MSC
MicroSave Consulting

OMIDYAR NETWORK

VOICES OF INDIA'S MSMEs

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

Access to finance

Edition 3

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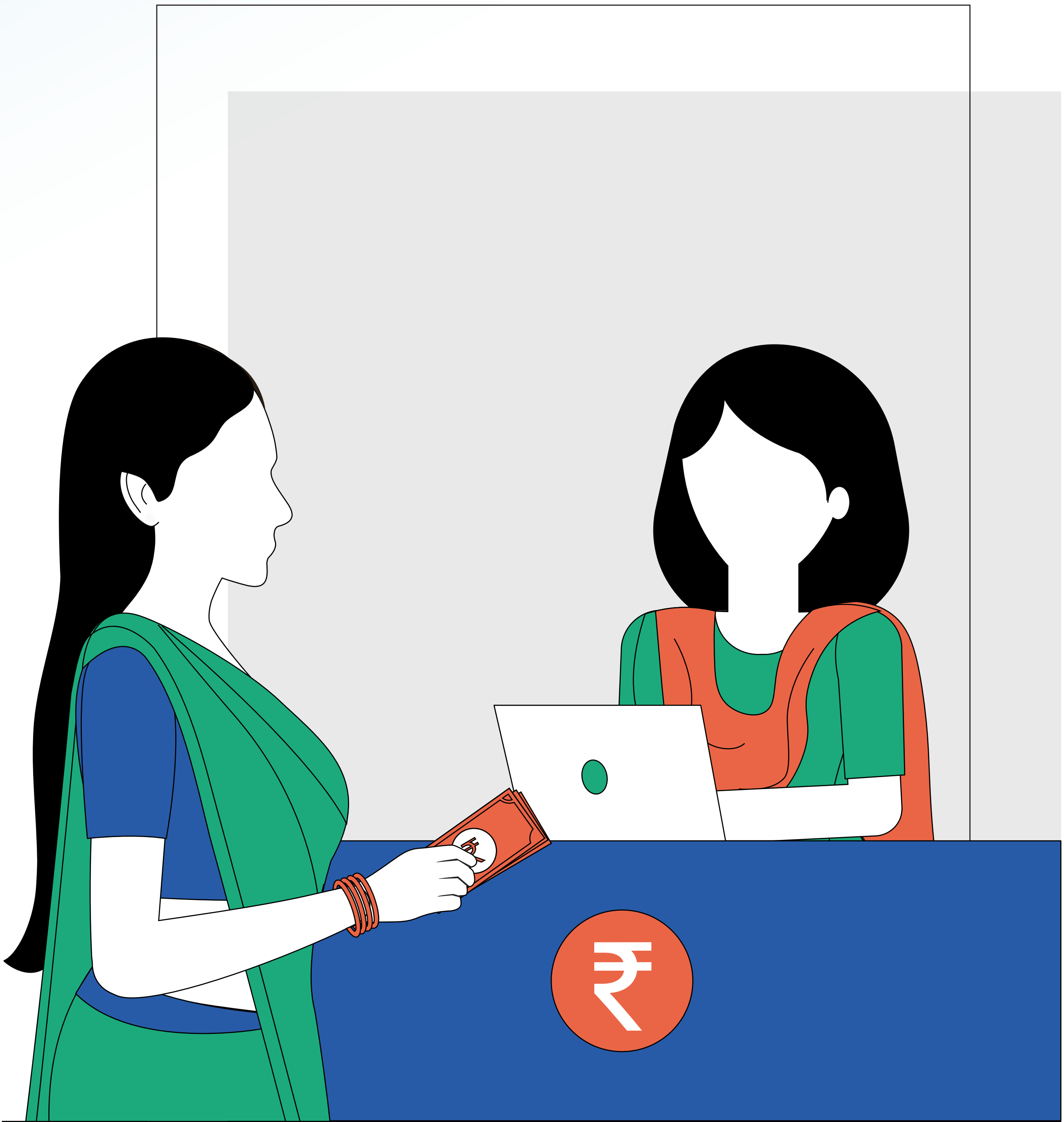

