

## Building a Reliable MFI Funding Base: Donor Flexibility Shows Results

by Paul DiLeo

*This case study explains how donor flexibility enabled an MFI to secure the mix of capital required for long-term growth. The flexibility of donors such as the Swiss Agency for Development and Cooperation (SDC), the Ford Foundation, and the Canadian International Development Agency (CIDA) allowed BASIX, an innovative new Indian MFI, to build a diverse and reliable funding base.*

### Overview

The Indian MFI BASIX started in 1996 with concessional loans from Indian and foreign donors (Ford Foundation and SDC). By the end of 2002, the MFI had over fifteen different funders providing seven different forms of financing, including convertible loans and deposits from the public. BASIX had achieved its goal of a diversified and reliable funding base, positioning the MFI to provide a wide range of financial services to its rural clients over the long term.

The flexibility of initial bilateral donors enabled BASIX to use their subsidized funds for start-up operations. Equity from quasi-commercial and fully commercial sources provided a base for leverage and scale, with commercial borrowings used to manage liquidity and public deposits providing stable, community-based funding. Today, BASIX is comprised of three separate operating companies that together provide 41,000 clients in three states of India with credit. More than 12,000 of these clients use savings and insurance products recently introduced by BASIX.

### Setting the Stage

In recent decades, India has poured enormous resources into microfinance through a variety of state-run initiatives and public-private collaborations. Although many people have received credit, most of these initiatives are dependent on substantial ongoing subsidies, suffer from low repayment rates, and do not respond to client needs. As a result, most will never be sustainable.

In the mid-1990s, Vijay Mahajan and a small group of collaborators sought to create a financial institution that would avoid these problems. BASIX would be a for-profit company with the mission of promoting sustainable livelihoods for rural producers, including women and the poor. From the start, the founders

wanted BASIX to have a broad array of donors and investors to ensure reliable funding for growth. They also wanted a diverse group of investors to build strong governance—blending commercial discipline with social commitment and creativity.

### BASIX Funding Strategy: Donor Aid Lays the Foundation for Commercial Money

The founders of BASIX laid out a funding strategy that started with international development assistance to build the financial base of the company. Funding from international financial institutions such as the International Finance Corporation (IFC) was expected to be the “bridge” between donor assistance and local commercial capital. Although its early funding needs were satisfied by donors, BASIX cultivated a wide array of funders from the outset to establish a track record as a reliable borrower in local and international capital markets.

Ironically, this prudent long-term strategy often complicated and delayed donor funding and increased the MFI’s short-term operating costs. Donors found it hard to work with an institution that operated primarily through regulated, for-profit companies and had to adapt their funding approaches, as described below:

- *Donor grants often could not be accepted by BASIX due to legal or tax considerations either in the donor country or India. Donors had to find alternative financial instruments, such as concessional loans, to avoid “giving” money to BASIX.*
- *Donors were unaccustomed to working with a finance company or limited-powers bank, which caused significant funding delays.*
- *Negotiations involving such diverse institutions were complicated, and funding was delayed in several cases for a year or more.*

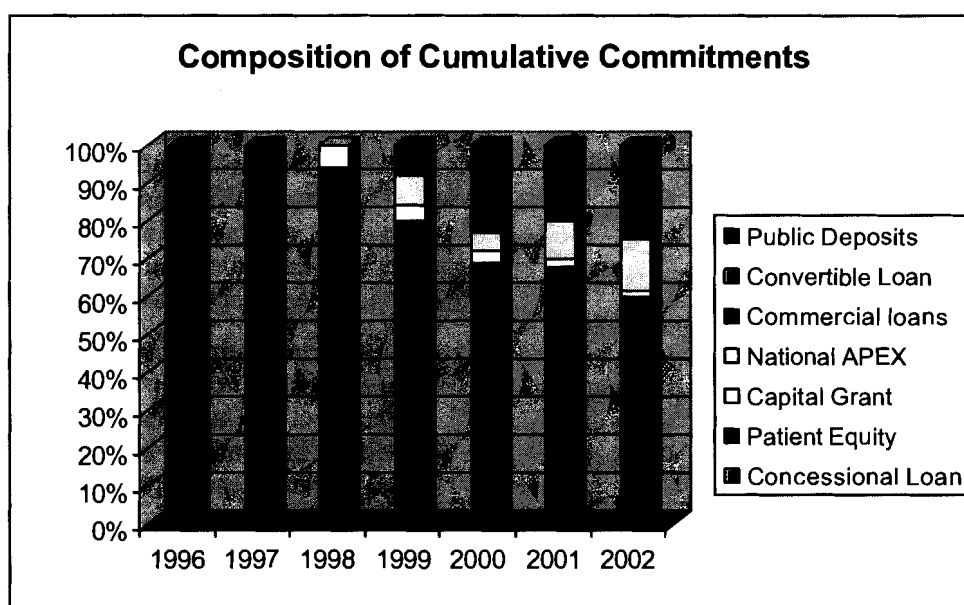
In spite of delays, frustrations, and increased short-term costs, BASIX successfully executed its strategy and accessed most capital market segments (with the exception of local commercial equity), within six years, as seen in Table 1.

