



# Building Hooks and Ladders:

A case for integrating digital payments and lending to small merchants

**Investigators:**

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CATALYST is an initiative funded by USAID under the mSTAR Program, through funding provided to FHI 360. Housed within IFMR LEAD, the initiative aims to expand digital payments and financial inclusion in India, especially for small merchants and low-income consumers.

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## EXECUTIVE SUMMARY

This study was conducted by IFMR LEAD for informing the credit operations of Catalyst – an initiative of the Ministry of Finance and USAID to promote digital payments, housed at IFMR LEAD. The study was commissioned for scoping and assessing needs to feed into testing the “credit-as-a-hook for digital payments among merchants” hypothesis. The study covered 1140 merchants in categories of fixed stores, home-based businesses, roving businesses, and street vendors. The primary data collection included a survey with merchants with questions that covered demographics, businesses cash flows, credit history, and business experience. The qualitative component involved interviews with merchants from various categories. Supply-side perspective was brought in by conducting semi-structured interviews with both formal and informal sources of lending. The study indicates that the merchants see value in digital payments and that there is a willingness to adopt digital modes of transaction. Merchants also indicated that they could push for digital payments with their customers if digital payments could help them get loans. In terms of the current credit scenario, friends, family and local moneylenders are the prime lenders to the merchants in Jaipur. Working capital loans are taken primarily for inventory, but does not really have periodicity. However, merchants reported discontent on existing lending mechanisms because they were either too expensive (informal sources) or too time consuming (formal sources). There is potential for digital lending due to the simplicity and ease of the application process, and saving of time. These are seen as the leading factors for the take-up of loans. The same factors also appear to be the popularly perceived benefits of digital payments.

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# 1

## INTRODUCTION

Evidence from Kenya with digital credit offered by Kopo Kopo suggests that merchants push digital transactions with their customers in order to improve their credit qualifications<sup>1</sup>. Merchants even doubled up their transaction volumes to qualify for larger advances. With these insights as cues, Catalyst, an initiative seeded by US Agency for International Development (USAID) and the Government of India, housed in IFMR LEAD, to increase adoption of digital payments in India, commissioned this credit needs assessment study with merchants spread across all markets in Jaipur to see if the “credit as a hook” hypothesis holds true in Jaipur.

The study covered 1140 merchants in categories of fixed stores, home-based businesses, roving businesses, and street vendors. The primary data collection included a survey with merchants involving questions covering demographics, businesses cash flows, credit history, and experience with digital payment solutions. Digital payments were defined as payments by any means apart from cash and cheques, including cards, e-wallets, UPI, etc. The qualitative component involved interviews with merchants from various categories and geographies. The supply-side perspective was brought in by conducting semi-structured interviews with both formal and informal sources of lending.

*Provided below is a summary of the key findings from all sections of the report, and recommendations based on those in the context of digital credit.*

### Key Findings and Recommendations

#### a. Business Credit Needs

- **Revenue-Expense Gap:** When compared at the Rs. 25,000 level, only 1.75% merchants indicate that their revenues are higher than the expenses. The figure slightly improves to 4% for fixed stores. Further, both median and mode values for operating expenses point to an additional Rs. 2000-5000 in operating expenses.
- **Liquidity Crunch:** 63% merchants report that there is no fixed periodicity in cash outflows and is based on needs spread across the month. Supplier payments also happen daily (43%) and at the time of procurement (37%). About 66% respondents who faced challenges in conducting business reported procuring supplies and inventory as a major challenge.
- **Expansion/Renovation:** The maximum number of loans availed by merchants (both from formal and informal sources) were for the purpose of expansion or renovation. 58% reported business expansion as the top purpose for availing a loan, followed by “meeting operating expenses” at 13%. 42% respondents indicated further expansion plans. Of these, 47.5% expressed interest in taking loans to fund the expansion.

*Recommendation* – Although self-reporting bias leads to under-reporting in revenues, this data has indicated a significant gap for credit requirement to meet operating expenses. Further, no periodicity in cash inflows or outflows leaves the merchant with uncertainties about liquidity. In this case, there is an opportunity for digital lenders to fulfil their credit needs by offering a line of credit or working capital loans.



<sup>1</sup>Responsible Digital Credit for Merchants: Insights from Kenya, CGAP Blog (2017), accessed at <http://www.cgap.org/blog/responsible-digital-credit-merchants-insights-kenya>

## a. Credit Behaviour

- **Loan Size:** 27% of the loans are of ticket size of more than Rs. 1 lakh, followed by loans in the range of Rs. 20,000-50,000 at 25%. Of the loans reported for the purpose of expansion/renovation 58% are of the ticket size of Rs 50,000 or less.
- **Loan Tenure:** While 51% of the loans have a tenure of more than a year, 67% of the loans under Rs 50,000 have a tenure of less than a year.
- **Source of Loans:** 69% of the loans are sourced from friends or family and local moneylenders. Merchants expressed dissatisfaction with local moneylenders because of the exorbitantly high interest rates going up to 30 per cent per month. However, formal sources (banks) are not the first choice because of the hassles associated with documentation and the speed of processing the loan.
- **Interest Rate:** The local terminology for rate of interest varies with different communities in the city, which make it difficult to capture the number consistently. Qualitative data, however, points to a guesstimate of about 15-20% per annum flat rate, which seems to emerge as the prevalent interest rates in the case of formal sources of borrowing. Merchants also tend to make decisions about the interest rate from intuition and mental arithmetic. The simpler the better.
- **Repayment Schedule:** 66% of the respondents said they preferred monthly repayments of instalments.

*Recommendation* – The loan size distribution and the tenure demonstrates demand for not only larger loans, but also smaller loans in the sub-Rs 50,000 category that can be offered by digital lenders. A significantly high proportion of merchants tend to gravitate towards loans from informal sources even when interest rates offered by them are higher than formal lending sources due to the quick disbursement and easy application process. To compete with the credit offered by informal sources, a digital credit product, more than being cheaper, will therefore, have to be quick and easy to apply for.

## b. Credit-as-a-Hook

**Awareness and Interest:** Of the 92% business owners who were aware of digital payment solutions, 53.5% said they would be interested in availing credit through a digital platform.

**Perceived Benefits of Digital Payments:** Ease of process, quick decisions and disbursements are the main factors for loan take-up, especially based on revealed preferences associated with the uptake of informal vs. formal credit. This indicates a promising opportunity for digital lending. Interestingly, ease of use and time-saving are also the most popular features associated with digital payments by these merchants.

**Willingness to Adopt:** 56% of the respondents said they would encourage customers to use digital payments if it helped them get a loan. Of these 56% of the respondents, 39.5% said they would be able to get 10-20 transactions per week if they could become eligible for loans.

*Recommendation* – Presently, while merchants perceive benefits of digital payments, a very minor fraction of merchants avail credit regularly for business operations. There is opportunity in terms of communicating and promoting digital products that smoothen liquidity for merchants. A quick and easy credit product combined with some IEC activity around liquidity smoothening and peer influence is recommended to promote a regular take-up of digital credit.

# 2

## SNAPSHOT OF MERCHANTS



Of the total of 1140 merchants surveyed, 494 were fixed stores, 71 were home-based businesses, 251 were roving merchants, and 324 were street vendors. Below are some summary charts on these demographics:

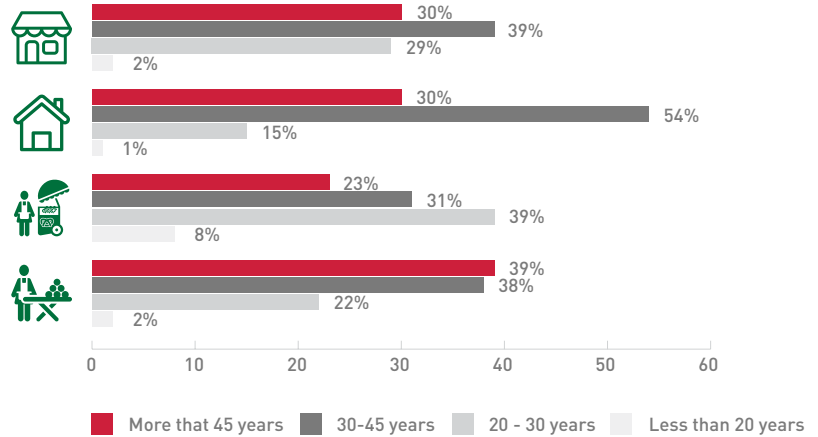
Most merchants are aged 30 or more. The majority of roving merchants are in the 20-30 years bracket. The business owners in markets in Jaipur are predominantly men in contrast with the higher participation of women in home-based businesses.



