



Mann Deshi Bank's Cash Credit Product for Micro-Entrepreneurs A Case Study

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CONTACT

Dr. Detlev Holloh

A-2/18, 4th Floor,
Safdarjung Enclave,
New Delhi 110 029 / INDIA

Phone: +91-11-4949 5353
Telefax: +91-11-4949 5393

Email: detlev.holloh@giz.de

HOME PAGE

www.giz.de

RESPONSIBLE

Amit Arora amit.arora@giz.de

AUTHOR

Karuna Krishnaswamy karuna.krishnaswamy@giz.de

EDITOR

Nitin Jindal

ART DIRECTOR

Anshul Sharma

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1. INTRODUCTION

An estimated 30,000 urban and rural weekly markets operate in India¹. They are well-attended by retailers who sell both food and non-food products to consumers. Retailers are either traders who purchase from wholesalers, farmers or producers who grow or make their own stock or a combination of the two. It is a well-known fact that a sizeable number of the retailers finance working capital through debt - either by taking short-term loans from moneylenders or by purchasing stock from wholesalers on credit - at interest rates that range between 1 and 10% per day. A sizeable fraction of their profits goes towards servicing this high cost debt. Moreover, despite being in the trade for many years, most vendors' businesses do not grow in scale in real terms over time.

It is a puzzle why vendors do not use savings or cheaper sources of credit to finance working capital when potential gains to profit can be substantial. Despite the high interest rates they currently pay, and hence the potential business opportunity, neither banks nor other financial service providers have made inroads into servicing this market

in any sizeable numbers.

Supply side credit constraints is not the only answer, since some traders have access to cheaper informal credit such as the thandal² loan in Tamil Nadu, but use it for purposes other than working capital.

In 2013, Mann Deshi Mahila Bank and Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH partnered to design a product to service micro-entrepreneurs in Satara district in rural Maharashtra. Mann Deshi observed that the weekly markets in this region are vibrant with business activity but have scant use of formal financial services. To understand the markets and to inform the product design, a preliminary study was conducted in 2013. The vendors operating in these markets frequently purchased goods on credit from wholesalers who charged daily interest of up to 1.4%. Moreover, credit buyers had less bargaining power than cash buyers and would often be given poor quality goods by the wholesaler. While there was no evidence of moneylender borrowings, the bank staff believes that there are many instances of

1 Planning
Commission of India

2 Moneylender
loan for 100 days
at 70% annual
interest rate



1.4%

is the daily rate of interest the operating vendors pay in these markets frequently to the wholesalers for purchasing goods on credit



informal borrowing at high rates of interest.

The study further suggested that the bank's existing term loan product for Joint Liability Groups would not be suitable for market retailers due to the variability of sales and the risk inherent in trading in perishable goods and that a cash credit product would better suit their cash flows, needs and type of risks faced. Hence, financial diaries were used to collect high frequency data to design a new 'Weekly Market Loan' product. This product was designed to replace high cost debt from the wholesalers with a lower cost option and to help grow the businesses of these credit-constrained entrepreneurs. Further, the project sought to demonstrate that a product custom-designed to suit the variable and daily income streams of low income customers

could offer better client value and be serviced profitably by the bank.

Finally, while the Reserve Bank of India has mandated that Basic Savings and Bank Deposit Accounts should offer a cash credit facility, not many banks have successfully implemented such a facility in a sustainable manner. This project sought to demonstrate a viable model of delivering a cash credit product through individual Business Correspondents.

It has been a year since Mann Deshi launched the weekly market product. This report describes this market segment, the product terms and design principles, and the early experiences in terms of client value and business case.

2. ABOUT THE MARKET

Use of financial diaries to understand customers

In 2013, data on vendors in markets in four towns - Dahiwali, Pilib, Mhaswad and Gondavale - was collected using a short questionnaire, the so-called “financial diary” by Mann Deshi staff. Each town has one big weekly market attended by up to 500 vendors, and smaller daily markets. 134 arbitrarily randomly selected vendors were interviewed every week at the weekly market for a year, giving us 3,689 data points. High frequency of data collection provides us with insights into variations in financial parameters over the course of a year that a single cross-sectional survey would fail to capture.

Approximately 28% (Table 1) of the vendors interviewed reported selling at one weekly market only, 34% at 2 - 3, 26% at 4 - 5 while 11% sold at 6 - 7 different big markets regularly.