**Table 1. BASIX Financial Stakeholders**

| Funder Type                   | Funders                       | Instrument                       | Total Commitment<br>1996-2002<br>(US\$ millions) |
|-------------------------------|-------------------------------|----------------------------------|--|
| Local Philanthropy            | SR Tata Trust                 | Capital grant                    | \$0.43   |
| International Philanthropy    | Ford Foundation               | Program-related investment       | \$2.68   |
| Bilateral Donors              | SDC                           | Concessional loan, capital grant | \$2.35   |
|                               | CIDA/DID                      | Grant/Loan                       | \$0.85   |
| International NGO             | Cordaid                       | Loan                             | \$0.85   |
| Government Apex               | SIDBI                         | Loan                             | \$1.98   |
| Private Development Investors | Shorebank                     | Equity, convertible loan         | \$1.00   |
|                               | Hivos-Triodos                 | Equity                           | \$0.50   |
| Multilateral Investor         | IFC                           | Equity                           | \$1.00   |
| Indian Financial Institutions | GTB, HDFC, ICICI, Canara Bank | Loans, lines of credit           | \$2.83   |
| Other Indian Institutions     | ITC Agrotech                  | Loan                             | \$0.09   |
| Public Deposits               | --                            | Deposits                         | \$0.32   |
| <b>TOTAL</b>                  |                               |                                  | <b>\$14.88</b>                                   |

As shown in Figure 1, concessional loans to BASIX dropped from over 90 percent of total funding in the early years to less than 50 percent in 2002. At the same time, the proportion of Indian funding, mostly commercial, rose to nearly 40 percent. These commercial funds provide BASIX with reliable capital needed for growth.

**Figure 1. Composition of Cumulative Commitments**



## How did Donors Find the Flexibility to Help BASIX Achieve its Goals?

1. **Early donors were prepared to take greater risks.** The Ford Foundation supported the design phase of BASIX. It was fully committed to the vision of a for-profit institution that would attract commercial as well as donor financing. When the time came to finance BASIX's start-up, Ford agreed to assume greater risks than usual in terms of foreign-exchange exposure and lack of guarantees.

*"Ford was supportive of the BASIX goal from the outset: the only way for a self-sustaining entity to reach scale is to attract commercial investors. To some extent, we had to accept a higher level of risk—forgoing guarantees or other kinds of security—to ensure that BASIX could attract those investors. At the same time, we had the flexibility to structure our investment in a way that both accommodated the needs of commercial investors and enabled BASIX staff to retain control of the organization's development mission."*

Frank DeGiovanni, Director, Economic Development, Ford Foundation

2. **Donors tailored their funding to support the clear institutional vision and strategy of BASIX.** CIDA initially wanted to disburse Canadian \$1.35 million to BASIX. The disbursement was, however, delayed by a year as the agency looked for a way to provide loan funds instead of a grant. The delay was frustrating to CIDA and costly to BASIX, but the eventual solution strengthened the BASIX profile as an institution oriented towards the commercial funding market.

*"The transaction was complicated for CIDA, which could not provide loans, only grants, which BASIX could not take. It took at least a year to solve the problem. By creating a fund in one of the BASIX companies, CIDA, Développement International Desjardins, and BASIX were able to ensure proper management of the funds. CIDA... staff recognized that for BASIX, equity and loans were better ways to ensure sustainability."*

Yves Lafond, Advisor to Développement International Desjardins

3. **Donors recognized the value of the BASIX strategy of using a variety of financial instruments simultaneously.** Donors were clear on their individual roles and the distinct roles of other financial stakeholders. SDC, for example, saw its role

as providing "risk capital" as a base for more risk-averse funders.