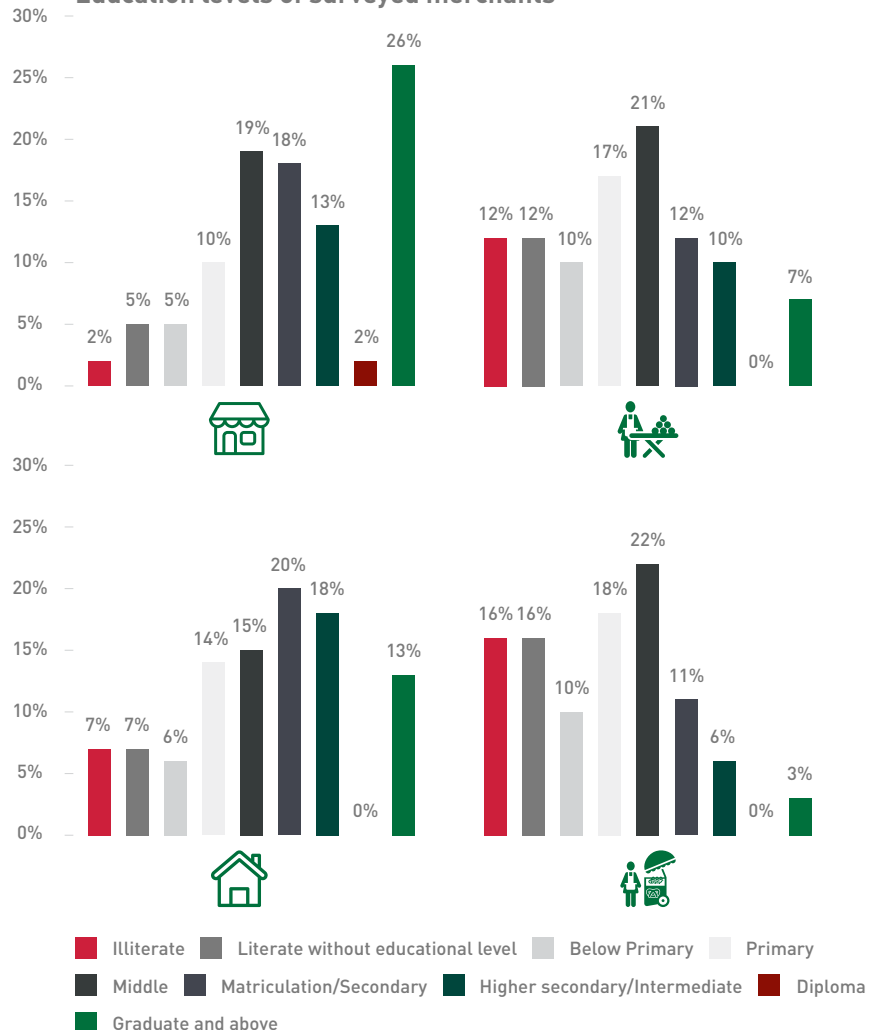
Only 8 per cent of the respondents reported being illiterate.



### Merchant Age-Groups in Jaipur



### Education levels of surveyed merchants



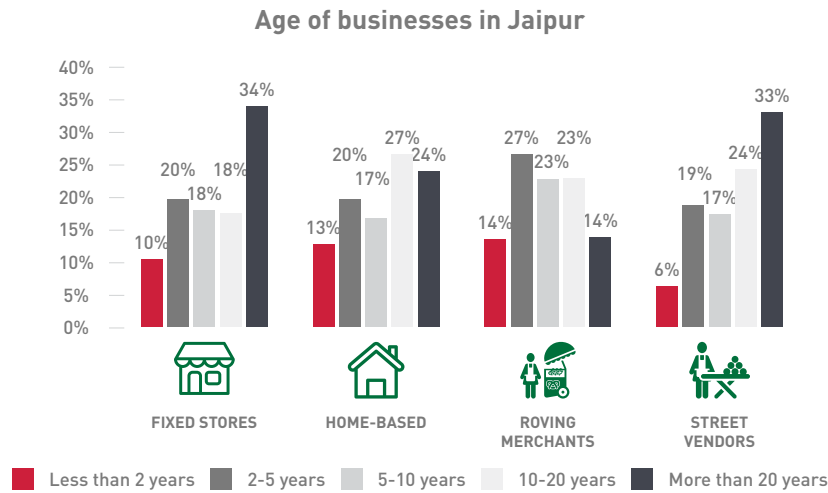
■ Illiterate    ■ Literate without educational level    ■ Below Primary    ■ Primary    ■ Middle    ■ Matriculation/Secondary    ■ Higher secondary/Intermediate    ■ Diploma    ■ Graduate and above



# 3

## BUSINESS PROFILING

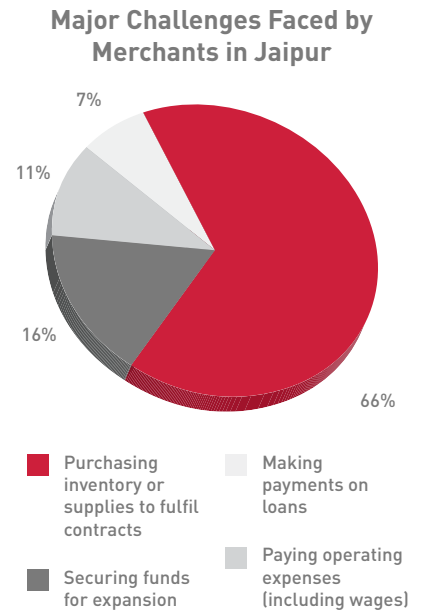
50% of the total surveyed businesses in Jaipur reported that they have existed for more than 10 years. The graph below provides the category-wise business vintage:



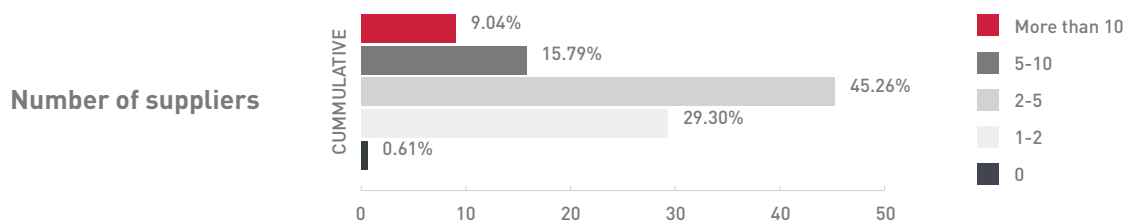
Data also indicates that most businesses are sole proprietorships with only 13% of all respondents reporting having additional paid employees besides the owner. The percentage of businesses having additional paid employees increases to 24% in the case of fixed stores, and about 20% in the case of home-based businesses.

50% of the merchants who own fixed stores said that their family members were part of business. The three main activities for these family members are helping with daily activities (98%), helping in making financial decisions (61%), and procuring inventory (37%). These figures are representative of a very solidified code of conducting business.