The vendors were of three types: retailers who had a permanent shop in the market, vis-

Table 1: No. of markets of operation

| No. of weekly markets | Percentage of vendors (%) |
|-----------------------|---------------------------|
| 1 | 28 |
| 2 or 3 | 34 |
| 4 or 5 | 26 |
| 6 or 7 | 11 |

iting traders from neighbouring villages who rented a designated spot and bought from the wholesaler in small quantities to re-sell, and farmers that sell their own produce. 77% of the vendors sold vegetables or fruits, 8% sweets and the remainder food, spices, confectionary, clothing or other items.

Their monthly individual incomes ranged from INR 1,000 to INR 14,000 for an average of INR 4,600, while their household incomes ranged from INR 3,000 to INR 47,000 for an



average of INR 15,000, placing them in the lower middle-class bracket. They were almost all married women between the ages of 23 and 65. Sixty percent of the respondents had landholdings of an average size of 2.2 acres. About half of them owned a mobile phone

and used it for business purposes. Eighty-five percent had a bank account although only 30% used the account more than once a month. Thirty-six percent reported borrowing from informal sources.

Understanding vendors

Current working capital needs are modest but vary considerably

Table 2 provides us a sense for the vendors' working capital needs. It presents the average total stock purchased in a day for each of the 134 vendors over a year. The average worth of stock bought per day was INR 5,050. Half of the vendors had INR 2,500 of stock or less; 43% were in the INR 2,500 to 10,000 range; with a few larger businesses in the INR 10,000 to 58,000 range.

The above averages conceal the variation over the season. An illustrative example is the median vendor, Sakhubai Katre, who operates in three markets. Her average cost of stock per day is INR 2,500, but over the season it varies considerably from INR 1,000 to 5,000 (Figure 1). As a rule of thumb, peak stock in a year was twice the average stock size.

FIGURE 1: STOCK VARIATION OVER THE SEASON - MEDIAN VENDOR

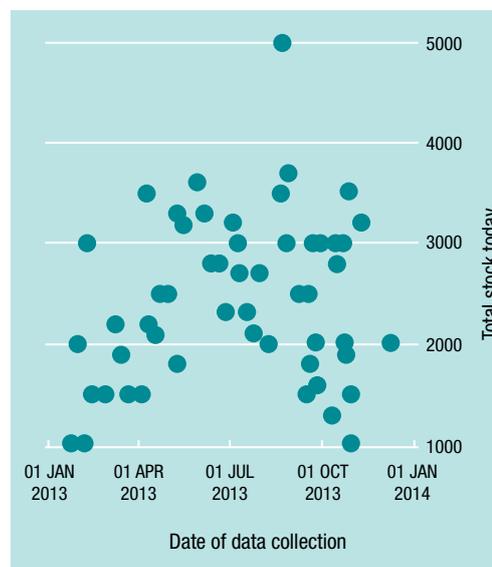


Table 2: Stock per day

| Amount of stock at cost price | No. of vendors | % | Cumulative % |
|-------------------------------|----------------|-----|--------------|
| < INR 1000 | 12 | 9% | 9% |
| INR 1000 – 1500 | 24 | 18% | 27% |
| INR 1500 – 2000 | 18 | 13% | 40% |
| INR 2000 – 2500 | 11 | 8% | 49% |
| INR 2500 – 3000 | 13 | 10% | 58% |
| INR 3000 - 4000 | 15 | 11% | 69% |
| INR 4000 - 5000 | 13 | 10% | 79% |
| INR 5000 - 10000 | 17 | 13% | 92% |
| INR 10000 - 58000 | 11 | 8% | 100% |

Credit purchases are common but not continuous

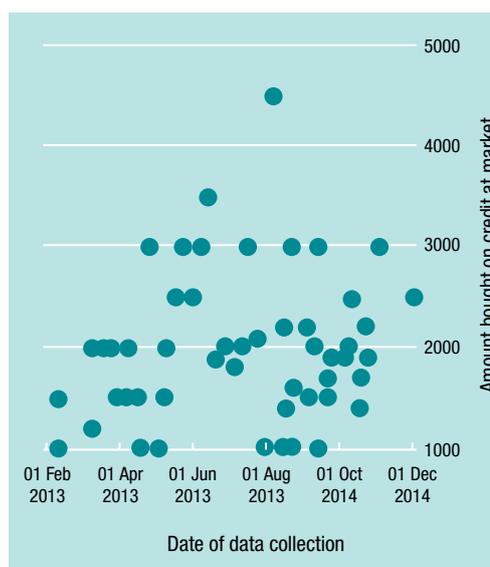
Purchasing on credit was a common phenomenon. Ninety-one percent of all respondents had bought on credit at least once from the wholesaler. However, only on 46% of the market days these vendors purchased some amount of their stock on credit while on the remaining days they used cash. This may be because they did not need fresh stock, used cash or may have purchased stock at another market.

