Voices of India's MSMEs: Insights notes from The Diaries

Supply chains of informal enterprises

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Content

Decoding the supply chains of informal enterprises

Insight 1:

For informal enterprises, the frequency of transactions with suppliers is the major differentiating factor in defining the type of supply chains. Supply chains of IEs can thus be broadly classified into three categories—high frequency, medium frequency, and low frequency.

Most informal enterprises exist below the data radar. Hence, supply chains that interact with informal enterprises present a rare avenue to understand the business environment in which informal enterprises survive and seek to flourish. Understanding the supply chains can provide insights into what informal enterprises need and expect from supply chains, the quantum and quality of information that flows through them, and how supply chains can benefit informal enterprises.

The frequency of interaction of the enterprises with their suppliers helps us understand the supply chains and segment them. The table below summarizes our observations on the three defined categories of supply chains and how they impact informal enterprises:

Which IEs interact with these supply chains

Category 1: High-frequency supply chains

- Mostly retail trading units and those dealing in perishable goods
- Many operate with minimal physical infrastructure
- Most are single-person operated, with no paid workers

- They need to get their supplies daily and intend to sell all their stock on the same day as they lack storage facilities
- Example: vegetable and fruit stalls, fish vendors, tea stalls, roadside eateries, etc.

Category 2: Medium-frequency supply chains

- Mostly small retail and manufacturing IEs
- Operate from a fixed location through established shops
- They need to get the bulk of their supplies and raw materials each week or each month

- They also stock perishable goods, which they get more frequently
- Operated mainly by family members; only a few employ paid workers
- Example: grocery shops, book stalls, etc.

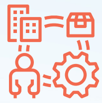
Category 3: Low-frequency supply chains

- Mostly service category of IEs that operate out of a fixed location shop, which reach out to suppliers when they need to replenish their stock
- Operate from a fixed location, established shops; many are home-based businesses

- Mostly single-person operated, higher footfall units employ one to three paid workers
- Example: beauty parlors, salons, photocopy shops, tailors, automobile repair workshops, etc.

Key characteristics of the supply chains

Category 1: High-frequency supply chains



- IEs dominate this category by a large margin over the formal sector
- Category with the highest usage of cash, minimal use of digital solutions, and poor banking habits
- Among the three categories, this category has the lowest understanding of digital platforms

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- Ultra-local base of operations and customers; shops that are part of a larger market setup get more new customers
- Rarely give credit to customers
- Have fixed arrangements with suppliers. Suppliers are either paid daily while buying supplies or have a routine payment system established

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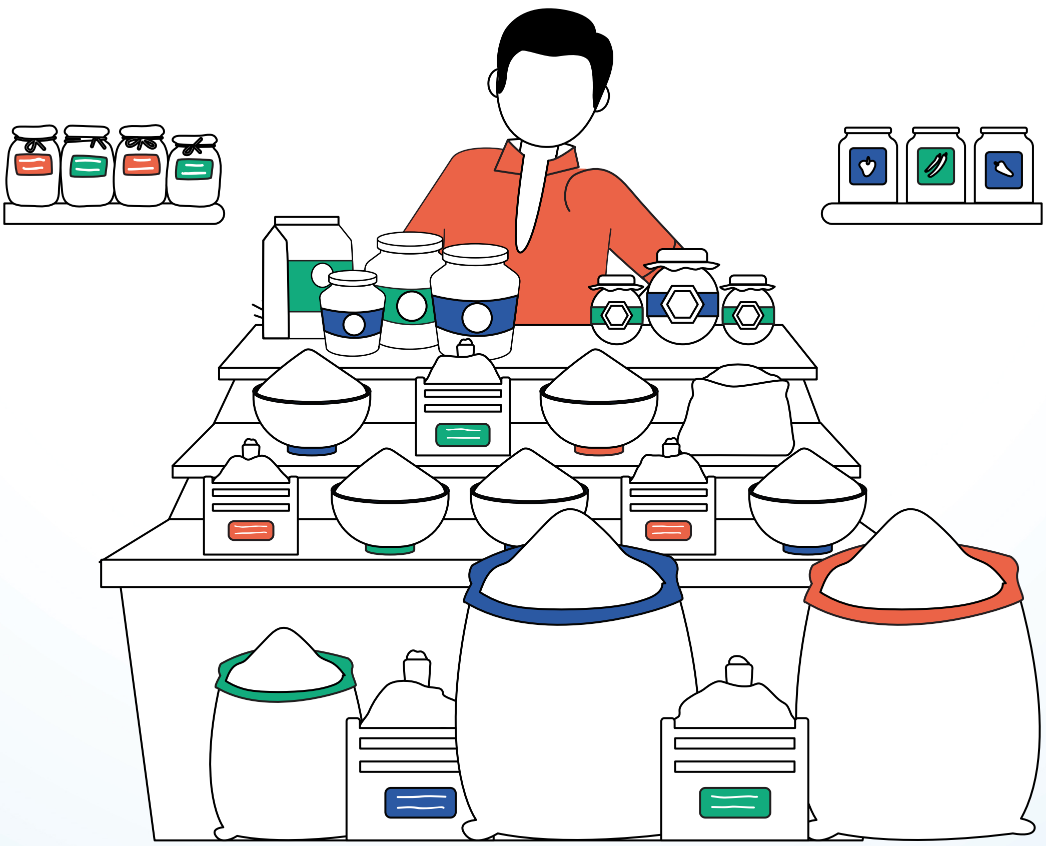
- Generally do not get stock on credit and hence need a steady cash flow to buy supplies
- Choose suppliers based on the quality of supplies, convenience, and timeliness of delivery
- Less prone to change suppliers

