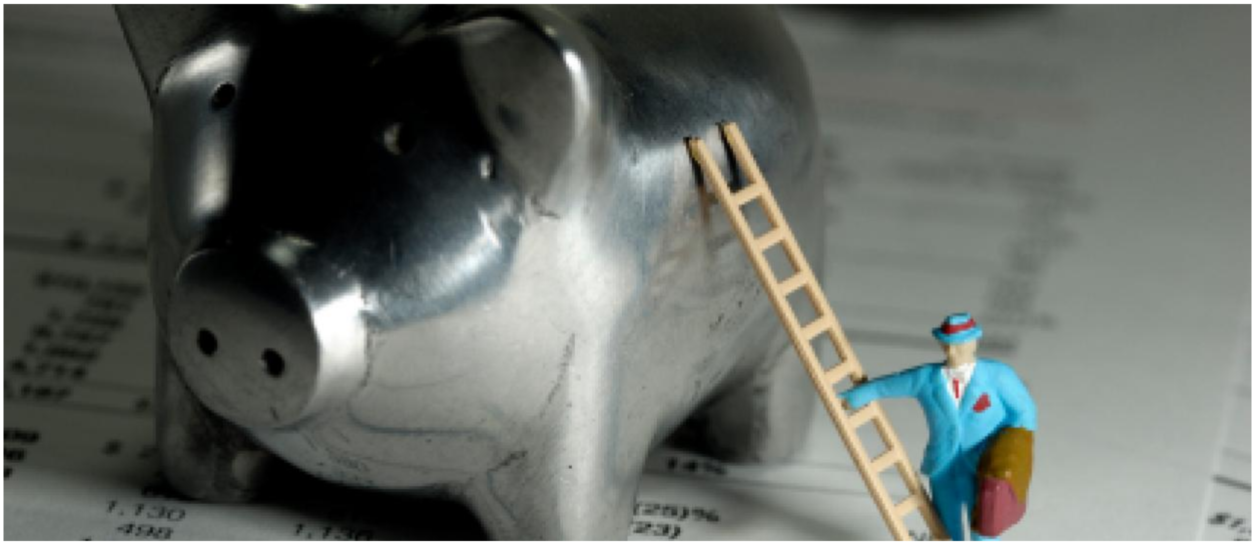
Capitalism: Making Altruism Sustainable



By Amitava Chattopadhyay , INSEAD Professor of Marketing

Those with a genuine interest in helping the poor can apply capitalist principles to understand the needs of the market and provide it with what it needs.

The advent of microfinance has changed the lives of many in developing countries. The provision of microloans to low income borrowers with little or no records or access to formal financial services has pulled millions out of poverty. In rural India, a small loan of a few hundred dollars can enable even the poorest borrowers to become entrepreneurs. Farmers can buy tools to make their work more productive or industrious homemakers can buy sewing machines and start a small textile business, generating more income to pay the loan back and increase their wealth.

Microfinance was popularised by Nobel Prize-winning Bangladeshi economist, Muhammad Yunus, who founded Grameen Bank. Grameen sparked the boom of an industry and while microfinance originally used donations for its lending, the industry had to stand on its own two feet as there simply was not enough charity to keep pace with growth in demand. But the industry only became financially sustainable by charging high interest rates (as high as 35 percent in India).

This isn't as outrageous as the headline interest rates suggest, as the cost of servicing such loans is significant. With uncertain income streams among its borrowers and undefined risks, microfinance institutions collect repayments on a weekly basis and do so at the borrower's door. Add the fact that India's prime lending rate is 7.5 percent and it's not unreasonable for a financial institution there to charge high rates to cover its costs.

Nonetheless, this has led to accusations that microfinance is not helping the poor, and even that it is contributing to more suffering for low income borrowers who get caught up in debt due to uncertainty in their income, especially as not all borrowers are as entrepreneurial as the ones who reach the newspapers.

Altruism at its heart

One microfinance organisation called BASIX, reflected on this and asked itself the hard question: Are we helping or hurting our borrowers? The answer to this question saw the turning point for the company that embarked on an ambitious and altruistic mission to support borrowers beyond credit.

BASIX, as we discuss in **this case study**, was started in 1996 by Vijay Mahajan, who had acquired a passion for rural development while doing his MBA at the Indian Institute of Management in Ahmedabad. He went on to spend a decade working for NGOs and government agencies. His work exposed a shortage of credit to the rural poor but also crucially, an absence of support, such as training, product design, market linkages, market infrastructure and producer organisations.

Before starting BASIX, he travelled to Bank Rakyat in Indonesia, and Grameen Bank and BRAC in Bangladesh to study ways to make microfinance more helpful with training. While at BRAC, for example, he learned that the organisation ran a bull station to improve cattle breeds for farmers on its programmes and microfinance loans, as well as a dairy plant for milk processing and marketing.

By 1997, BASIX had 15 staff and 12 customer service agents. The company experimented with agricultural produce market-yards and large scale non-farm enterprises among others to assist its borrowers. But by 2000, financial services were the core of BASIX's work and in 2002, the company carried out an institutional assessment to understand what it was doing wrong or right. The leadership was dismayed to discover that only 52 percent of its 3-year microcredit customers reported an increase in income, 23 percent reported no change and 25 percent actually reported a decline.

While the main reasons for these figures were clients' unmanaged risk, low productivity in crop cultivation and livestock rearing and an inability to get good prices in markets, it was clear that lending alone was inadequate to get people out of poverty.

The livelihood triad

The study gave Mahajan the impetus to move BASIX towards an integrated, comprehensive approach to the complex livelihood problems of the poor, which he dubbed "the livelihood triad". This comprised of financial services, agricultural and business development services and institutional development services. While all three elements had been within BASIX from the beginning, those outside financial services were not on an equal footing. Now all three elements were equally important in the overall strategy.

BASIX morphed into a livelihood facilitator to solve the problems of its struggling customers. To become useful to less enterprising customers, it decided to start such customers with savings and insurance products before they could borrow microcredit. This would cover risks such as the breadwinner dying or cattle and crop damage due to weather or other externalities.

Besides lending in rural areas, BASIX organised agricultural and business development services into groups, associations, cooperatives or producer companies. Non-financial services piggybacked on existing delivery channels, avoiding extra expenses. And it supplemented its income with action research.

Crucially, BASIX's microfinance arm charged its customers for its agricultural services and its bank, KBS LAB provided technical assistance and support for agriculture and business development. Field staff, who already existed, were able to advise clients. So not all arms of the organisation were profitable, but by creating an ecosystem to help the end-consumer to improve their livelihood, BASIX was able to fulfil its first goal of helping the poor, but secondly, to do so profitably.

Challenged on the ground

BASIX essentially constructed a portfolio of companies by testing and learning along the way but it was difficult to reconcile it with mainstream investors. This was reflected in its challenges with retaining talent and attracting capital. The highly experimental approach to its work had given its staff excellent exposure, which made them appealing to emerging competitors. On the funding side, the diffuse nature of BASIX's work made valuation complex as investors prefer simpler models.

Such organisations often get themselves between a rock and a hard place trying to prove that every part of the operation is profitable, but in the case of BASIX, it has been able to improve the lives of its customers and help them scale with a balanced ecosystem approach. While it charges for its assistance, it does so at reasonable pricing (Rs300 per year for agricultural services such as soil testing and advice on seed) and supports those in difficulty with a different set of products that keep them long-term. While investing to make a social impact takes time, applying capitalist principles is not only possible, but profitable.

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