Close to half of the credit borrowers bought their entire day's goods on credit while the other half bought a small fraction (less than 10% of their daily total purchase) on credit. On average, 33% of goods were bought on credit (by those with the credit habit). The amounts are small. On average, vendors spent INR 2,720 in buying at the market out of which stock worth INR 2,150 was bought on credit and worth INR 575 by cash. Credit purchases ranged from INR 30 to INR 25,000 over the year in the total sample. Fifty-seven percent of the market days had zero credit purchase, 29% with credit purchase of less than INR 2,000 and 14% over INR 4,000.

Table 3 presents the frequency distribution of the average amount borrowed by a person over the season for the 122 borrowers in our sample. About a third were in the less than INR 1,000; INR 1,000 to 2,000; and in the INR 2,000 – 9,000 brackets each. These are modest amounts. Very few borrowed more than INR 10,000.

However, this does not present the variation in credit needs over the season. Figure 4 below presents the amount purchased on credit by the median borrower. Credit taken varies considerably over time from zero to INR 3,500 for an average of INR 970. Peak requirements are about three times the average.

FIGURE 2: AMOUNT PURCHASED ON CREDIT PER DAY



Wholesalers charge up to 1.4% interest per day for credit purchases. As a rough estimate, an average vendor spent INR 22 per day on servicing interest or about INR 450 per month, roughly 10% of their monthly personal income. This figure does not include high interest borrowing from other informal sources.

Risk in sales and liquidity

There is a large variance in sales, unsold stock and closing cash balance from week to week and hence in liquidity constraints, profits and thereby potential ability to repay.

Table 3: Credit purchases

| Amount | Number | % | Cumulative % |
|-----------------|--------|-----|--------------|
| < INR 1000 | 38 | 31% | 31% |
| INR 1000 – 2000 | 40 | 33% | 64% |
| INR 2000 – 4000 | 27 | 22% | 86% |
| INR 4000 – 9000 | 14 | 11% | 98% |
| > INR 10000 | 3 | 2% | 100% |



Table 4: Sales & Closing Cash Distribution

| Amount | Break-up of sales per day (%) | Break-up of closing cash (%) |
|-----------------|-------------------------------|------------------------------|
| < INR 2000 | 8% | 45% |
| INR 2000 - 2500 | 25% | 16% |
| INR 2500 - 3000 | 36% | 5% |
| INR 3000 - 4000 | 24% | 11% |
| > INR 4000 | 7% | 23% |

The following figures show the variations in closing cash and average percentage of unsold stock of the median vendor over time. Her average sales per day is INR 2,860 ranging from INR 1,000 to INR 5,500. In other words peak sales are double the average figure. Closing balance of the median vendor is on average, INR 2,400 ranging from INR 880 to INR 5,500 (Figure 3). The variation in the percentage of unsold stock is high (Figure 4).

These variables vary substantially for a given person over time as well for aggregated averages for the entire sample. We conclude that

- The sales lifecycle from purchase to sales may only last a week but the need for working capital is perpetual.
- The vendors' working capital amounts are not fixed but vary over time in an unpredictable manner. While the average total stock

per day is valued at INR 5,000, it varies from INR 0 to INR 100,000.

- Their sales and profits vary dramatically over time. They have good days and bad.
- They sometimes lose their capital partly due to the perishable nature of their goods. They will need time to recover this amount from their high profit days.
- Simple average over time or a one-time cross-sectional survey data collection will provide a misleading picture of their financial needs.

This is a lucrative business

Precise profit figures are difficult to obtain. However, at an aggregated level we find that the profit margins are high. The average stock