- Suppliers and IEs take utmost care to minimize excess stocking and ordering, as supplies are perishable



Key characteristics of the supply chains

Category 2: Medium-frequency supply chains

• Cater to high-footfall businesses with a local business and customer base	• Offer credit to customers	• Most have a loyal base of customers who purchase monthly supplies
• Most accept digital payments	• Generally have a fixed set of suppliers. They change suppliers only if a significantly better option arises	• Credit arrangement varies across suppliers. After COVID-19, most suppliers demand upfront or same-day cash payments from IEs. Even in cases where they give stock on credit to IEs, the credit exposure and repayment period have reduced significantly.
• IEs choose suppliers based on the pricing, their relationship with suppliers, and access to credit	• Moderately prone to change suppliers	• If any perishable goods remain unsold, IEs try to return them to the suppliers. In cases where suppliers refuse, IEs have to bear the cost of total loss on such stock. This facility is also a major consideration for IEs when they choose suppliers.

Category 3: Low-frequency supply chains

• Cater to businesses with moderate to low footfall of customers compared to the other two categories	• The customer base includes local, not-so-local, and many first-time customers	• Generally do not give credit to customers.
• Most do not have fixed suppliers; they explore the market and buy from the suppliers that provide the best deals	• As transactions with the suppliers is limited and can often be planned up in advance, cash-flow is rarely an issue in buying supplies for IEs in this category	• For most IEs that deal with this category of supply chains, prices of products do not vary significantly across suppliers; the quality of the product decides the price which usually is consistent across suppliers

- Generally, choose suppliers based on pricing and the quality of (or warranty provided on) the product; the quality of supplies is the most important consideration for the IEs