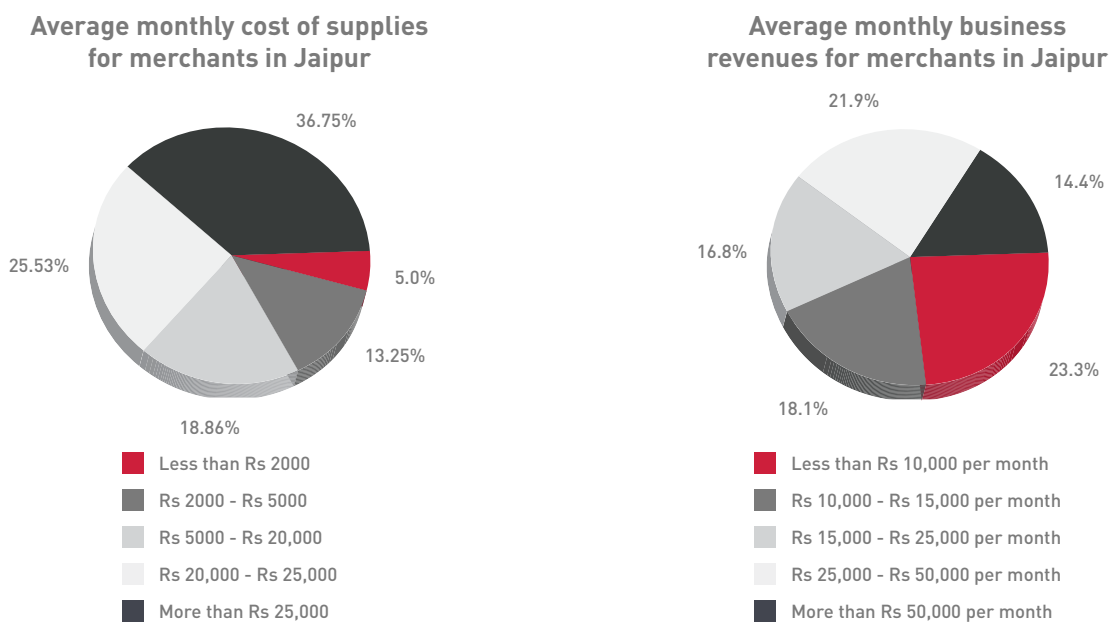
When asked about challenges faced in their daily business operations, 66% respondents said they did not face any challenges. Of the remaining 44%, 66% of the business owners said that purchasing inventory and fulfilling supplies was a major challenge. The pie chart below gives an overview of the major challenges faced by merchants in Jaipur:



To analyze the challenge of purchasing inventory, the supplier dynamics of the merchants in Jaipur was further explored. The survey shows that most merchants in Jaipur have 2-5 suppliers that they use for procurements. This is shown in the graph below.



The reason for supply procurements becoming a challenge for merchants could be attributed to the fact that there is no substantial periodicity in cash outflows for merchants to be able to plan this in advance. 63% of merchants reported that suppliers are paid at the time of purchase. Only 15% said that they see regular cash outflows at the end of the month. The reported average monthly cost of supplies and revenues for merchants is shown in the figure below.



As these charts indicate, 62% of merchants have reported supplier expenses above Rs 10,000, while only 53% have reported a monthly income higher than Rs 15,000 per month, which could indicate a significant income-expense gap. On further analysis, when compared at the Rs. 25,000 level, only 1.75% of merchants indicate that their revenues are higher than their expenses. The figure slightly improves to 4% for fixed stores where revenue outweighs the expenses. However, it is important to note that revenues tend to be under reported in most surveys. Nevertheless, the gap presented by this data provides an opportunity for lenders.

Both the median and mode values for operating expenses

(wages, electricity, etc.) point to an additional amount of Rs 2000-5000 in operating expenses. For the majority of the businesses (66%) where employees other than the owner or owner's family members work, the wages/salaries are paid on a monthly basis. 26% of the merchants report paying daily wages to employees working in their stores, while the rest are paid on a weekly basis or as and when there is a need for an extra hand at work.

However, when asked about funding for business activities, 98% of the merchants said that they funded their activities from retained business earnings; 17% use their personal funds; and only

8% looked at external sources of financing.

In terms of dealing with challenges in business, making a late payment appeared to be the most common way to deal with the challenge, followed by using personal funds or taking additional debt. While there is no means to verify this, the local moneylenders reported that the occurrence of a loan default is very rare. Merchants are usually able to repay their loans without the need for continuous follow-ups.

To sum up the discussion on the business profile, described below is a day in the life of a fixed-store owner and a street vendor.

## A Day in the Life



### Fixed Store Owner

Mahesh Lal of Lal Textiles (names changed) is a seasoned business owner. He has been running his business since 1985, when he started with selling textile cut-pieces with an initial capital expenditure of Rs 40,000. “For starting a similar business today, it would cost Rs 25 lakh at least!” he proudly exclaims. Today he operates from the same place, but has expanded his business to selling textile material for suiting and shirting.

Maheshji tells us that the shop has seen a lot of changes and expansion since he started 33 years ago. He expanded the area by adding a floor to the building. For this he utilized the earnings from his business and took small short-term loans from local moneylenders when he faced a liquidity crunch. He admits that the expansion was not properly planned and was driven by aspiration more than anything else.

Lal Textiles opens at 11 AM and closes at 9 PM. Maheshji has in his employ one full-time and two part-time employees to help with the daily sales and other activities. Maheshji reports an average footfall of about 600-750 customers every month. “I have a margin of 20-25% on the sales, but I am only able to save about 10 per cent,” he says. His other expenses are in the form of business are labour (~ Rs 15,000), store maintenance (~ Rs 1000) and a rent of Rs 27,500 per month.

Maheshji has 10-20 suppliers, most of whom have served Lal Textiles for a long time. “My loyalty to a supplier depends on reasonable rates, proper system for payments, cordial relationships and most importantly – the variety of goods he brings to me since the textile business is all about variety,” he says seriously, as he welcomes a supplier in. He is here to collect a payment. Maheshji writes out a cheque for the due amount after checking his records and hands it over to the supplier. “Cheque payments help in taking away the burden of managing cash when the payment sizes are large,” he says. Upon further questioning, he says that he makes 80% of his payments to suppliers through cheques and 20% in cash. At any one point, Maheshji says he maintains an inventory worth about Rs 50,000-60,000.



### Street Vendor

A daily wage labourer previously, Shankar (name changed) decided to become a street vendor around four and a half years ago in the absence of demand for labour work. Shankar says he got into the business of selling tobacco and allied products on the street because he was not educated and did not have enough money for any other business. He was able to start vending on the street with an initial capital expenditure of Rs 5000, which he borrowed from friends.

Being a labourer once himself, he claims to understand their requirements and thus operates for 11 hours a day between 7 AM and 8 PM. His peak timings are between 7:30 AM to 11 AM and then from 4 PM to 7:30 PM as labourers start coming in to and leaving from work.

Shankar's gets his supplies on a daily basis. He buys supplies worth Rs 1500-1600 on an average pays the supplier the entire amount in cash every day. Shankar is flexible about which supplier he buys from, preferring to buy from the one selling the products at the lowest price. “The margin in the business is very small and that is why the supplier price is crucial,” he says. “On most days I am able to make sales of about Rs 1800 which I use for supplier payments again the next day,” he continues. This leaves him with an income of about Rs 200 a day. Since he has no shop or employees, he does not have any other costs to worry about.

# 4

## CREDIT BEHAVIOUR

To gauge credit history and experience, merchants were asked to list their previous loans, and if they had any ongoing loans. To the first question, 58% said that they had never taken a loan, while 41% reported that they had taken a loan. One per cent refused to reveal this. For the second question, only 29% reported having an outstanding loan. High level of inconsistencies were observed in reporting interest rates. With varying tenures spanning between a month to several years and local terminology varying with different communities in the city, merchants make decisions intuitively as to whether the rate of the credit is favourable or not. However, qualitative interviews with a few merchants indicate a guesstimate of around 15-20% per annum flat rate for loans from formal sources.