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About Omidyar Network India

Omidyar Network India invests in bold entrepreneurs who help create a meaningful life for every Indian, especially the hundreds of millions of Indians in low-income and lower-middle-income populations, ranging from the poorest among us to the existing middle class. To drive empowerment and social impact at scale, we work with entrepreneurs in the private, non-profit, and public sectors who are tackling India's hardest and most chronic problems. We make equity investments in early-stage enterprises and provide grants to non-profits in the areas of Digital Identity, Education, Emerging Tech, Financial Inclusion, Governance & Citizen Engagement, and Property Rights. Omidyar Network India is part of The Omidyar Group, a diverse collection of companies, organizations, and initiatives, supported by philanthropists Pam and Pierre Omidyar, founder of eBay.
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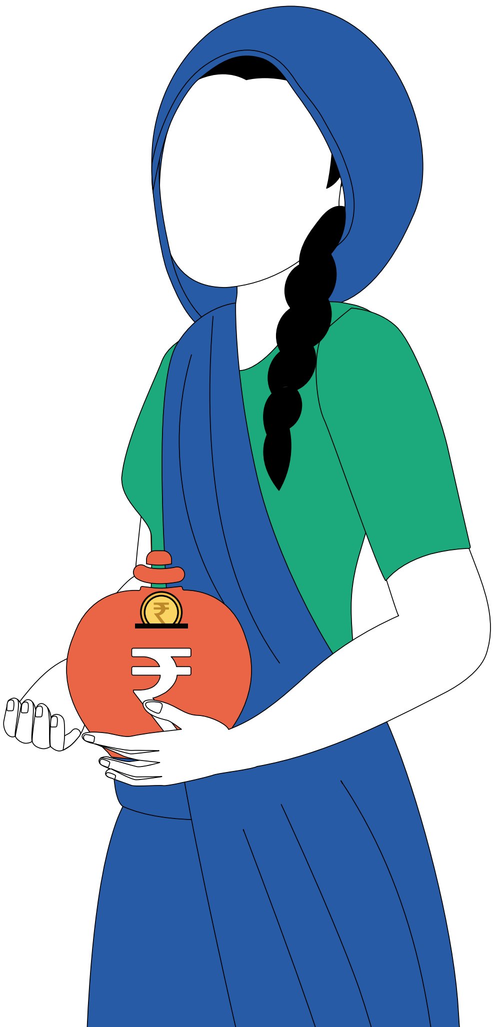


About MSC

MSC (MicroSave Consulting) is a boutique consulting firm that has, for 20 years, pushed the world towards meaningful financial, social, and economic inclusion. With 11 offices around the globe, about 180 staff of different nationalities, and varied expertise, we are proud to be working in over 65 developing countries. We partner with participants in financial services ecosystems to achieve sustainable performance improvements and unlock enduring value. Our clients include governments, donors, private sector corporations, and local businesses. We can help you seize the digital opportunity, address the mass market, and future-proof your operations.
https://www.microsave.net/

How do India's informal enterprise owners save?

Insight 1:

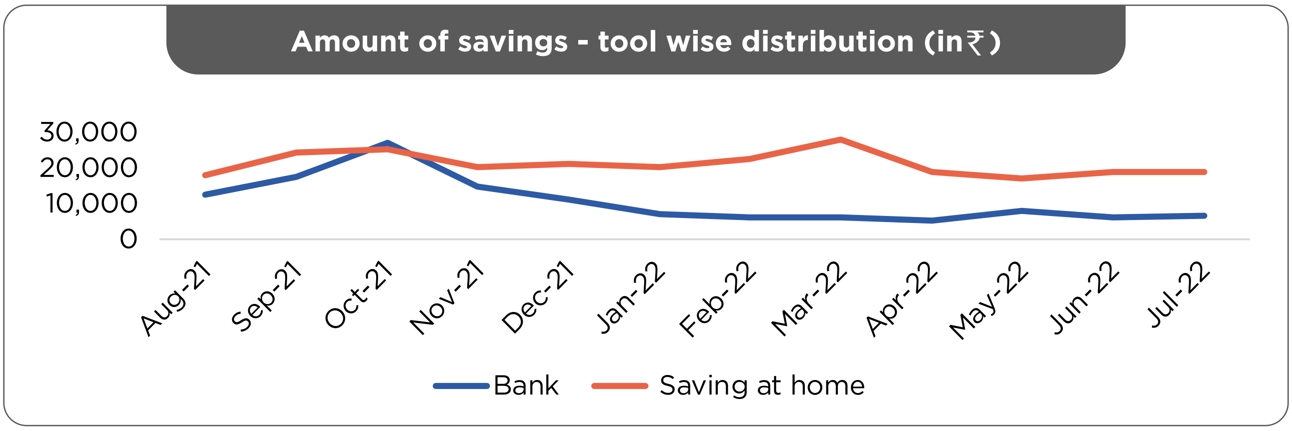
Despite having bank accounts, most IEs prefer to save at home. They start saving in their bank accounts only after the amount they have saved at home reaches a substantial value.