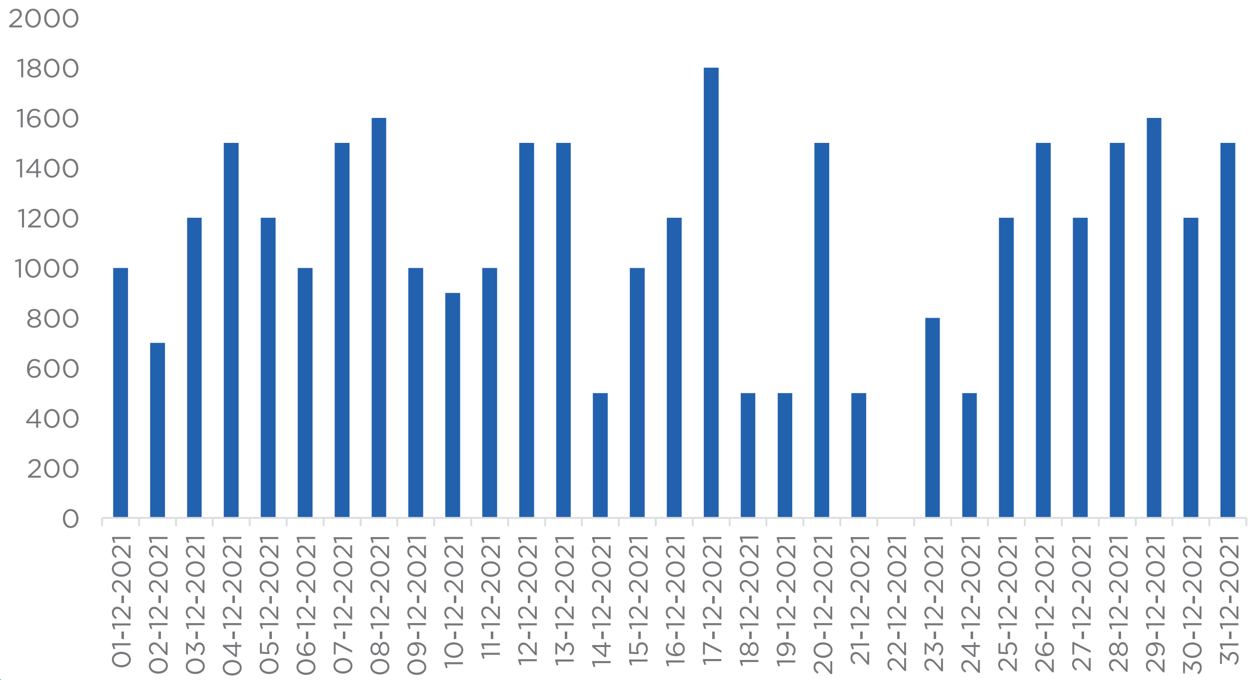
Examples from Diaries research on the informal enterprises in each type of supply chain:

01 **Informal enterprises in category 1 supply chains:** Devender Agarwal, tea shop owner, Lucknow

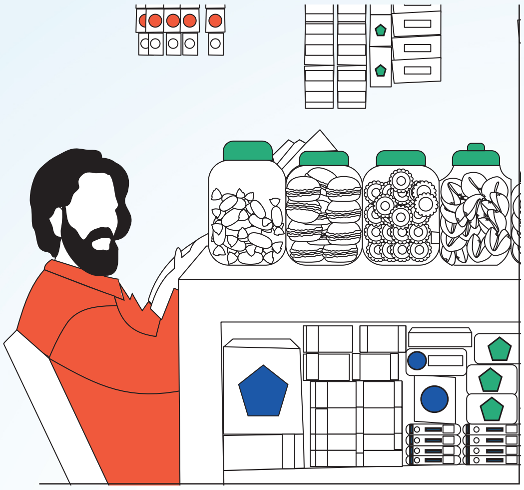
Devender runs a tea shop in a busy neighborhood in Lucknow. The location is close to a bus stand, which gives the advantage of consistently high customer footfall. He gets all his stock at a high frequency, mostly daily or at most, every two days. He has to source his stock from various suppliers. He gets 24 liters of milk every morning, for which he pays in the evening. In case of shortages, he can get more stock from his supplier by placing an order on call. He also buys 15-20 packets of bread daily, 1-2 kg tea, and 3-5 kg sugar every second day. He has to purchase all items in cash, except bread, for which he gets a one-day credit period. He also needs to replenish his LPG cylinder every 3-5 days, for which he pays in cash. This purchase leads to a spike in his expenses every 3-5 days. Graph 1 below, which depicts his December expenses, shows this.

He ensures timely payments to his suppliers as any delay may harm his creditworthiness with the supplier who may refuse to give him supplies on credit. He does not buy in bulk because he neither has the requisite storage facility nor enjoys a bulk discount. He gets a 10% discount from his bread supplier as a regular customer. He gets all these items delivered on call, and all his suppliers deliver promptly on the same day.