An interesting observation about credit behavior is that while most merchants look at inventory

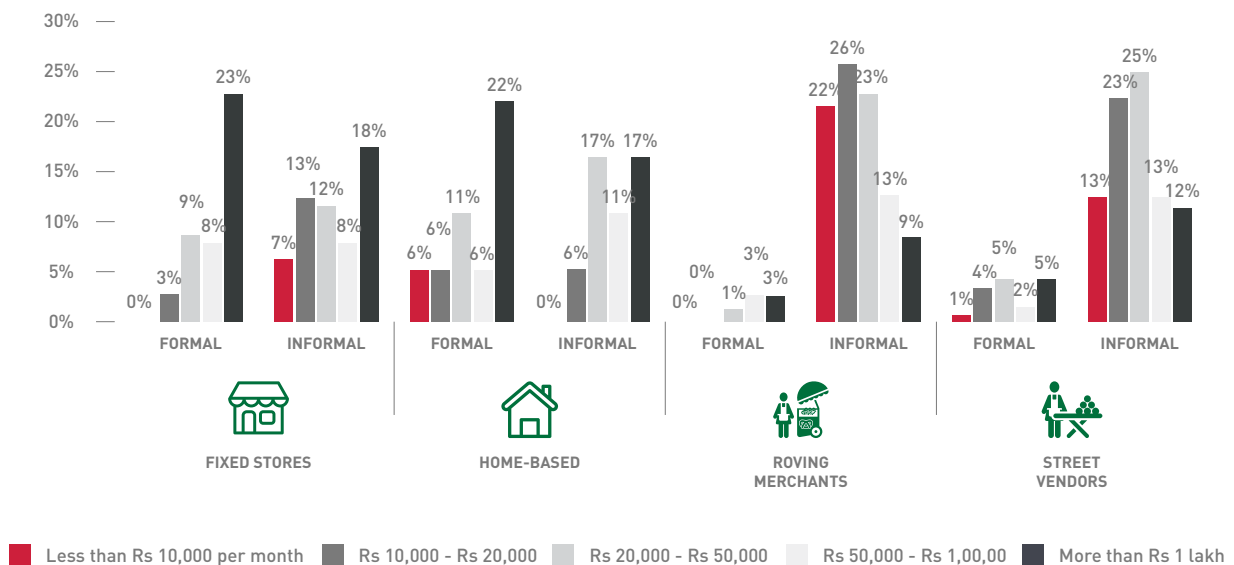
procurements and working capital as major challenges, most loans are reported to be used for the purpose of expansion or renovation. These loans are usually of a bigger ticket size (>1 lakh) and data indicates that fixed store owners and home-based businesses source these from formal sources more than informal sources. Interviews with merchants reveal that there is a paucity of suitable loan products that meet working capital requirements. Besides, since these are ad hoc needs, formal sources are not quick enough in disbursements. The merchants, therefore, rely on local moneylenders for short-term borrowing.

The graphs below profile loans based on characteristics besides interest rate:

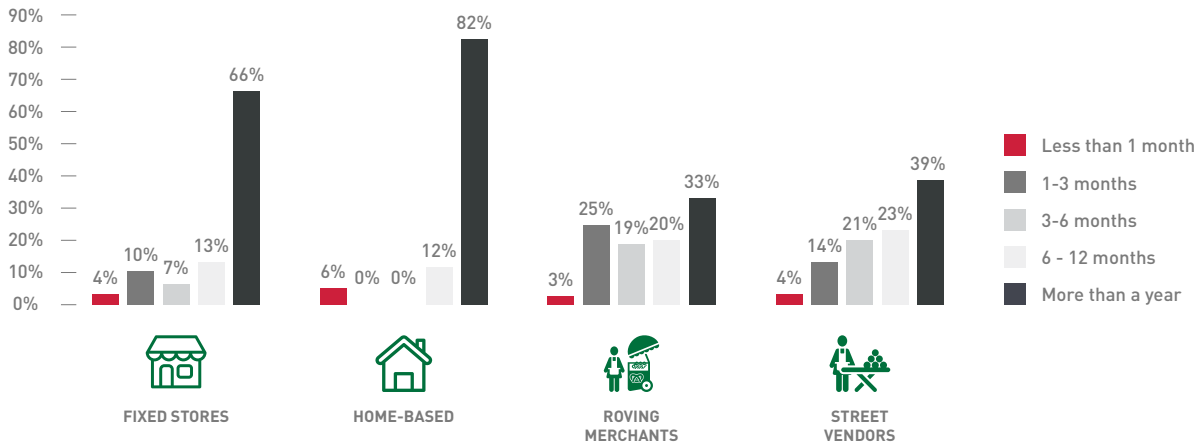


Upon enquiring if there are any issues with payments to suppliers or paying for other operating expenses, Maheshji said that there were liquidity crunches once in a while, which is common in his business, but these are managed by supplier credit and post-dated cheques. When asked about borrowing money to meet these expenses, he said that the requirements were not large enough to go through the hassle of bank loan processes every time there was a need. "Also, the local moneylenders are very expensive, sometimes charging even up to 30% interest per month," he says.

Loan size break-up based on source of borrowing



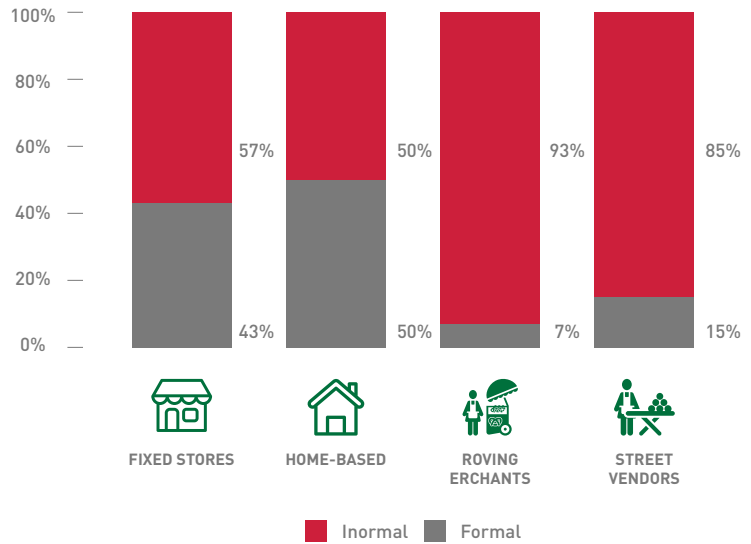
### Loan tenure by business type







As the charts show, informal lending continues to be the primary source for merchants to borrow even when most of them report that the cost of the loan is too high.

Further break-up of the purpose of credit according to merchant category gives the following picture:

### Source of borrowing for business



	Purpose of Loan	For expansion	To meet operating expenses	To refinance existing loan or pay personal debt	Others*
	Fixed	80	17	11	27
	Home-based	7	2	2	6
	Roving Merchants	38	12	8	11
	Street Vending	69	12	12	18
	<b>Total</b>	<b>194</b>	<b>43</b>	<b>33</b>	<b>62</b>

\*Others indicate loans for housing, vehicle and personal loans for meeting wedding and medical expenses.



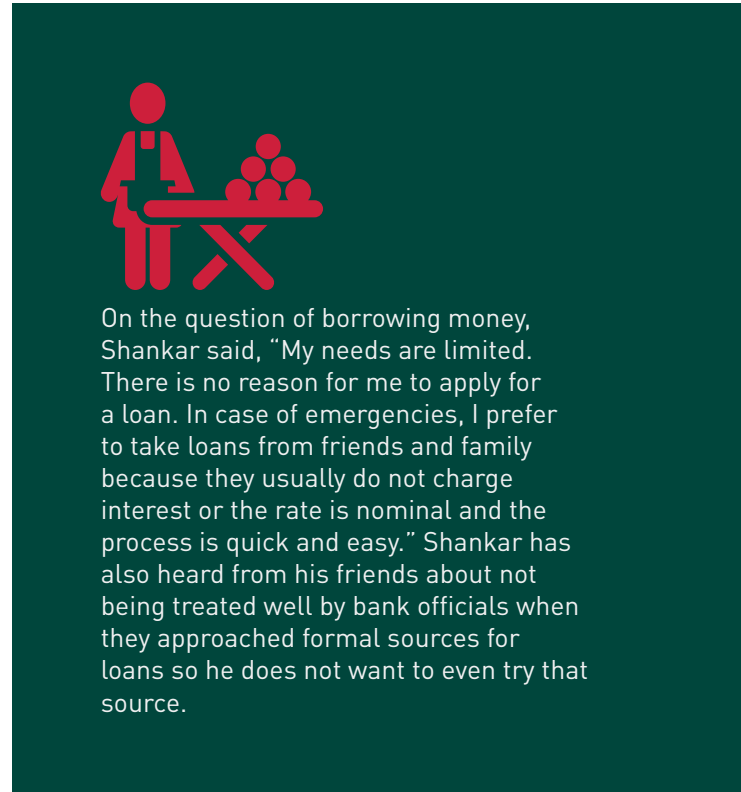
## Analysis of Factors of Lending

Taking cues from the Small Business Credit Survey<sup>2</sup>, a logistic regression model was conducted to find a statistical association between factors influencing loan decision and loan take-up. Questions were asked to determine what factors influenced the take-up of existing and past loans. The following factors were taken into consideration:

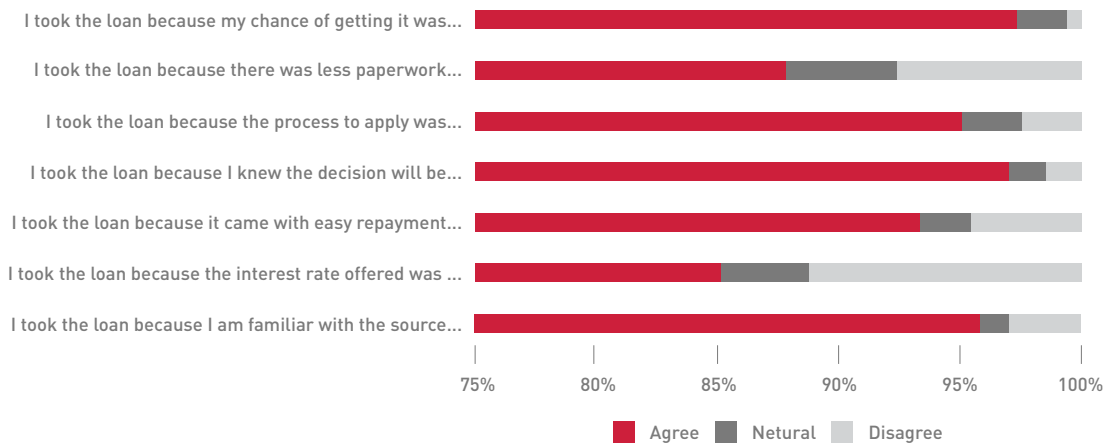
- Familiarity with the lending source: moneylender/banks
- Competitive interest rate
- Easy repayment options
- Quick decision-making process
- Simple and easy application process
- Less paperwork required
- Higher chance of getting the loan

The regression model indicated statistically the significant association of “quick decision-making process” and “simple and easy application process” for loan take-ups.

We also present the results of the responses to the factors stated above in the graph below:



**Factors for credit take-up by merchants in Jaipur**



<sup>2</sup>The Small Business Credit Survey (SBCS) is a collaboration of the 12 Reserve Banks of the Federal Reserve System (United States) that provides intelligence on small business financial needs, decisions and outcomes to policymakers, researchers and service providers.

# 5

## DIAGNOSTIC FOR DIGITAL CREDIT

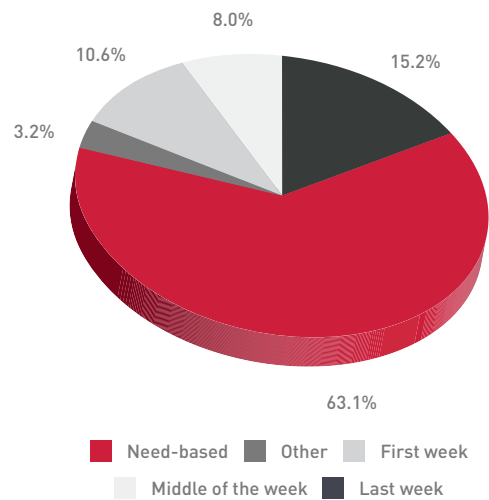
### a. Demand-side

Two key aspects emerge for further exploration to understand the demand:

1. Is there a requirement for credit in the business operations?
2. If/when yes, what are the constraints in availing this credit?

To understand the credit requirements, the first level of analysis involves looking at the revenue-expense gap. Cumulatively, about 75% of merchants in Jaipur spend less than Rs 5,000 on their operating expenses. Additionally, about 62% spend more than Rs 10,000 on supply procurements. Most merchants pay these suppliers on a daily basis or as and when the purchase is made. When it comes to revenues, 56.8% fall within the Rs 10,000 to Rs 50,000 monthly revenue. The timing of the cash outflows is also important in assessing the requirements for working capital credit. As discussed in the section on business profiling, there is no substantial periodicity in cash outflows.

Cash outflow routines



This pattern is consistent with what the local moneylenders have to say about the demand for credit from merchants in Jaipur. These lenders report that the demand for credit comes in only occasionally from merchants and these are mostly to fulfil inventories. During interviews, merchants mentioned that capital requirements arise when they anticipated an increase in sale and they need to stock up on inventory. Paying for operating expenses (viewed exclusive of

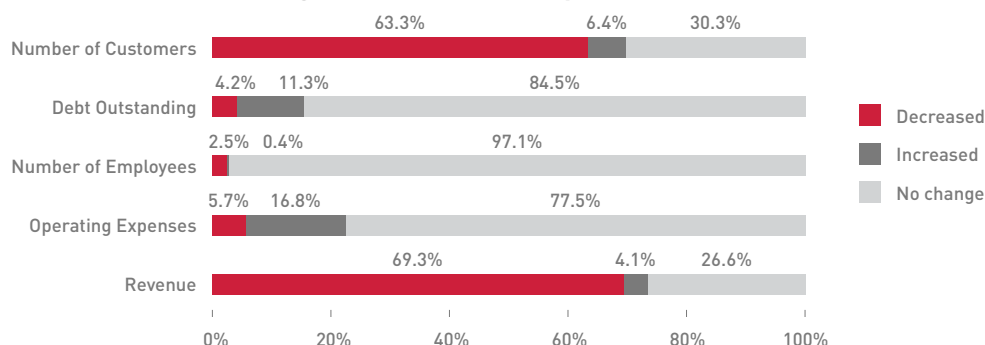
the above inventory costs) on a regular basis is not perceived as a major challenge and in general short-term requirements are met by borrowing from friends or family or supplier credit, which is usually interest free and has flexible repayment schedules.

The second instance for credit requirement is during the expansion phase. Upon asking questions about growth plans, 42% of the respondents said that they would like to expand their

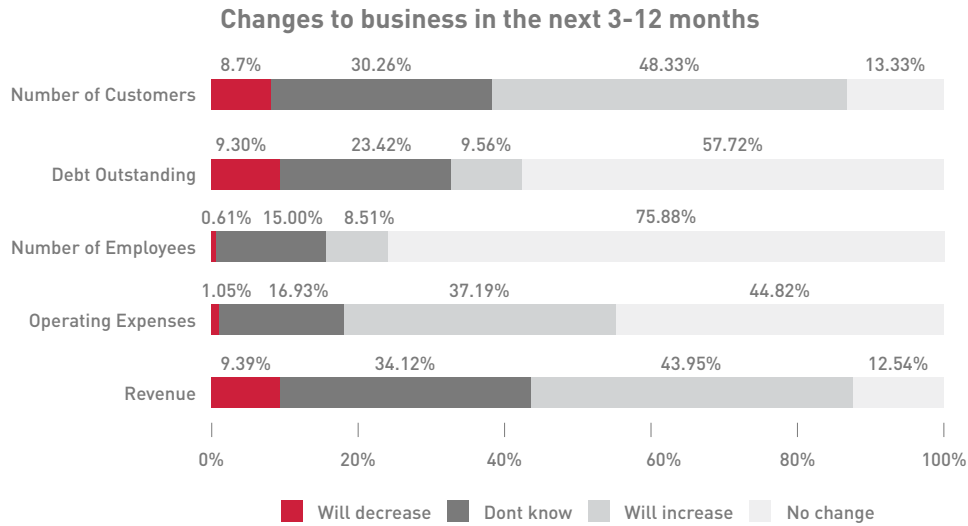
businesses while about 18% were uncertain of their plans. Of those willing to expand, 97% anticipated immediate capital requirement for the expansion. Further, 47.5% of those who felt the need for capital said that they would apply for a loan.

