

The Alchemy of financing

Over 50% of Indian households earn less than Rs500 a day.

For most of us, this statistic conjures up images of hundred-rupee notes being handed out to a daily wage worker at the end of the day, or a field sales executive finding Rs15,000 credited to her bank account at the month's end. The reality is very different—for the 60% households in India that are farmers or in trade, incomes are seasonal and highly volatile. If you plotted their household income across the year, it would find two or three spikes and dead silence in between. The expense curve, on the other hand, is an unrelenting saw-tooth curve ripping into the peace of mind of these households every month. How do these folks then manage to make ends meet? It is through the rigmarole of debt.

While readers of this column fret and fuss on issues such as improving fixed deposit yields, refinancing the home loans, buying life insurance, or dabbling in stocks, the average two-acre farmer is involved in a far more complex life-and-death calculus of making the unpredictable income from two harvests separated by six months last for a whole year of daily expenses, the unfortunate but inevitable health emergency, and life events such as a wedding in the family.

Getting through a year often involves harnessing up to a dozen financial instruments, most of which are informal—Kisan Credit Card loan, credit from the local grocer and agri inputs store, top-up credit from the aarhat (grain trader), health emergency borrowing from local money lender, microfinance loan, chit fund membership, informal credit and savings arrangements with neighbouring households, “money-guard” relationship for shoring-up daily surpluses, etc. For a masterclass on this subject, head no further than the 2009 classic *Portfolios of the Poor*, a thoroughly insightful analysis of the cash-flows of over 250 very poor households across India, Bangladesh and South Africa, and the stories of their incredible ingenuity in using the tools of finance to fund bare necessities as well as survive exigencies.

It is true that the bespoke financing innovations of the informal sector have always saved the day for these folks. But barely, as they come at high costs and without guarantees.

At the turn of the millennium, commercial microfinance started bringing in formality at scale to this fragile financing ecosystem. In the joint-liability-group loan, microfinance found a winning product that came to the doorstep of the customer in a remote village, didn't ask for onerous collateral, and could collect small repayments on a weekly basis at relatively low interest rates, thus unlocking formal financing towards “consumption smoothing” for households that had volatile incomes. Unfortunately, regulatory constraints, and the allure of the almost magically scalable joint-liability lending model have kept “microfinance” limited to microcredit and not reach its full potential; at least until very recently. On the credit side too, the lack of matching repayment schedules to household income-flows has ensured the continued existence of additional informal borrowings at high costs to bridge the cash flow gaps. Most poor households, as a result, are still not able to improve their financial net worth even in the good years.

Microfinance's reliance solely on the boots-on-the-ground approach to distribute and collect loans can't afford personalization. When you run a company with a field force in the thousands serving millions of customers scattered across the country, it is difficult to resist the regimented one-size-fits-all collection model to make the economics work.

All of this will change now. The dream of delivering personalized financing products at an affordable cost to our aspiring billion will be a reality in your pet cat's lifetime.

Thanks to the most audacious technology installation event of the last decade globally, we now have the holy trifacta of JAM—Jan Dhan, Aadhaar and Mobile. That is over 1.2 billion people with a secure digital identity through Aadhaar, 300 million households with access to formal banking system through Jan-Dhan accounts and 400 million active mobile internet users growing at 30 million a quarter.

Then there is the all-important India-Stack that makes it possible for JAM to mesh together and enable the delivery of digital services. In the financial transaction context, Aadhaar offers the authentication layer, bank accounts—the vehicle to transact, and mobile phones—the means to transact.

But it is the India-Stack that provides the plumbing to integrate these elements through a set of common protocols and tools that enables companies big and small to simply plug into the system and deliver financial products digitally at a disruptively low distribution cost.

The combination of almost zero distribution and personalization cost, new underwriting approaches and data sets, and a trust factor in mobile transactions that is now firmly established, now offers us the rare opportunity to mimic the three design principles (below) that have made informal sector financing so successful. And we can finally offer it at a price point that unshackles poor households towards building positive financial net worth. Every year.

Synchronize: Match payment schedules (loan repayments, savings contribution, insurance premiums) to when income is generated (seasonal) to avoid refinancing needs

Sachetize: Make the size of contributions and payments small enough to be in tune with the household's daily expense and income streams.

Specify: Build bespoke products to meet the specific goals and aspirations of each household.

When this vision becomes a reality, financing will no longer be a rigmarole, it will turn into alchemy.

Kartik Srivatsa is managing partner at Aspada Investment Advisors. The Bharat Rough Book is a weekly column on building businesses for the middle of India's income pyramid.

END

Downloaded from crackIAS.com

© **Zuccess App** by crackIAS.com