Graph 1: Business expenses of Devender Agarwal for December, 2021



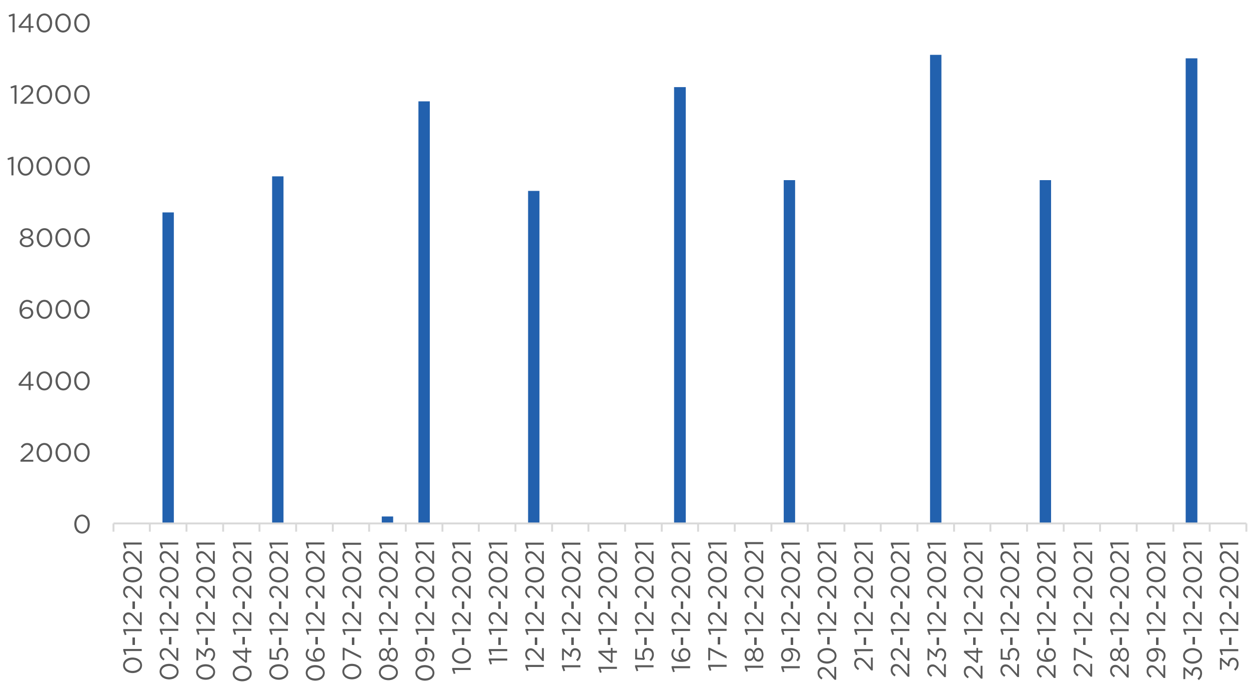
02 **Informal enterprises in category 2 supply chains:** Anand Sharma, grocery shop owner, Panipat



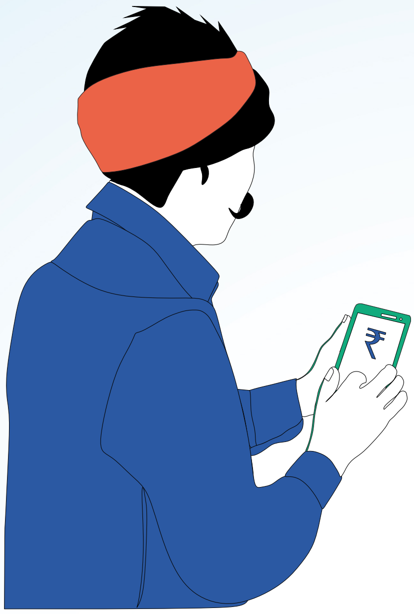
Anand runs a grocery shop in Panipat selling daily necessities like groceries, packaged snacks, cosmetics, toiletries, and cigarettes. He gets his supplies every 10 days, placing him in the second category of supply chains. He has 10 suppliers—four wholesalers for grocery items like flour, pulses, spices, etc., and six others that deliver various packaged items. Except for the bulk grocery items, such as flour, pulses, and spices, he gets all his supplies delivered to his shop without additional cost by the suppliers. For the bulk items, he incurs transportation costs ranging from INR 250 to INR 500, depending on the volume of purchase.

Grocery items contribute to most of his cash outflows (78%), followed by packaged snack items, cigarettes, and cosmetics. He gets two to seven days to pay most of his suppliers. Suppliers offer discounts on some items if a purchase is made in cash. He places his orders over the phone, and most suppliers deliver the requested stock the next day. All his payments to suppliers are in cash, and no digital payments are made or accepted. Graph 2 depicts Anand's business expenses data for December 2021. The sudden drop in business expenses in December 2021 was because of a slack period in the business during which very little stock was purchased by Anand.

