FROM A VICIOUS CYCLE TO A VIRTUOUS CYCLE

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The economic impact of the pandemic spared few, but there is now evidence that those in the informal sector faced especially devastating consequences. A key reason was the challenge of raising capital. India's formal credit system is inhospitable to informal sector workers and micro-entrepreneurs — they cannot even get a small personal loan to tide over cash flow issues in their businesses because they lack the papers and the collateral usually required for admission to the formal credit market. Why should it be so? Bankers would say the working poor are not good credit risks and lack the behaviour and aptitude associated with successful repayment outcomes. Unfortunately, this becomes a self-fulfilling prophecy. Unable to borrow, the working poor cannot establish a credit history, or learn how to manage their debts, and invest the loan in productive expenditures that would bolster their earnings and allow them to make their EMI payments on time. They are excluded from the formal credit economy. Banks are denied potentially good customers and the economy is denied their entrepreneurial energies.

Systematic evaluation of a pioneering new blended finance instrument called a returnable grant (RG) suggests we can break this vicious cycle of financial exclusion. Developed as part of the Revive Initiative by Samhita Social Ventures and Collective Good Foundation (CGF), and supported by philanthropic funding, the RG concept is simple and innovative. Recipients receive a 'grant', with ticket sizes tailored to their needs (typically under 10,000). But unlike conventional grants, there is an expectation to return (or repay) the grant, either in a lump sum or in EMIs over a pre-agreed time period. Beneficiaries are told that timely return of the grant will allow Samhita-CGF to support other workers like themselves, and that additional benefits, such as interest-rate subsidies or access to skilling and insurance products, may be forthcoming for them. The grants are disbursed in partnership with local civil society organisations that have prior relationships with the beneficiaries. Started in 2020, the RG programme has grown to reach more than 1,00,000 beneficiaries across over 50 unique cohorts. Samhita-CGF invested in a rigorous evaluation framework that utilised third-party survey organisations to collect baseline, midline, and endline data on individual recipients. Analysis of the data provide valuable insights about how we can serve the financially marginalised better.

The most striking finding is that the average repayment rate is high. Of the 13,000 participants who have either completed their repayment or are close to doing so, 60% made their payments

on time, yielding a capital recovery rate of 72%. These repaid funds have been ‘revolved’ to new beneficiaries, resulting in a multiplier effect of 3X on the initial philanthropic investments.

Recall that there was no legal obligation to repay and since it was interest-free, there were no financial penalties either. Yet, not only did the RG recipients repay at a high rate but also used the funds to invest in their economic futures. For instance, a cohort of ‘beautypreneurs’ reported using the funds to continue to purchase supplies so they could provide service at homes when parlours were locked due to COVID-19 regulations. Artisans used the funds to buy material and keep up production even when global value chains paused their orders. This allowed them to service their contractors as soon as the lockdown was lifted. These findings are seen across cohorts; across gender, age, income and educational categories; and in urban and rural localities.

The programme’s success provides insights for scale and replication. First, it is critical to work with implementation partners which have long-term relationships and are deeply embedded in the communities being served. Those with strong financial expertise understandably fare better at managing the returnable grants and at securing timely repayment. Second, working with partners willing to make regular calls to beneficiaries to check on their progress and provide timely reminders of their repayment obligations yields measurable benefit. Relatedly, providing flexible and customised repayment options are key to maintaining high repayment rates. People want to do the right thing; they just need a helping hand.

The RG innovation spawned other innovations. For instance, an RG-as-voucher spin-off provided recipients from a farmer cohort with vouchers they could redeem for fertilizers and equipment. Other cohorts were offered subsidised interest-bearing loans. Timely repayment was rewarded with interest reductions.

The RG experience could create a ‘graduation’ pathway to formal credit for informal sector workers and entrepreneurs. The repayment data from the RG can be used to create a ‘pre-credit score’, which banks could use to make a ‘starter loan’ to these borrowers. An ideal pre-credit score would be a document-less, surrogate-driven but triangulated methodology which attempts to build statistically validated default indicators that lending institutions could use to assess ‘new-to-credit’ cohorts. These starter loans could be supported by credit guarantees or interest subvention, using philanthropic funding, in order to incentivise banks to get started. The repayment track record of these starter loans could feed into a formal credit score, essentially opening the door to mainstream formal credit in subsequent cycles.

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