*"The hypothesis of BASIX—that it IS POSSIBLE to do social banking with sustainable operations—was perceived to be a risky venture, but a challenge that SDC thought was worth supporting. SDC wanted to limit its role to that of a provider of venture capital on which BASIX could leverage further. SDC encouraged BASIX to approach other investors from the commercial sector in the belief that it was indeed important for BASIX to build alliances with the mainstream financial sector and to attract loan and equity from commercial sources."*

Swiss Agency for Development and Cooperation, New Delhi

4. **Different funders took the time to learn about one another's constraints and capabilities.** The IFC signed agreements for its investment in BASIX in November 2000. As the needs of other investors became clear, however, the IFC reopened its discussions with BASIX and ended up signing revised agreements in December 2001. The long discussion about the investment structure resulted in a unified group of financial stakeholders, a US\$3.5 million increase in equity, and three new BASIX board members.

*"The IFC recognized that donor support had carried BASIX through its initial stage, but that more commercial investors and lenders were needed. BASIX needed all these funders to come together to move it along the path to full-fledged private funding. But the diversity of the group added time to the process; the IFC had to reopen issues already negotiated to arrive at a consensus, bearing in mind the views of all the investors."*

Pramada Reddy, Investment Officer, IFC

5. **The success of BASIX in attracting many new and different funders diminished the relative financial importance of its original donors.** The type of support needed from donors now changed. The donors' clear understanding and commitment to BASIX strategy ensured that the funding evolution was smooth. SDC is an excellent example of how donors evolved from grantees to strategic partners.

*"Initially, the dialogue with other funders was in the spirit of openness and transparency with the key parameter being the empowerment of BASIX to take decisions consistent with [its] vision and mission. In the later years, when BASIX accessed loans, grants, and equity from a wider range of national and international sources, SDC was happy that BASIX had acquired the strength on its own to negotiate these deals, independent of its initial promoters. In a way, the BASIX-SDC consultation on strategic matters continued right through, irrespective of funding commitments. The relationship with BASIX, as SDC saw it, evolved from that of a grantee to a dialogue partner."*

Swiss Agency for Development and Cooperation,  
New Delhi

## Benefits to BASIX and its Clients

The diversity of BASIX financial stakeholders has resulted in a stronger institution in several important respects.

- *Financial evolution has been smooth.* The MFI's forward-looking plan to establish a presence and track record in multiple segments of the funding market resulted in a smooth evolution of financing. Each stage—from donor subsidy to commercial debt to patient equity to public deposits—prepared, rather than hampered, the next stage.
- *Clients can rely on a stable institution.* Diverse funding has helped BASIX manage and overcome inevitable delays, surprises, and setbacks, making it an institution that can keep its promises to clients and grow with them in the future.
- *Governance combines different perspectives and expertise.* Some BASIX board members are focused on development outputs, others on financial prudence and operational discipline. The combination enables BASIX to be a strong financial intermediary committed to social goals.

## Conclusion

By December 2002, total BASIX assets exceeded US\$11 million and its after-tax return on assets exceeded 2 percent. The MFI's operating expenses, which comprise 15.4 percent of loans outstanding, were comparable to those of *MicroBanking Bulletin* South Asia group (14.3 percent in November 2002). While BASIX Portfolio-at-Risk performance is not stellar (PAR > 90 days is 8.1 percent), this may reflect the high proportion of agricultural borrowers; write-offs to date are within industry averages.

Perhaps the last word should be given to Vijay Mahajan, whose vision from the outset was to create a diverse and reliable funding base for BASIX.

*"Like in most things, there are pros and cons to having a diverse stakeholder base. To begin and stay with just one or two funders would have constrained both our growth [and] our autonomy. In addition, we wanted to show that institutions lending to the poor are 'investment worthy.' But dealing with this diversity imposes a lot of consensus-building strain on the management team, which is already small and usually over-burdened with getting operations going. In our case, because of our pioneering position in India, we had the additional burden of seeking policy and regulatory changes. Still, I would recommend stakeholder diversity any day to other development finance institutions."*

Vijay Mahajan, Managing Director, BASIX Group of Companies

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## Website

BASIX website: [www.basixindia.com](http://www.basixindia.com)

*Paul DiLeo is currently a BASIX board member. The case is based on interviews with the quoted donors, BASIX staff and references.*