Of our 50 diarists, 94% reported saving in cash at home, while 86% reported using savings accounts to save. None of the diarists used a separate savings account for their business except for one respondent. The usual practice among IEs is to start saving the surplus income in cash at home after they pay off suppliers, wages and salaries, and utility bills, among other expenses. Once they save a substantial amount at home, they deposit the money into their savings bank accounts.

Some enterprise owners also chose frequency over amount as the threshold—among such IEs, most prefer to make deposits monthly. Most IEs perceive the effort and time needed to deposit to their bank account as an avoidable cost, as it requires them to close shop temporarily and wait in queue at the bank. Moreover, most IEs need some cash in hand for regular business expenses and payments. Besides cash and bank accounts, some IEs also save in LIC (Life Insurance Corporation of India) and Indian Post office savings schemes primarily due to the perceived safety and trust in such government-backed instruments.

Graph 1 below attests that IEs save more money at home than at banks. Data across 12 months shows that the amount of savings is always higher at home than at the bank, except in October 2021, which was a high-income month due to the festive season when the surplus exceeded the norm. However, the same behavior was not seen in March 2022, when revenues were again in surplus due to the harvesting season.

Graph 1

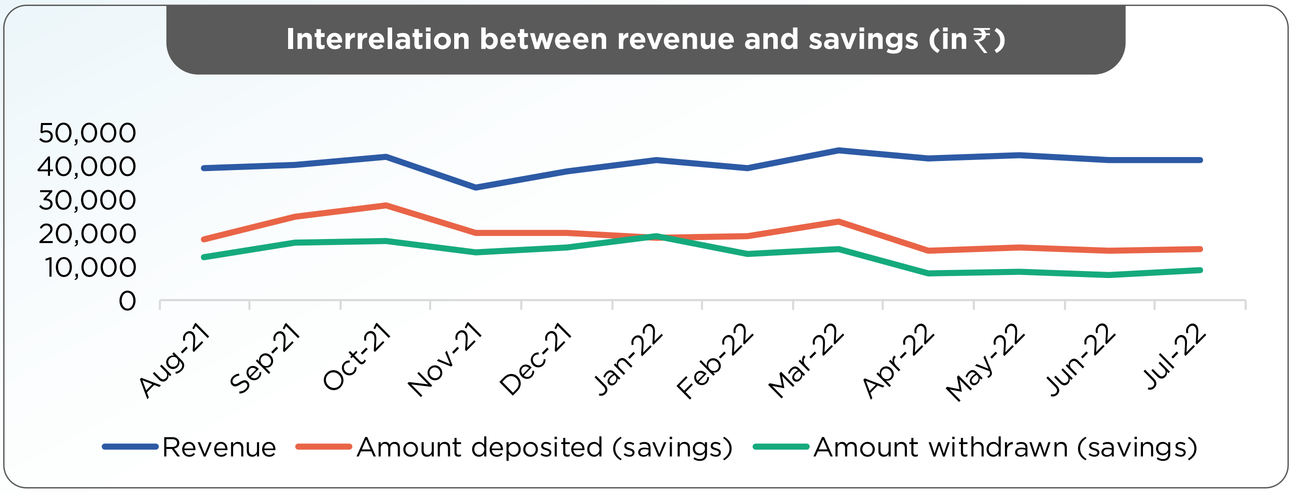


Insight 2:

Business revenue impacts savings directly

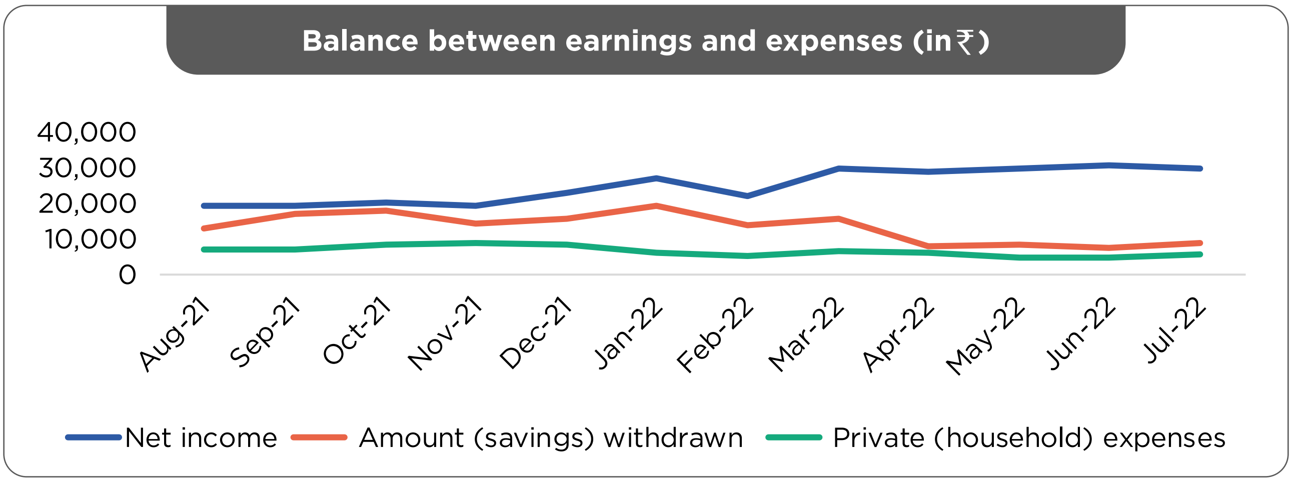
Of all factors, revenue from business dictates the IE owners' savings. Graph 2 shows this trend across 12 months, where the amount saved is similar to that of revenues. The diaries data also shows that high savings result from windfall gains in revenues in March.

Graph 2



But what happens when the revenue drops? The diarists highlighted the predominant measure they use to cope is to reduce the amount saved rather than reducing personal expenses or withdrawing savings. Graph 3 attests to this fact: for the months when revenues dropped, the IE owner neither withdrew savings nor reduced expenses. The positive gap between net incomes and private or household expenses provided a substantial buffer for our diarists to ensure that they did not have to reduce their household expenses or liquidate savings despite lower income.

Graph 3



Formal credit eludes IEs

Insight 1:

IE owners rely primarily on their immediate personal and professional network and then on moneylenders to meet credit needs.

The IE owners mostly approach friends, relatives, neighbors, or fellow business owners for small ticket-size loans. They try to repay these loans as early as possible, but the repayment period is generally flexible. When they need a higher amount or more urgent credit, these sources do not work. Then the next option is moneylenders. Accessing loan through them is easier, simpler, convenient, and free of collateral and paperwork. Moreover, moneylenders are just one call away, and the IE owners can get the money at their doorstep within hours. But the cost they pay takes the shape of high effective interest rates—it can be in the range of 40% to 140% per annum. The IE owners must also pay another cost if they miss a repayment on due dates—harassment.

> If I want to take a loan of ₹ 10,000 from the money lender, I will receive only ₹ 9,600/- in hand. Then from the next day itself, I have to pay ₹ 100 per day for the next 120 days. If I fail to pay it all by the 120th day, a much higher rate of interest (12% per month) will be levied on the entire amount. And it will be calculated from day one.

- Kamal, cobbler, Lucknow

> Once, I took a loan from a local moneylender. I could not repay it in time due to my family's poor financial condition. The moneylender threatened and physically assaulted me. I somehow arranged the money and repaid him. After this bad experience, I never took any loan from any source. In case of small money requirements, I take it from my relatives. I have started to save more so I can use the saving at the time of need for larger amounts.

- A diarist from north India who runs a tea shop, he preferred to remain unnamed.