FIGURE 3: VARIATION OF CLOSING CASH AT END OF DAY

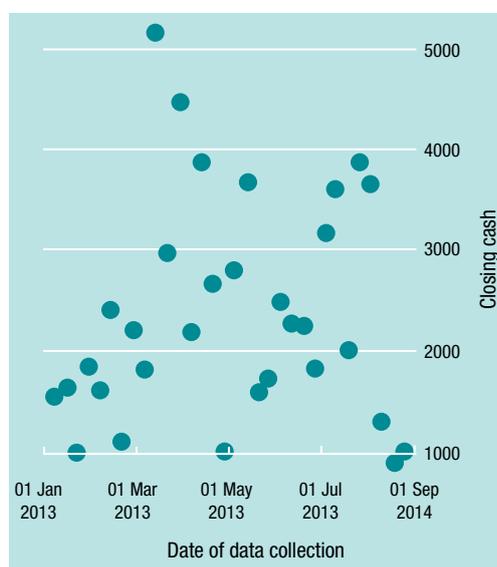
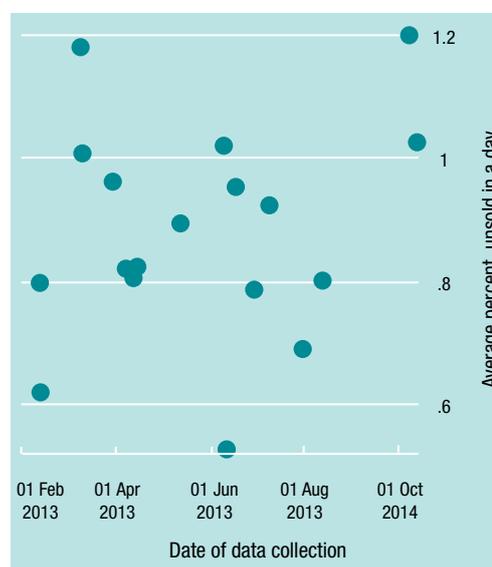


FIGURE 4: VARIATION OF PERCENT OF STOCK UNSOLD IN A DAY



bought on a given day at cost price is worth INR 2,200 while the average sales per day is INR 2,850. The average profit margins per day is 30%. This however factors in the risks, variable nature of the business and low volumes.

Borrowers are a little different from non-borrowers

Out of 134 respondents, 122 had the habit of borrowing while 12 had never borrowed from the wholesaler. Though the sample size is small, we make two observations. Although the average stock size of borrowers is INR 5,000 compared to INR 7,500 of cash customers, their total sales per day is identical at INR 2,800. This may be because the profit margins of the goods sold by borrowers are

higher than that of others, reflecting higher risk in their business and perhaps because they sell more of their stock (89%) within a day compared to others (69%).

There is a statistically significant correlation between total sales and the amount of spending on discretionary personal expenses (not stock) per day at the market among credit buyers while this correlation does not exist among non-credit buyers suggesting that borrowers may intrinsically have a lesser propensity to save or a higher propensity for discretionary expenses.

We did not find statistically significant correlation between amount bought on credit and the amount of unsold stock or amount of closing cash balance from the previous day.



3. THE PRODUCT

Based on the characteristics of the clients studied, Mann Deshi launched a cash credit product for the sellers at the weekly markets in the towns that it operates in. The salient features of the product are presented in Table 6.

Observations

- In addition to the eligibility criteria, the Field Service Assistants (FSAs) observe potential loan applicants in the market for a period of time and make enquiries about them at the market.
- Drawing power is increased progressively based on the regularity of repayment of interest and principal. However, it is not based on the scale, profitability or risks of the business, nor is it mandated for use of expansion of business. After piloting for several months, the original drawing limit of INR 5,000 has now been permanently increased to INR 10,000. Loan sanction is for a period of three years so that no fresh sanctions need to be given every time drawing power is raised.
- It remains to be seen how much the upfront fees of INR 938 acts as a retardant to take-up.

- Interest repayment on the outstanding amount is required to be paid every week. In case the client is absent or is unable to make the payment, it is to be paid by the guarantors. The borrowers are additionally encouraged to repay at least 10% of the loan amount every month, by repaying some principal amount weekly. However, this has practically encouraged customers to treat the product as a term loan whereas the ideal repayment pattern would be to deposit when the trader makes higher profits and withdraw more when her surplus is lower.

Sales cycle

Origination

While launching the product in a new market, FSAs observe the market and the vendors closely over a period of time. They then approach and offer loans to vendors who run business at the market regularly. Once the first set of loans are made, other vendors in the market approach the FSAs for loans after coming to know about it through word of mouth.

