rs 96 today. According to Sanjay Sinha, however, **IPOs and equity investors can have a great impact on microfinance** provided institutions do not over value their real value, maintain an equilibrated and realistic growth, recognize the differentiations in the market and **keep the clients in the centre of their attention**. "We need not be pessimistic in the long run, just realistic, and learn some lessons from what has happened."

After the lunch, the forum speakers and the audience held an interactive discussion on the question **"what is a reasonable interest rate?"** While the participants did not come to a conclusion, it seemed important that the interest rate charged by microfinance institutions should be set below the rate of return of the financed activity in order to allow clients to grow their business. It is also important to create transparency in the market, by publishing the remuneration of board members and explain to clients which costs are covered by the interest rate. Clients should be given the **ability to make informed choices**.

A second question was addressed to the audience on **"over indebtedness in the context of multiple lending"**. Sanjay explained that the Reserve Bank of India has set a limit on lending to individual clients, based on the calculation of the surplus after households have covered their basic consumption needs. Individual clients can borrow up to 20% of their income. People however are ready to decrease their consumption temporarily in order to pay back a loan. Malcolm argued that there should not be a "one fit for all" rule, but that banks should look at what the income generated through the loan will give as return. The problem however is that **income of many low income households are very irregular and risky** and loan repayment should thus have certain flexibility.

Sanjay took us then over to **Bangladesh** where the microfinance sector was not hit by the crisis, but growth - in terms of clients, portfolio and return on assets - has slowed down in recent years and some regions of Bangladesh are largely over served with standard credit products. The sector, which makes up 7.3% of the countries loan portfolio, has not managed to innovate in new products and mobilize important volumes of saving. Thus the **sector is fragile** and might suffer from another high monsoon season or political interference.

And finally, Malcolm showed us some insights from East Africa on the **potential of mobile phone technology** in order to increase the outreach of microfinance in remote areas and decrease transaction costs. India could learn from these experiences!

Hans Ramm from SDC closed the forum with a few lessons learned. He emphasized once again that **financial services are only one out of the five capitals** needed to improve the livelihood of the poor, next to natural, physical, human and social capital, which may even be more important. In India, the sector became a victim of its own success and **foreign investors jumped in without knowing the context** well enough and not realizing that the microfinance institutions presented overly optimistic business plans. Mr. Ramm also mentioned that each type of intervention (financial services; business and agriculture advisory services etc.) should operate under its own legal entity, since objectives, approaches, funding types and sources are different. MFIs which operate with an extensive branch network can play an important role in distributing **livelihood services in partnership with NGOs**. Whether multiple types of services as provided by BASIX can be financially viable has not been proven yet, and due to the microfinance crisis in India, the answer to this question will still have to wait a few years. Although India is a center of **technological innovation**, the microfinance sector did not yet benefit from it and can learn from experiences in Africa.