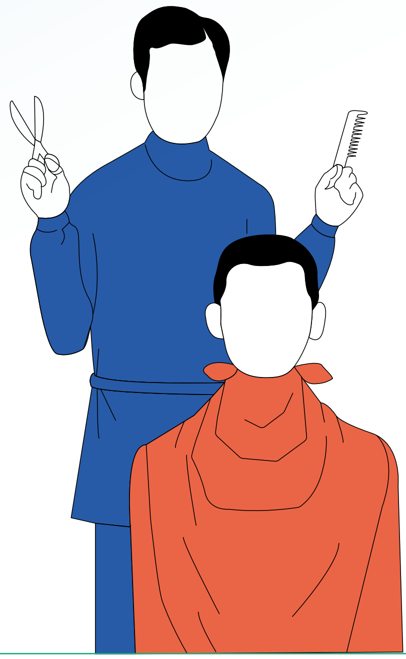
Only 10 of our 50 diarists reported having taken a loan from a bank, with an average ticket size of ₹ 1,60,600. Six others had availed of loans from other formal sources, such as NBFCs or MFIs. Some mentioned buying assets, such as motorcycles and mobile phones using credit instruments from NBFCs—known as buy now pay later or BNPL. Of the 50 diarists, 10 had taken loans from informal sources, predominantly from friends and family.

For IE owners, formal finance from an established financial institution was relegated to a last resort.

Insight 2:

Informal enterprise owners continue to struggle with access to finance, despite the government's efforts to provide collateral-free loans

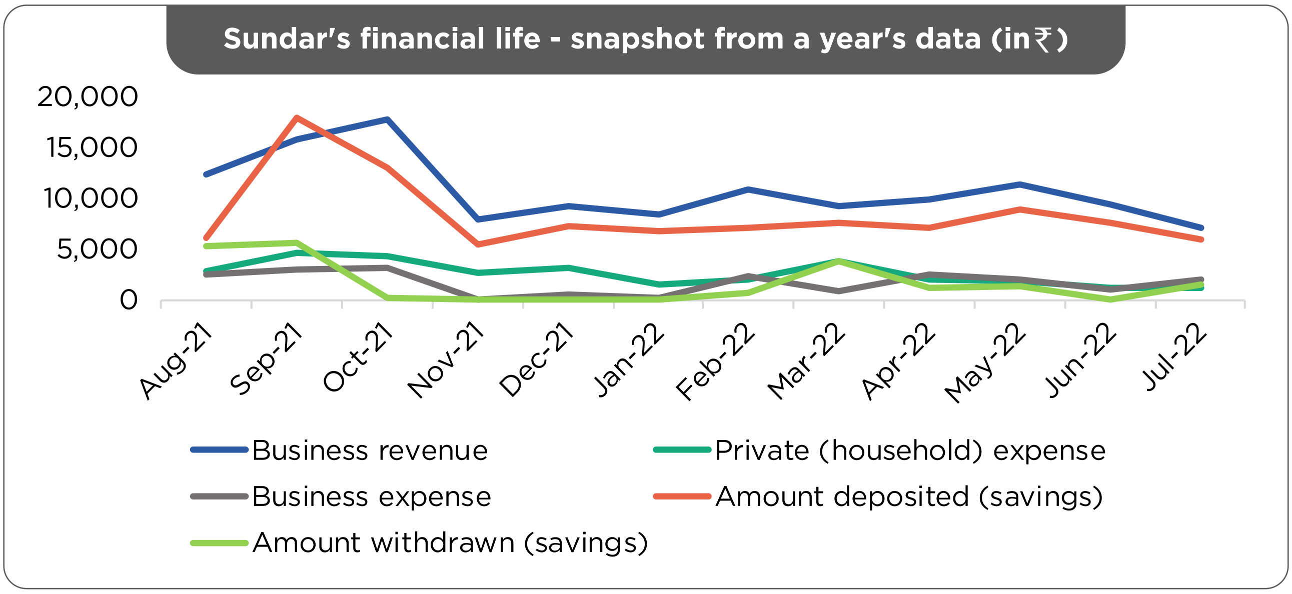
Starting from the MUDRA to PM SVANidhi Yojana, the Government of India has launched several initiatives to bridge the access to credit gap for informal enterprises. Financial institutions have also launched several credit products targeted at MSMEs. But the significant majority of these initiatives and products are targeted at the larger and formalized MSMEs. Formal finance eludes most informal enterprises.