Answers to questions on business operations in the last three to six months to analyze growth patterns, showed the following:

Changes to business in the past 3-6 months

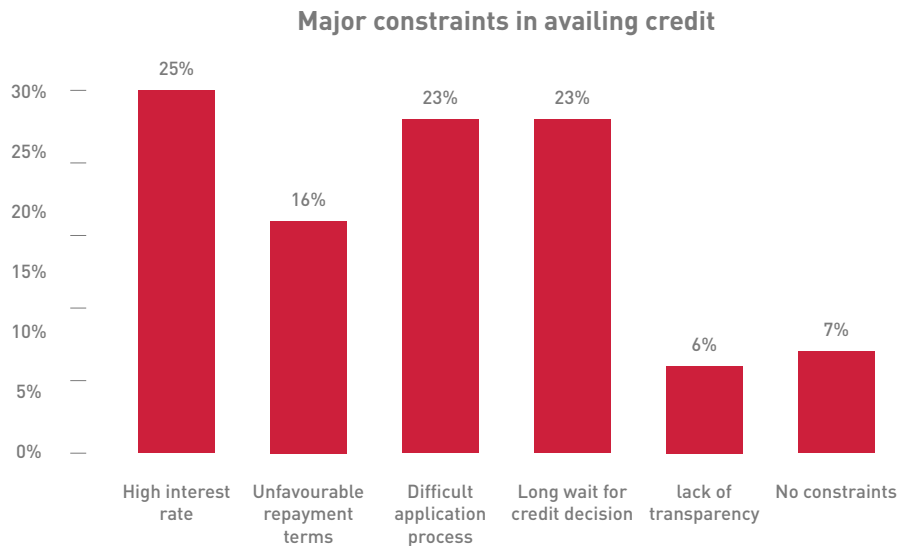


After this, respondents were asked to predict what their businesses would look like in the near future. Their responses are summarized in the chart below:



While it is evident that the decrease or no change on all fronts in the last 3-6 months outweighs the increase, interestingly, the merchants predict the business to get better in the next 3 to 12 months. This study also shows demand for credit is correlated to perceived economic improvements, which presents a near-term potential opportunity for digital lenders.

To answer the second question about constraints in availing credit, let us first look at responses to the survey summarized in the graph:



As the data indicates, the main constraints come in the form of high interest rates and difficulty due to the time taken in the application process. One merchant admitted that the credit offered by local moneylenders was indeed very expensive with rates as high as 15% per month sometimes and that merchants could ideally avail loans from banks and other formal institutions at much cheaper rates. But since the requirements were usually sudden and erratic with little leeway in time, the merchants usually resorted to borrowing from informal sources in order to avoid tedious procedures and save time. A few street vendors and small fixed shop owners reported misbehaviour from bank officials turned off any desire to reach out to formal sources of lending for availing credit. This shows the importance of initial experiences when a shift from the status quo happens.

Survey responses indicate potential for digital finance to play a key role in addressing this demand. 1059 respondents out of 1140 (92%) were aware of digital modes of payments, while 567 (53.5%) said that they would be interested in availing digital credit. 56% of the respondents said they would encourage customers to use digital payments if it would help them get a loan.



An important fact to note here that the numbers on internet connection on phones are poor, especially in the case of street vendors and roving merchants. This presents a great demand barrier. Shankar, the street vendor, has a basic feature phone that he barely uses. He does not have a bank account and given the size of his savings does not see any point for having one. With digital payments he has no experience as he says he has never felt the need since the purchase amounts are very small.

## b. Supply-side

Informal moneylenders operating locally thrive on relationships that they have had with merchants over the years. Moneylenders report that they lend to merchants with their personal assets as collateral. The rate of interest and the collateral required is dealt with on a case-to-case basis depending on the amount and the standing relationship with the merchant. The merchants claim that “90 per cent” of all their loans fund working capital needs. While merchants do not themselves report any periodicity in availing credit, local moneylenders report that most of their customers take credit fairly regularly. They did not report any significant constraints from a service delivery point of view.

For formal digital lenders, business analytics with data from banks and NBFCs are the basis for lending. Since these lenders need to comply with statutory requirements like KYC completion, their reach is limited. Digital lenders usually cater to customers who are fairly tech savvy, people with smartphones and email ids. Of the 1140 respondents surveyed, only 33% had a smartphone and 29% had an internet connection on their phone. This represents challenge that digital platforms face in catering to this segment. While the physical parts of the digital lending process, such as obtaining post-dated cheques (PDCs) from customers still remain bottlenecks and delay processes, there is opportunity if these time delays can be reduced, combined with a simple user-friendly interface for applications.



### Enabling Digital Credit for Maheshji

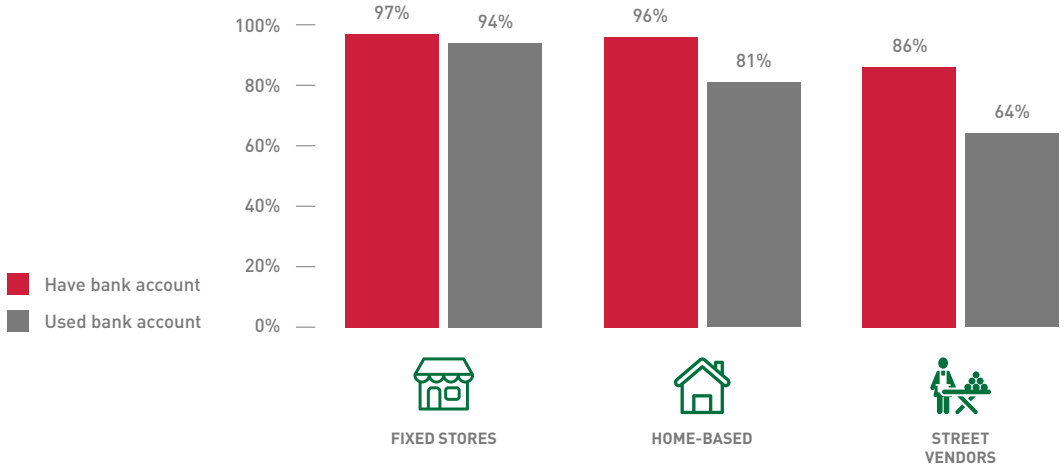
Maheshji has aspirations for growth and expresses his desire to develop his store into a showroom someday. Lal Textiles has already seen one stage of expansion where the financing needs were met by retained earnings and ad hoc borrowing from local moneylenders. Maheshji admits that better planning could have gone into that expansion. While he is presently able to manage his finances on supplier credit and post-dated cheques, he does face a liquidity crunch every once in a while due to uncertainty in cash flows. This inhibits him from further expansion immediately.

While borrowing options from banks and local moneylenders are open, business owners are wary of these options on account of them being tedious and expensive, respectively. Business owners who have had experience using digital platforms for payments find value in them in terms of benefits such as simplicity of use and saving of time. There is thus great potential for a digital line of credit that is available at the tap of a button. Technology-enabled digital credit has an advantage over conventional sources in being faster and cheaper, and that is a great value proposition for business owners. A digital line of credit can help business owners like Maheshji to not only manage their cash and savings more effectively, but also help them in achieving their aspirations.