Graph 2: Business expenses of Anand Sharma for December, 2021



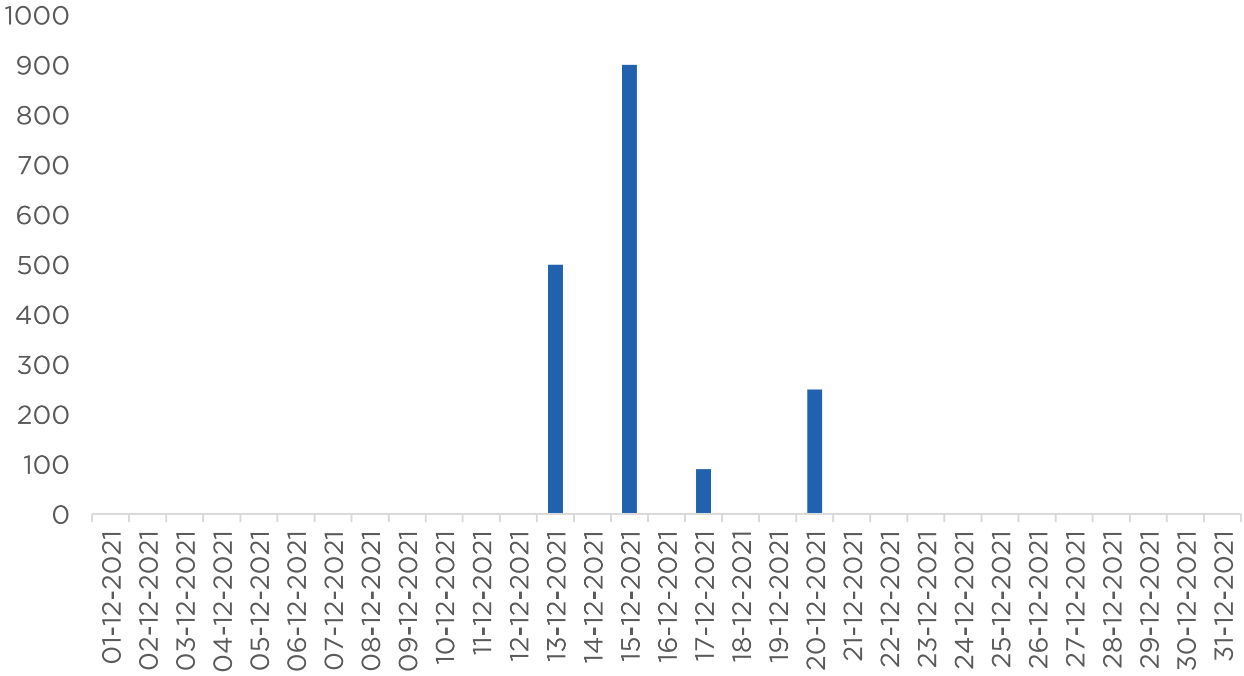
03 **Informal enterprises in category 3 supply chains:** Hari Chaturvedi, manufacturer of home decor items, Delhi NCR



Hari runs a home-based manufacturing unit that produces home-decor items. He manages the forward and backward linkages of the supply chain, whereas his mother and sister look after manufacturing. Hari buys raw materials from the industrial area close by and receives orders from retail shops in nearby markets and Noida, a city close by. He pays 60-70% of his suppliers digitally; the rest do not accept digital payment. His suppliers prefer cash as they lack the skills to operate digital payments owing to old age and their previous experiences of fraud with digital payments.

As most of his sales are B2B (business-to-business), his purchases are also linked with the timing of orders from buyers. He buys additional supplies only after he gets orders from buyers or when he runs out of materials needed in the manufacturing process. He procures his stock with direct upfront payment. The suppliers do not provide a credit period. Graph 3 below depicts Hari's business expenses for December 2021. He needs to buy supplies only thrice in the entire month, which places him in the third category. The spike in expenses is due to his workshop's electricity bill payment.

Graph 3: Business expenses of Hari Chaturvedi for December, 2021



Insight 2:

The supply chains of grocery shops are the most complex and have the maximum scope for intervention.

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I have three suppliers. One is a local wholesale store where I buy supplies in cash; he does not sell items on credit. The other two are representatives of FMCG companies (one local brand and another a national brand). They come to my shop on fixed dates to replenish my stock—one each Monday and Wednesday and the other to replenish my stock each Tuesday and Thursday. They give me printed bills. I pay for both in cash. The national FMCG brand’s representative also accepts digital payment. But I deal in cash with all of them as my customers also pay me in cash.