Illustrative example: How the system fails us—Sundar Singh's story

Sundar runs a roadside barber shop in a major north Indian city. He saves a significant amount of his income and controls his household expenses. This habit helped him a lot to marry off two of his elder daughters. His other unmarried daughter (age 17) and son (age 15) are currently studying. He needs to save more to secure their future. Graph 4 summarizes Sundar's financial life for an entire year.

Graph 4



Besides the regular income from his barber shop, Sundar has two other income sources. He has agricultural land in his village, from which he earns ₹ 20,000 per year. He also has a side business selling bottled water, soft drinks, and buttermilk during the summers.

Sundar needs ₹ 10,000 to start this side business every year. His only known option is the local moneylender, who lends at a usurious (approximately 35%) annualized interest rate. This means that for an ₹ 10,000 loan, he has to pay back ₹ 1,000 as repayment installments each month for the next year, along with an upfront deduction in the loan amount as a "processing fee." This year, the MSC field research team encouraged Sundar to think differently in terms of his options for credit for his business. The team helped him understand the various available formal credit sources suitable for his purpose.

With his revised understanding, Sundar's first thought was to approach the branch of the nationalized bank where he had a savings account for more than six years. When Sundar visited for the first time, the bank branch manager made him wait and later asked him to return another day. On his next visit, the bank was closed due to a nationwide strike by the bank staff. During the subsequent two visits, he came to know that it was the financial year closing time, due to which everyone at the branch was occupied. The bank staff informed him that the branch had completed its loan targets for the existing financial year and would not entertain new loan applications. The bank staff told Sundar to visit the branch next month when the new financial year starts.

When Sundar visited the bank branch next, the branch manager told him that the bank could not offer him a loan under any scheme because Sundar lacked a registered business and, subsequently, formal track of business transactions or credit history. He was told that his personal and business profile makes him a potentially risky borrower. So, even after five visits, Sundar failed to get a loan. As a result of the ordeal, he also lost confidence in his ability to get a bank loan.

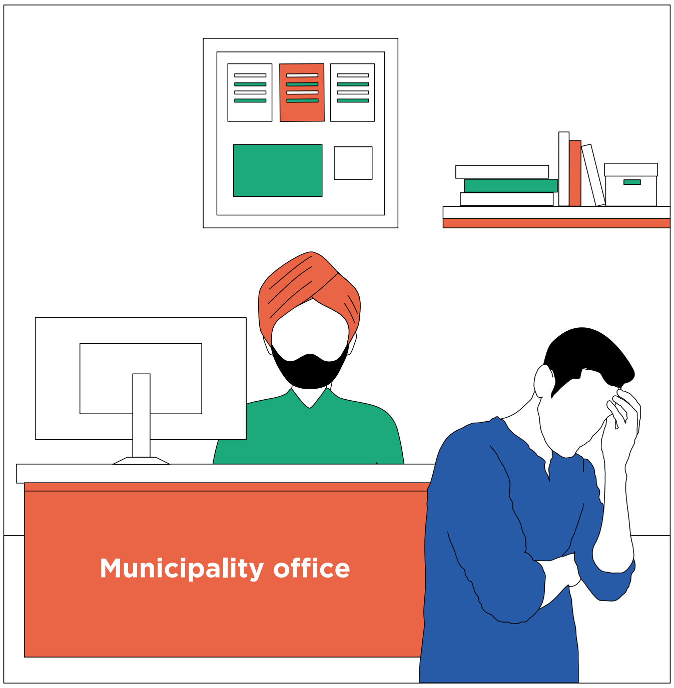
His second attempt was with a leading Indian NBFC, which he contacted through its customer care number. However, the customer care executive informed him that if Sundar wanted to apply for a business loan, he had to first furnish several documents related to the business, such as ITR and address proof, among others. He received similar feedback from other NBFCs he approached.

After his unsuccessful attempts with the bank and NBFCs, Sundar chanced upon a news article in a local daily about the Indian government's PM SVANidhi Yojana, also known as PM Street Vendor's Atma Nirbhar Nidhi. Intrigued, Sundar sought details from his fellow businesspeople and customers and realized it was an ideal solution for his business credit needs.