The FSA gathers clients in groups of three

| Features | Details |
|--|---|
| Eligibility Criteria | <ul style="list-style-type: none"> - Age between 21 and 59 years - Females only - Has a business in the weekly market where the loan is to be taken - Has been coming to the market regularly for the past three months - Business is not seasonal but conducted throughout the year |
| Guarantor/Joint Liability Group (JLG) | Two guarantors with a business in the same market as the client are required. Each member guarantees at least the interest component of the loan of the other two members. |
| Required Documents | Photo ID (Voter ID, Aadhaar card, PAN Card, Bank Pass Book) Address Proof (Voter ID, Aadhaar card, Bank Pass Book, Electricity Bill, House Tax Receipt) Relationship Proof (Ration Card) |
| Credit Limit | INR 10,000 initially, increased to INR 20,000 upon regular repayment |
| Loan tenor | Three years |
| Interest Rate | 24% per annum on reducing balance computed every week (0.47%) on outstanding amount |
| Processing Fees | INR 100 per quarter |
| Other mandatory upfront Charges | Refundable <ul style="list-style-type: none"> - Contribution to Share Capital: INR 500 - Savings A/c minimum balance: INR 100 |
| | Non-refundable <ul style="list-style-type: none"> - Share Registration: INR 50 - Nominal Shares: INR 100 - Insurance Premium: INR 188 Total <ul style="list-style-type: none"> - INR 938 |
| Repayment terms | Required payment: Accrued interest every week Recommended repayment: At least 10% of loan amount |
| Location | Collection of documents, disbursement, repayments and withdrawals take place largely in the weekly market that has been pre-decided. Client also has the option to withdraw or deposit at the bank during working hours. |

(as guarantors), collects their details and explains the product terms to them.

After inspection, the file is sent to the Branch Loan Committee (BLC) for approval.

Loan approval

- If the group fulfils the criteria and understands the product terms, the application is filed. A branch official makes a visit for verification.

- If the loan is sanctioned, the group is called for loan agreement documentation. Disbursement takes place in the pre-decided weekly market where the loan application was generated and in which all the three guarantors operate.



1.4%

is the daily rate of interest the operating vendors pay in these markets frequently to the wholesalers for purchasing goods on credit



Transactions

Clients can make transactions either with the designated FSA at one market or at the bank on any working day during working hours. Currently collections and withdrawals are authenticated by fingerprint using an off-line Point of Sale (PoS) device. Transaction details are recorded as well in the client's passbook.

Repayments and fresh drawings take place largely in the same market where the loan was originated. Once the Core Banking System is enabled, the bank will allow transactions with any FSA in any market that Mann Deshi operates in, enabling multiple transaction locations for the clients who operate in multiple markets.

Distribution

Mann Deshi services the weekly market product through individual Business Correspondents also called FSAs. FSAs were previously Mann Deshi's full time salaried staff working on other credit products, but in this new position, work purely on commissions. The commission rate is 20% of the interest revenue that they bring to the bank based on the outstanding loan balance.

Each FSA is assigned three to four weekly markets and is expected to handle 150 to 250 clients in all. Each branch has four to five FSAs supervised by a Loan Officer. Loan Officers are supervised and monitored by one Head Office staff.

4. CURRENT OUTREACH AND BUSINESS CASE

As on July 2014, the product had 213 clients, with total loan outstanding amount of INR 2.6 million serviced by six FSAs covering seventeen markets. The target for 2014-15 is 1,200 loan clients from 12 weekly markets in Satara district, tripling to 3,000 clients by March 2016. These numbers are projected based on targeting a maximum of 10-15% of the 300-500 vendors in each market. This ceiling is due to the bank's mandate of only lending to women and more significantly to mitigate the repayment risk associated with lending to too many clients in the same market.

While it is still early days, the conditions for viability of the product are sound. Mann Deshi faces no competition in these markets. Bank staff report that there no other formal lenders or moneylenders attempting to lend at the market. The vendors' business activity is visible, being long term vendors and easily verified. Repayments can be collected immediately after their earnings for the day before it dissipates. Further, economies of density is high with 500 potential customers in a small market area. Finally, the current rates of interest that customers are paying is adequately high for Mann Deshi to provide a viable substitute.

We present below, business projections for sustainability. The key elements of the business case are presented in Table 7. The sources of revenue are

- Interest income on the amount outstanding. Eighty percent of the 2% per month interest rate is kept by the bank.

- Fee income

The sources of costs are

- Staff wages

- Commission to the BC (20% of the 2% interest income)

- PoS device and maintenance

- Cost of funds

We ignore product design, and other shared head office, management and branch costs such as rent and power in this analysis since these shared costs may be allocated to other cost centers.