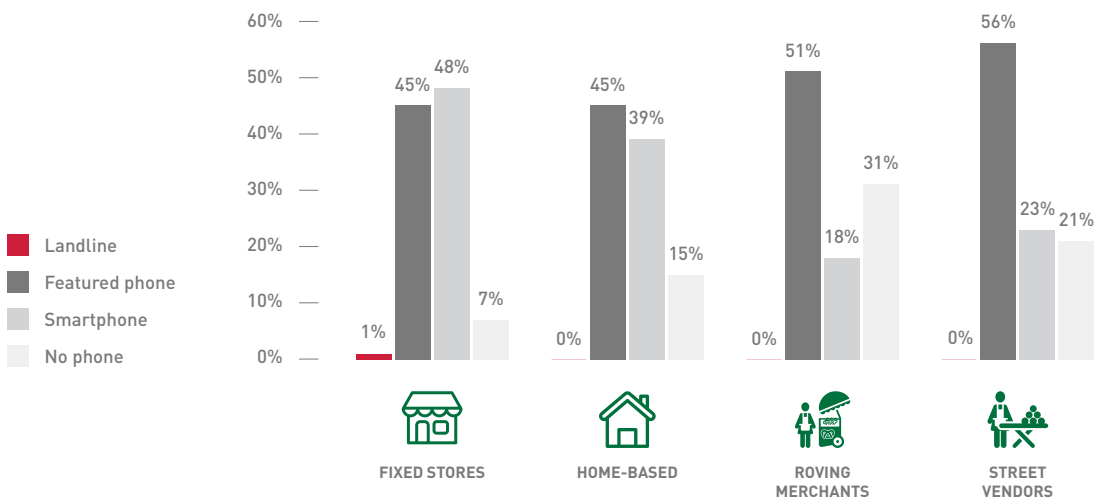
## Infrastructural Readiness for Digital Payments

It is also important to take into account the infrastructural readiness of businesses and merchants. As mentioned above, the low internet coverage presents a great challenge for digital lenders. However, the banking status shows a more encouraging trend, at least in the case of fixed stores and home-based businesses. The graphs below show the figures on phone type and internet connection by business type.

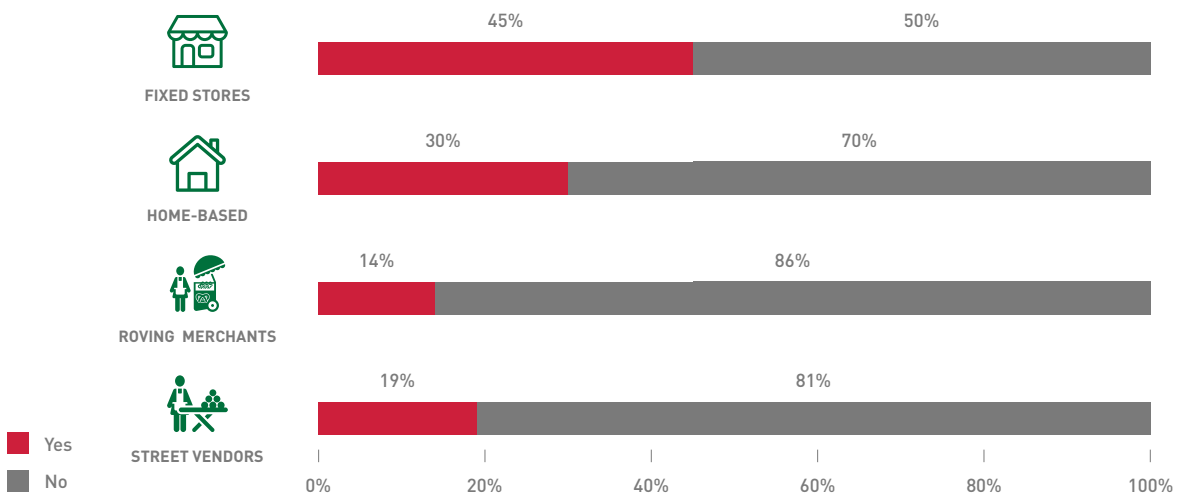
**Banking status of merchants** (Data source: PRICE survey)



**Phone type for surveyed merchants**



**Internet connection on phones for surveyed merchants**





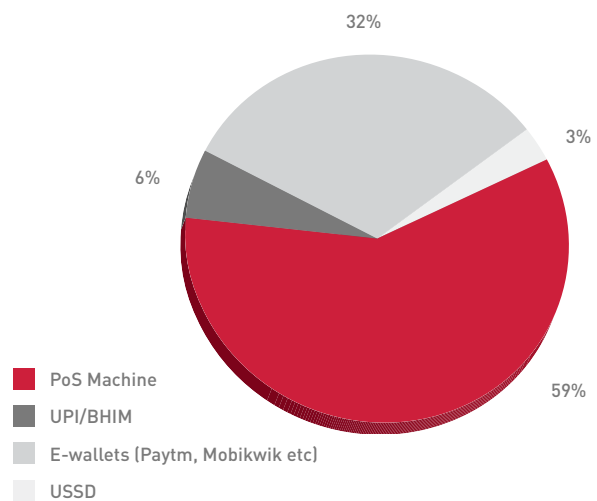
# 6

## CREDIT-AS-A-HOOK FOR DIGITAL PAYMENTS

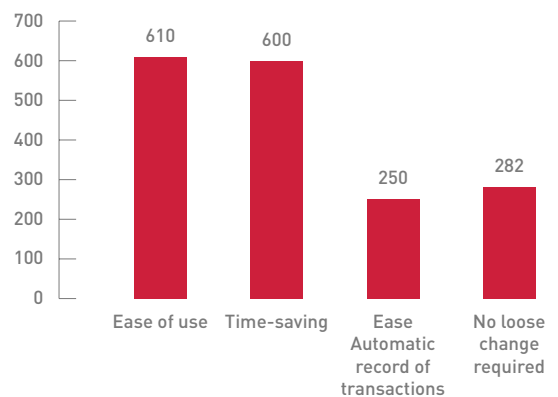
The idea of credit-as-a-hook is a system where merchants regularly avail credit, and make all or part of their repayments digitally, thus keeping the merchants on a hook. In Jaipur, conventional loan products are the most availed form of finance. Even though working capital is identified by respondents as a major challenge, line of credit and trade credit seem to lag far behind loans taken for expansion or renovation. Most of these loans are also more than Rs 1 lakh with tenures of more than a year. The smaller loans are usually taken from local moneylenders. This seems likely to be attributable to the fact that merchants find formal lending cumbersome and resort to local moneylenders for ad hoc borrowing. This is the opportunity that digital lending can exploit.

Forty eight per cent of those surveyed were using some form of digital payments of which PoS machines and e-wallets were the most common digital modes of payments. The statistics are summarized in the chart:

Use of digital payments by merchants in Jaipur



Perceived benefits of digital payments for merchants in Jaipur



In the previous section, it was noted that “quick decision-making process” and “simple and easy application process” have a direct statistical association with loan take-ups. When asked about the perceived benefits of digital payments, the ease-of-use and time-saving attributes also happen to emerge as the most popular features of digital payments with merchants. Other perceived benefits are presented below.

While these perceived benefits may help to convince merchants to avail credit digitally, the key aspect of the credit-as-a-hook for digital payments hypothesis is regularity in availing credit. However, this does not seem to be very widespread in Jaipur, and therein lies the challenge. The data and interviews with merchants indicate that businesses in Jaipur have a solidified code of conducting business and there is inertia in shifting to newer dynamics.

Nevertheless, among the merchants in Jaipur who are aware of digital payments, there is willingness to adopt digital payments. Of the 607 spoken with, 240 respondents who said that they would like to avail digital loans also said that they would be able to get 10-20 transactions per week if they were eligible for loans. Data shows that most businesses have expenses spread out across the month with no periodicity. These non-periodic payments comprise mainly of supplier payments. Although supplier credit is available in the market, 66% of the merchants who faced challenges in business said that making supplier

payments was a major challenge. Interviews also suggest that merchants want credit that is quickly available and does not involve hassles of documentation. This surfaces as the prime reason in interviews for merchants to resort to local moneylenders even when the interest rates offered by them are perceived to be high. These data points reveal a need for liquidity smoothening.

While the data points to only about 11% financing as line of credit, there are two points worth considering. First, it was reported in one of the merchant interviews that a well-marketed working capital loan by a nationalized bank was taken up extensively by merchants when it was offered; and second, merchants seem reluctant to go through bank processes for short-term borrowing because of the turnaround time on the decision and the application process, and hence, usually avail these from local moneylenders. These two points reveal the demand for a line of credit. Digital lenders can target these merchants by marketing products that instantly deposit money in bank accounts at the tap of a button on their

smartphones. A one-time KYC as per the regulations can be completed at the time of onboarding and a starter loan in the range of Rs 20,000-50,000 can be made available based on the risk profiling as per prevalent banking norms. For this credit to act as a hook, it needs to be conveyed to the merchants that they will be eligible for bigger loans based on their repayment through the app and their digital transaction records.