Sundar visited the nearest municipality ward office and sought more information but was told by officials that the concerned person was unavailable and would return after a few days. After a few days, Sundar visited the ward office and met the concerned official. This official explained that all the applications are filed online, and he should seek help from a certain person who can be found outside the office. Being digitally illiterate, Sundar had to seek help to meet the person who asked Sundar to visit the next day with his bank passbook, Aadhaar card, and other documents. When Sundar visited the next day, the contact person demanded 10% of the loan amount he had applied for—that too in advance and without any guarantee of the loan being approved. Sundar was baffled and frustrated as he had no money to offer. Hugely disappointed, he returned to his shop.

Yet Sundar was determined. He inquired further about loan options and learned that a certain bank offers collateral-free loans to small businesses. Sundar visited the nearest branch of that bank. There, he learned that only a dedicated branch of that bank gives such loans and that he should visit there. Sundar then visited that branch, yet it was all in vain. He was told that to get a business loan, he had to furnish documentary proof of business registration, along with other documents that he lacked.

Sundar made five visits to his bank to secure the loan, two visits to Bandhan Bank, and three visits to the municipality office. He also spent about an hour to speak to the NBFC representatives over phone. He had to incur travel cost for all these inquiries and also lost business for time he had to shut shop. In the whole process, Sundar incurred a total of ₹ 240 as travel cost and ₹ 530 as opportunity cost. The ₹ 770 he spent alongside his efforts failed to bear any fruit.



The only option left for Sundar now was the moneylender. He knew, however, that a loan from the moneylender would hurt business as the loan amount would be inadequate, and the interest rate would be too high. His hopes to secure a loan from a formal source were dashed, and Sundar finally gave up on his quest to scale up his business through a loan. Though the current financial ecosystem has many provisions to extend credit, it fails Sundar and millions of other businesses like his.

What opportunities do financial service providers and policymakers have at this juncture?[1]

Banks and NBFCs need to design tailored credit products for nano and micro businesses:

- **Use alternate credit data to assess repayment capacity:**

  Lenders need to tailor their credit criteria to suit the profiles of informal microenterprises. These microenterprises lack business registration documents and are new to credit. Most fail to furnish any collateral. Traditional credit assessment mechanisms centered on credit bureau data will prove inadequate for informal enterprises.

  Lenders can, however, use other financial and non-financial data on such IEs to assess their creditworthiness. Digital payment data, such as UPI payments, can be effectively explored as a source of alternate credit data. Financial Service Providers (FSPs) also can explore partnerships with FMCG supply chain players to use transaction data available with supply chain players that interact with the IEs. An accurate assessment of the business and IE owner will help calculate the suitable loan amount the IE can repay successfully. Lenders should also explore the feasibility of tailoring the repayment schedule of certain IEs to factor in the seasonality of the business.

- **Customize processes to suit the requirements of micro and informal enterprises:**

  IEs owners typically lack awareness of different loan products and processes. FSPs need to tailor the customer-facing processes, such as loan application, query or grievance resolution, and loan repayment, to suit the needs of IEs. Reduced turnaround time (TAT), easy-to-understand documentation and terms and conditions, and doorstep delivery are essential to make credit accessible and productive for IEs. Product marketing should focus on conveying the specific advantages of the loan and its benefits for micro and informal enterprises.