Table 6: : Cost assumptions

| Assumptions and projections | |
|---|------------|
| Average loan outstanding per client per month (INR) | 10,000 |
| No. of clients an FSA can handle | -150 - 250 |
| No. of FSAs per Loan Officer | 5 |
| Revenues | |
| Interest rate per annum | 24% |
| Interest rate per month | 2% |
| Share of interest income kept by bank | 80% |
| Costs | |
| Commission paid to FSA on interest collected | 20% |
| Salary of Loan Officer per month (INR) | 8,000 |
| Salary of Head Office staff per month (INR) | 10,000 |
| Cost of GPRS enabled POS machine (INR) | 12,000 |
| Cost of CBS enabled POS machine (INR) | 25,000 |
| Cost of funds (savings interest per annum) | 5% |

Table 5: Table 7: Profit projections – at loan outstanding amount of INR 10,000

| | | | | | | |
|-----------|--------------------------------------|----------------|----------------|----------------|--------------|--|
| 1 | No. of clients | 100 | 113 | 150 | 225 | |
| 2 | No. of months to reach | 9 | 11 | 14 | 21 | |
| 3 | Avg. outstanding for the month | 1,000,000 | 1,130,000 | 1,500,000 | 2,250,000 | |
| 4 | Interest earned for the month | 20,000 | 22,600 | 30,000 | 45,000 | |
| 5 | No. of FSAs | 1 | 1 | 1 | 1 | |
| 6 | Commission paid to FSA | 4,000 | 4,520 | 6,000 | 9,000 | |
| 7 | Commission per FSA | 4,000 | 4,520 | 6,000 | 9,000 | |
| 8 | No. of Loan Officers | 1 | 1 | 1 | 1 | |
| 9 | Monthly salary per Loan Officer | 8,000 | 8,000 | 8,000 | 8,000 | |
| 10 | No. of Head Office staff | 1 | 1 | 1 | 1 | |
| 11 | Monthly salary per Head Office Staff | 10,000 | 10,000 | 10,000 | 10,000 | |
| 12 | Cost of technology (over 2 years) | 1,042 | 1,042 | 1,042 | 1,042 | |
| 13 | Cost of funds | 4,167 | 4,708 | 6,250 | 9,375 | |
| 14 | Bad loans (1% per year) | 833 | 942 | 1,250 | 1,875 | |
| 15 | Profit/Loss for the month | (8,042) | (6,612) | (2,542) | 5,708 | |

Table 8 presents projections based on the number of client acquisitions per month, expenses and income. We project INR 10,000 (50% of the highest loan principal of INR 20,000) as the average amount outstanding although the market demands higher. The number of customers assumed per FSA is 250.

As the last row in Table 8 indicates, the operating cash flows turn positive after the first year for the bank. The project breaks even after a year and a half. At the end of year two, the bank makes surpluses of about INR 150,000 per month.

The income to the FSA (Row 6) starts at INR 4,000 per month. FSAs made INR 4,000 per month formerly as full time staff. However from year two, the figure rises to INR 4,500 – 6,000 and finally to INR 8,000 in year three which is the target aimed for by Mann Deshi to incentivize them.



| | | | | | | | |
|--|--------------|---------------|---------------|----------------|----------------|----------------|----------------|
| | 250 | 500 | 1,000 | 1,500 | 2,000 | 3,000 | 5,000 |
| | 23 | 23 | 23 | 28 | 27 | 28 | 27 |
| | 2,500,000 | 5,000,000 | 10,000,000 | 15,000,000 | 20,000,000 | 30,000,000 | 50,000,000 |
| | 50,000 | 100,000 | 200,000 | 300,000 | 400,000 | 600,000 | 1,000,000 |
| | 1 | 2 | 4 | 5 | 7 | 10 | 17 |
| | 10,000 | 20,000 | 40,000 | 60,000 | 80,000 | 120,000 | 200,000 |
| | 10,000 | 10,000 | 10,000 | 12,000 | 11,429 | 12,000 | 11,765 |
| | 1 | 1 | 1 | 1 | 2 | 2 | 4 |
| | 8,000 | 8,000 | 8,000 | 8,000 | 16,000 | 16,000 | 32,000 |
| | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 | 10,000 |
| | 1,042 | 2,083 | 4,167 | 5,208 | 7,292 | 10,417 | 17,708 |
| | 10,417 | 20,833 | 41,667 | 62,500 | 83,333 | 125,000 | 208,333 |
| | 2,083 | 4,167 | 8,333 | 12,500 | 16,667 | 25,000 | 41,667 |
| | 8,458 | 34,917 | 87,833 | 141,792 | 186,708 | 293,583 | 490,292 |



5. CLIENT IMPACT

The early evidence of client value is promising. This product appears to be impactful to this segment of credit-constrained micro-entrepreneurs. We summarize observations below from a preliminary study, using structured interviews with twenty customers in the Mhaswad weekly market.

The majority of the clients interviewed were traders in vegetables and fruits who purchased from the wholesaler while a few were farmers selling own produce. They were all married women mostly in their forties. They had been in this business for 3 to 35 years, averaging over a decade.