Such a product would not only ensure liquidity for the merchant, but also become a regular system of availing credit that acts as a hook for digital payments. As for the more common loans for purposes of expansion, the survey found that 39% of the loans taken for expansion or improvement were for more than Rs 1 lakh with 15% being between Rs 50,000 to 1 lakh. Credit-as-a-hook is a potential mechanism to quickly graduate merchants from smaller-ticket, shorter tenure loans typically for working capital purposes towards larger-ticket, medium-term and growth-oriented loan products that are similar to bank loans but quicker in decision and disbursement.



# 7

## POTENTIAL WAYS FORWARD

- With the simplicity & ease of application and saving of time leading the factors for take-up of loans, the credit scenario in Jaipur presents potential for digital payments. Incidentally, the key determinants driving preference for loan take-up appear to be the same as those associated with digital payments. The main lenders in the existing credit scenario are local moneylenders and friends or family. Merchants have reported dissatisfaction with expensive credit offered by local moneylenders in the market and expressed interest in digital credit if it is timely and easy to apply for. Hence, if marketed successfully, digital lending products based on the recommendations might be

able to fill this gap and provide opportunities for improvement and the growth of micro-entrepreneurs.

### Things to Remember in Product Design and Communication

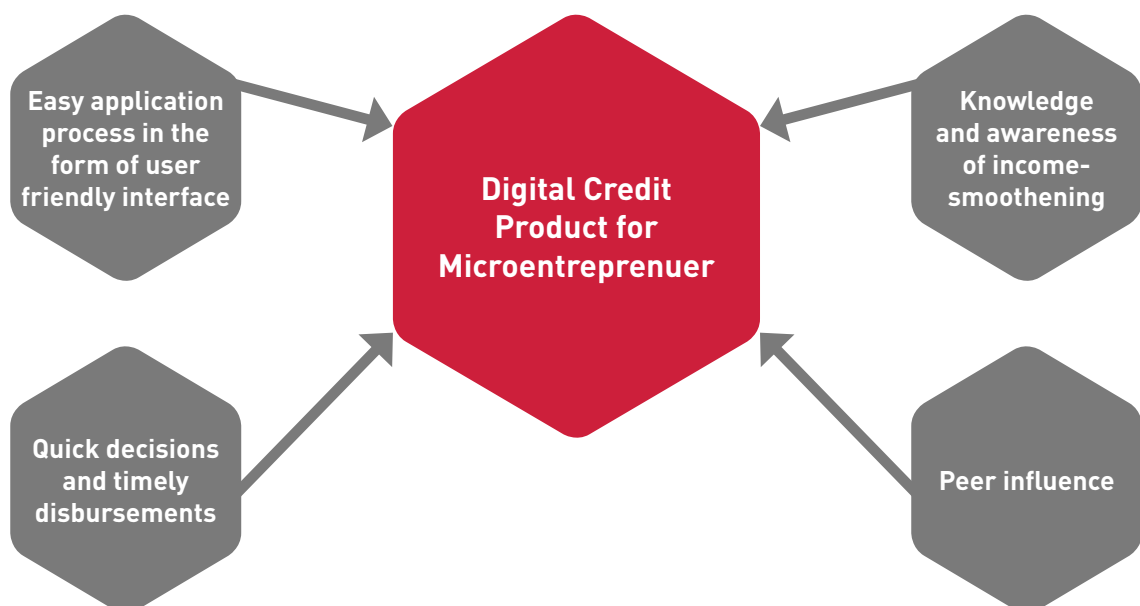
- Customer on-boarding and experience in the initial days are crucial. Merchants reported instances in which a digital wallet/lender on-boarded merchants promising eligibility on app-installation for loans, but then disbursements were declined. The customer service was also found to be unapproachable. This created a sense of distrust among merchants about digital lenders.
- It is important that the sales team on the ground is sensitized

in approaching potential customers with low income groups and less educated groups appropriately to preserve their dignity. A street vendor reported mistreatment by a bank official and being turned away even when he had the required documentation.

- To mitigate the inertia that merchants face in moving from cash to digital payments, one of the strategies would be to pick champions of digital payments and educate them about linked loan products that can help smoothen liquidity. They in turn can promote the product.
- In smaller markets, social networks and word-of-mouth were found to be stronger media of promotion rather than mass campaigns.

### LOAN PRODUCT FACTORS

### EXTERNAL FACTORS



# 8

## RESEARCH METHODOLOGY

For the purpose of this study, both quantitative and qualitative methods were employed.

The quantitative method involved a primary survey of merchants in Jaipur based on sample size calculation as described in the following section. The data from this survey was analysed to point at key trends and patterns. A logit regression model was applied to look at the key factors that determine loan take-up.

The qualitative method consisted of semi-structured interviews with merchants who claimed to avail loans to get a more in-depth understanding of the needs and requirements. Formal and informal lending players were also interviewed to understand the supply-side dynamics of credit provision to merchants.

### a. Sample Size

A total of 1140 merchant surveys were completed by the data collection team in Jaipur over a period of two weeks. Sample sizes were calculated based on PRICE listing of 10800 merchants in Jaipur. Markets covered by the study included the markets listed below:

Outside Walled City	Inside Walled City
Shastri Nagar (Bhatta Basti)	Kishanpole Bazar
Amanishah ka Nalla (near Vidyadhar Nagar)	Gandhi Market
Sikar House (before Chandelle)	Subhash Market
22 Godam Market	Near Hawa Mahal
Sodala	Brahmpuri
Ramgarh Mod to Transport Nagar belt	Tripolia Bazar
Sindhi Camp & Polo Victory (Tour & Travels)*	Bapu Bazar
Gujjar ki Thadi	Surajpole Gate (Nagtala)
Transport Nagar	Ramganj Bazar
Sanganer Thana	Idgah
Durgapur Backside (Surajnagar)	Katla Maket (Johari Bazar)
Hasanphura Market	Surrounding areas of Badi Chopar
Railway Station Badodiya Basti*	
Jhalana Basti (Near Apex Circle)	
Satkar Market (Malviya Nagar)	
Thadi Market (Mansarover)	
Janta Store (Bapu Nagar)	
Jawahar Nagar (few markets)	

*\*The responses of the survey piloted in the railway station and Sindhi Camp area have not been included due to inconsistency with the final version of the survey*



## b. Tool

The key survey tool focusing on collecting quantitative data was designed in consultation with the Catalyst team keeping the PRICE survey tool as a reference. The tool was designed to capture data on demographics and business and credit information along with questions on willingness and readiness for digital payments. The collected data was analysed using the statistical tool STATA® and Microsoft Excel®. For the qualitative part, semi-structured interviews were conducted. The responses were coded under recurring themes.

## c. Research Concerns

The data collection was prone to behavioral biases at both the responder and the investigator's end. Ideally a question conveys to the respondent the meaning of interest to the researcher. However, several linguistic, structural, and environmental factors affected the interpretation of the question by the respondent. Hence, the following caveats need to be taken into consideration when looking at the analysis:

- While adequate training was provided for administering the survey, the reporting on the sub-classification of fixed stores into retail, convenience, speciality, etc., are solely the interpretation of the surveyor. Back-checks have been conducted to rectify errors in most cases but there is scope for minor errors to have crept in.
- Surveyors in their end-of-day briefing reported that merchants were hesitant to reveal their incomes and revenues and the surveyors felt, from general observation and experience, that these figures were unreported. It is well documented that questions on information perceived to be sensitive elicit patterns of underreporting.
- Environmental and linguistic factors also appeared to have influenced the responses to questions on credit history and experience with receiving credit perceived to be socially undesirable by the population in Jaipur. Many respondents withdrew their consent on being further probed if their answer to taking credit was 'yes' initially.




These concerns need to be kept in mind while reading through the reported facts and insights from the data in this report.







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