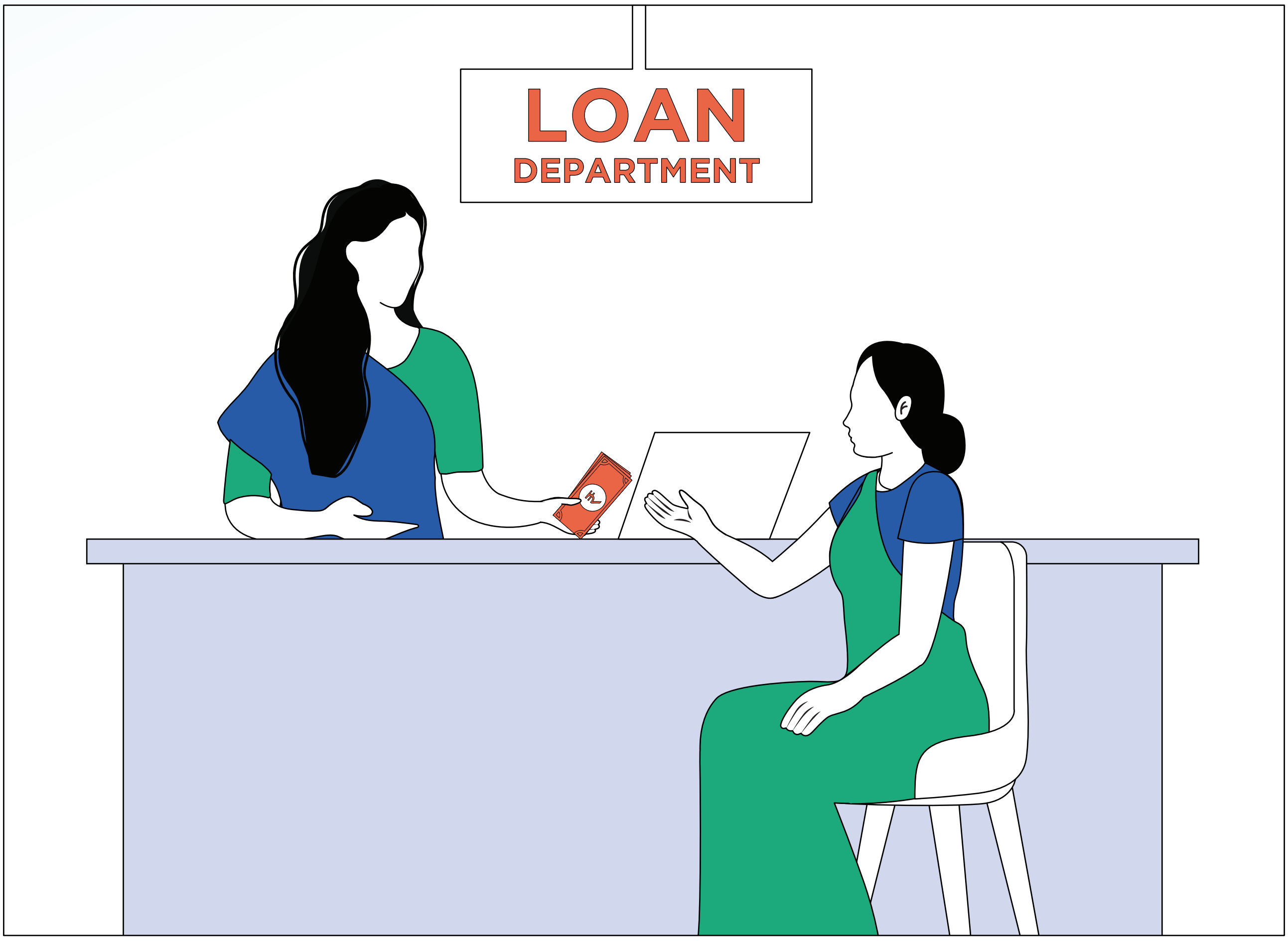
  The loan application process should involve interfaces in local languages and use easy-to-understand terminologies. Most important terms and conditions, such as the total cost of the loan and penal charges, etc., should be clearly mentioned in the regional language at the loan application stage to allow IEs to make informed decisions. Once a loan application is submitted, regular updates (via SMS to registered mobile numbers of IEs) on the application's progress will help the IE owner plan better.

[1] Our recommendations based on the data insights and inferences drawn from them.

FSPs should consider deploying additional channels besides the digital means of customer acquisition via self-service apps and websites. These could take the form of an assisted channel of agents by tying up with channel partners, such as Banking Correspondent Network Managers (BCNMs). Such agents can reduce an FSP's dependence on its own sourcing channels and provide vital support to IEs who need help to understand the products better and complete the loan application process.

Policymakers need to review the implementation of the PM MUDRA loan scheme and PM SVANidhi scheme to make them more beneficial for IEs:

While the MUDRA loan scheme has registered significant growth in disbursements, most loans in the Kishore category are through microfinance products. Such loans are typically standardized loan products not tailored to the credit needs or business cashflows of IEs. Also, since they mostly target women and are given in a group, they exclude the majority of IEs owned by men. In the other categories of MUDRA loans, most disbursements are from banks and NBFCs that typically target registered businesses and IEs. Policymakers should encourage FSPs like MFIs, banks, and NBFCs to offer loan products that target more IEs and offer loan amounts and repayment terms customized to IEs' needs. Policymakers can explore the option of setting up a loan guarantee pool to which lenders can subscribe as a hedge for the risk on loan portfolios where the customer base exclusively comprises IEs.



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