Their scale of business based on the size of opening stock ranged from INR 250 to INR 4,000 on a low day of the week to INR 1,400 to INR 11,000 on a high business day. Similarly, on a low day, total sales ranged from INR 400 – INR 5,000, while on a high day sales it ranged from INR 1,900 to INR 14,000. We estimate that profits range from INR 0 to 1,000 on a low day range to between INR 500 and INR 3,000 on a high day.

All the respondents previously used to purchase from the wholesaler on credit at a premium price (compared to paying by cash)

which was equivalent to an effective interest rate of 1.4% per day of the value of the goods. A few had outstanding moneylender loans taken for various other purposes.

Comparison of product terms

Table 9 below compares the potential reduction in interest payment for a customer switching to the Weekly Market Product from buying on credit from the wholesaler. We assume credit needs for working capital of INR 2,500 per day. Because of the lower interest rate of this product, the potential saving of debt interest paid is INR 800 per month.

Early promise of substituting customers out of lifelong borrowing habits

Almost all the respondents previously always bought their goods on credit from the wholesaler. Half the clients reported completely

Table 6: : Cost assumptions

| | Credit purchaser from wholesaler | Mann Deshi Loan |
|--------------------------------------|----------------------------------|-----------------|
| Working capital | 2,500 | 2,500 |
| Interest rate per day | 1.4% | 0.08% |
| Interest paid per day (INR) | 35 | 2 |
| Other fees (INR) | | 438 |
| Effective interest rate per day | 1.4% | 0.1% |
| Effective interest rate per year | 420% | 40% |
| Profit margins of vendor | 20% | 20% |
| Profits per day (INR) | 500 | 500 |
| Ratio of interest paid to revenue | 7.0% | 0.7% |
| Total interest paid in a month (INR) | 875 | 83 |

stopping buying goods on credit from the wholesaler after taking the loan. The remaining clients still bought goods on credit but most reported that the number of days per week or the amount of credit purchase from the wholesaler decreased after taking the loan. Only one client reported that credit purchase from the wholesaler remained the same even after availing of the loan. Of those who mentioned a reduction in the amount bought on credit from wholesalers, the amount of reduction was 50%.

This substitution has held for a while. The earliest client in this market had taken the loan in July 2013.

Increase in scale of business and profits

Most of the clients reported an increase in profit of 30 - 100% on availing of the loan. They attributed this to three factors. Firstly, they could now buy more goods at a lower price and better quality and hence their sale increased as did their profits. Secondly, the timeliness of the loan - being pre-approved and serviced at the market - the clients could withdraw whenever they needed to. This becomes especially useful when expanding their offerings to include seasonal and festival-specific fruits and vegetables or even to meet emergencies such as health expenses. The third factor is that the lower interest compared to the outside options has contributed to higher net profits.

Other benefits of purchasing with cash

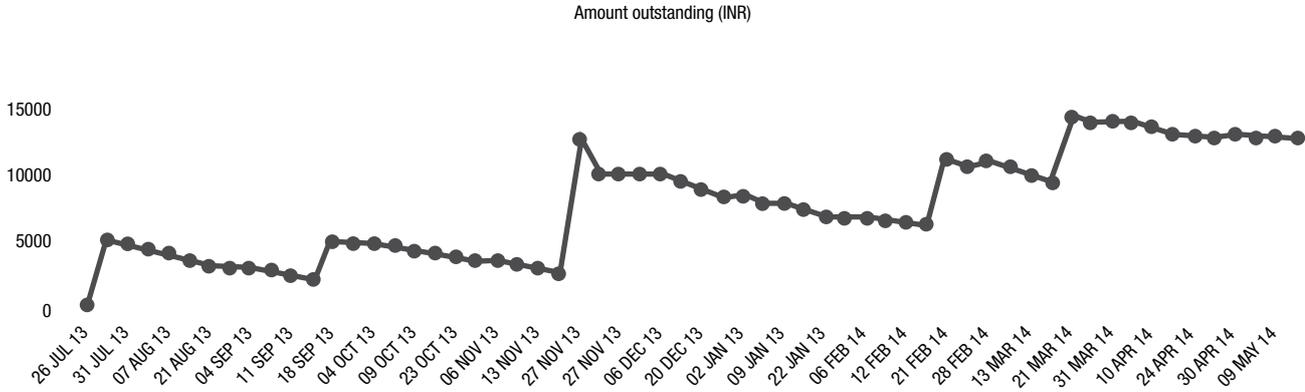
Paying by cash meant that they get more stock for the same price. Moreover, now that they had the option to buy from other wholesalers, their bargaining power was higher, and could shop around and insist on better quality goods. Additionally, some clients started buying high value produce that were available only for sale on cash and not on credit – being high returns but higher risk goods. One or two clients reported paying higher than customary interest rates ranging from INR 50-100 per INR 1,000 borrowed per day to 20% interest rate per day. However, the above was not true in the case of all the clients. Many clients reported that their wholesaler sold on credit without charging any interest, at the same price as cash purchase and offered the same quality. One reported that she still bought on credit because she had higher ability to return unsold vegetables if they turned to be of poor quality if she bought on credit.