- Subir, grocery shop owner, Kolkata

Grocery shops deal with various products and must track the inventory for all product types. While they have to constantly look out for new products that earn good margins, they also need to ensure that they are well-stocked with products that are most in-demand with customers so as to maintain customer footfall in their shop. Most grocery shops struggle to optimize the composition and value of their stock to earn the maximum profit while deploying the minimum investment in stock.

Managing multiple suppliers is another important aspect of their supply chain. Grocery shops need to remain vigilant to ensure they get the best deal from their suppliers. While the prices of packed goods remain steady, those of "loose" goods like wheat, pulses, etc., fluctuate frequently. Hence they need to manage multiple suppliers for the same range of goods to ensure optimum margins. They also need to accurately forecast the demand in their shop to decide on the value of the stock they need to keep in the short term. The convenience of access to inventory, that is, whether they get delivery at the shop, is another critical consideration for such informal enterprises when they select suppliers for each product. If they have to travel to get the stock, it has both time and cost implications.

Suppliers of FMCGs goods provide formal, computer-generated invoices, while local goods suppliers provide an on-demand, informal receipt. Suppliers registered as formal enterprises also provide GST invoices (pukka bill or formal bill), but the rest offer a non-GST, informal invoice. However, the informal enterprises have no use for the GST invoices and hence do not demand them from suppliers. Most FMCG goods suppliers accept non-cash payments (digital payments such as UPI or via bank account transfers and cheques). Payments via UPI are the most preferred mode as it is quick, safe, convenient, and most importantly, free. Suppliers that deal in locally manufactured or unbranded goods still prefer cash. The preference of such suppliers for cash is mostly because of two reasons:

a. Monetary

Accepting digital payment leaves a trail and which makes them liable for taxes, which local suppliers want to evade.

b. Convenience

Many suppliers consider digital payments (e.g., UPI) time-consuming. The local suppliers are used to dealing in cash for long periods of time. When they have to entertain multiple retailers during peak business hours, accepting UPI payments becomes cumbersome and takes time. The retailers often crowd around the payment counter (i.e., in front of the QR code). Many also need help with completing the transactions. Suppliers often need to deploy staff to confirm and reconcile the payments received through UPI from different retailers.

Insight 3

The new digital-led distribution model has disrupted the age-old distributor-driven supply chain of grocery shops; retailers' expectations on margins have changed, and this may render many suppliers and wholesalers redundant in the long term

A Reuters report states that India has 450,000 traditional distributors whose salespeople are spread across the country, including 600,000 villages. B2B platforms like Udaan, Reliance JioMart, and Jumbotail enjoy higher margins from FMCG firms and pose a challenge for the traditional distributor network. On average, these B2B platforms earn 15-18% compared to the 3.5-5% margin made by distributors. More retailers now source stock from the B2B platforms because of the discounted prices, which translate to better margins for retailers.

The difference in margins affects the business of distributors, wholesalers, and suppliers. While retailers, including informal grocery shops, get great deals out of this price war, the potential elimination of some supply chain players will disrupt the availability of facilities for informal enterprises, such as access to informal credit for stock purchases. The business ecosystem created by the supply chain players has evolved over a long period to benefit all players involved; dismantling this structure may compel informal enterprises to depend overwhelmingly on a handful of FMCG manufacturers.

What opportunities do service providers have in sight?

While digitization can help informal enterprises perform more efficiently, a more cautious approach is needed to push digitization onto informal enterprises. Khatabook, OKCredit, and Dukaan—all three big players in the KiranaTech industry have closed down their digital storefronts for retail grocery shops due to issues on both demand and supply sides. When the customer-facing side of KiranaTech is failing, the digitization of the supplier side and business management is still just picking up. Digital inventory management platforms like Gofrugal and digital supplier platforms like Reliance JioMart are growing fast.

Players in the informal supply chain comprise suppliers and informal enterprises that deal with non-retail customers. As formal invoices are still limited to large FMCG suppliers, developing a value proposition around invoice discounting can motivate these players toward formalization. FSPs can partner with FMCG players to digitize invoicing and establish a case for financial products like invoice discounting. With the digitization of the invoicing process, supply chain financing can be made accessible for suppliers and wholesalers. Such financing arrangement would best suit informal enterprises under category 2 of supply chains, given their need for supplies at fixed intervals. This would allow these enterprises access to affordable and timely finance and a flow of working capital best suited to the needs of their businesses.

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