Product usage patterns

The loan is allowed to be used for working capital or for other purposes. Ideally, the clients would draw less than the limit for working capital and deposit surpluses from a high sales day at the earliest to prevent it from unwittingly being used for non-productive purposes and to draw again when they face liquidity



FIGURE 5: TYPICAL REPAYMENT PATTERN



constraints. We analyzed the withdrawal and repayment patterns from the bank's transactions database of 70 clients and made the following observations:

- a) Customers seek larger loan sizes: Customers have tended to repay their first two loan cycles quickly in order to increase drawing power to INR 20,000 and then withdraw the entire amount. Since their working capital needs are modest, it appears that the loan is being used for other purposes as well. This is corroborated by client interviews.
- b) Flexible repayments appears to be desirable: Flexible repayments is one of the benefits of the product since the vendors' income stream is variable. However, only approximately half of the clients had an arbitrary repayment amount each week, suggesting that they were repaying more when they had higher surpluses and less on other days, while the other half repaid a fixed amount ranging between 2 and 10% of the principal every week. This may be a consequence of self-imposed discipline. The amount of weekly repayment was often considerably higher than the recommended amount which is the interest component plus 10% of the principal per month.
- c) Cash credit product features are not being used: In most of the cases, the product was treated as a term loan rather than as a cash credit account. The repayments were made on a weekly basis along with the mandatory interest payment and fresh amount of loan

was taken only on repayment of the full loan amount. Very few were making withdrawals in the middle of the loan tenor. Predominantly, after the drawing power was increased, clients first repaid the existing loan fully and then withdrew the new higher loan amount approved as a lump sum rather than simply withdraw the incremental eligible amount. An undesirable side-effect is that client may have needed to borrow money from somewhere else to pay the outstanding amount. Some clients reported lack of product knowledge as the reason for this.

- d) No signs of repayment issues after a year: There is no trend of instalment sizes decreasing over the course of the loan tenor or of customers only paying interest in later periods nor have there been any missed or delinquent payments thus far (Figure 5). However, in some cases, the repayment of the last few instalments of a cycle appear to be funded by the new loan as the outstanding balance of the previous loan was paid a few days after the fresh loan was taken.

While no repayment issues have surfaced yet, the product, by its very nature, is risky as after paying the first few instalments, if the capital is eroded due to business losses or if the loan has been used for consumption, the client may still keep paying instalments by taking up a new loan based on their drawing power and hence delinquency may not be tracked for a long time. However, while it is still early days, there is no evidence of threat of delinquency or defaults.



6. CONCLUDING THOUGHTS

We find early evidence that this product is appropriate for vendors, a credit-constrained class of micro-entrepreneurs. The business case for the bank to service them profitably looks promising. We make the following concluding observations.

Client education

If we take the view that vendors borrow because of the variability and risk inherent in their business and their inability to save, they would ideally withdraw less than their limit, deposit excess funds immediately into their account on good days and withdraw for bad days. We would see a higher cyclical pattern of deposits and withdrawals which we do not see at all.

While this cash-credit product is ideal for clients to repay at a rate proportional to their cash-flows, many are not using the flexibility of repayment amount and most are not using the feature to withdraw up to their limit at will. Hence, further efforts are needed to help the clients understand the product terms better and to provide them with guidance on an optimal repayment schedule.

Drawing power

Increase in drawing power should be based on the size and type of business or for business expansion rather than solely on the basis of track record of repayment. For instance, this could be based on furnishing business accounts separate from that of the household's.

Repayments

Despite the promising repayment performance thus far, future repayment cannot be taken for granted since loans may be getting ever-greened and since this business comes with high variability of income. With the current repayment patterns, repayment difficulties may arise during bad times, which could be mitigated by better product usage. A one year cycle with a higher loan size will provide us with a better picture.

Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH

GIZ NABARD Rural Financial Institutions Programme

A-2/18, 4th Floor,
Safdarjung Enclave,
New Delhi 110 029
INDIA

Phone: +91-11-4949 5353
Telefax: +91-11-4949 5393

Email: detlev.holloh@giz.de