STUDY SUMMARY

Flexible Loans and Locked Savings for Female Market Vendors in India

Small business growth is crucial for helping the poor improve their livelihoods, but expensive and inflexible financial products restrict business owners’ access to credit and constrain profits. Innovations for Poverty Action is supporting research that examines whether new financial products can help Indian female market vendors pursue borrowing strategies tailored to their business needs, while building up a reserve of savings they can use to finance week-to-week inventory purchases. The products feature increased flexibility in borrowing and repayment schedules, as well as an offsetting locked savings account that allows clients to build up savings while reducing interest rates on their loans.

Policy Issue

Millions of people rely on small businesses for their livelihoods, but expensive credit options restrict business growth and undermine profits. Traditional microcredit loans have not been able to help these small business owners improve their living standards. However, most microcredit programs offer term loans, which have inflexible repayment schedules that are not well-suited for borrowers with unpredictable income streams (such as traders or farmers). Financial products with more flexibility may help small business owners make better use of borrowed capital without defaulting.

Another barrier to small business growth occurs when business owners become dependent on high-interest loans to access necessary working capital, instead of building up their own savings that could finance week-to-week inventory purchases. Women business owners in particular face external demands on their earnings, making it even more difficult to accumulate and protect savings. Smartly designed savings accounts that make it easy for clients to deposit money but allow them to restrict access to their funds can help business owners shield their resources, potentially assisting them build up their own less expensive sources of working capital.

Evaluation Context

An estimated 30,000 weekly markets operate in India. Some vendors finance working capital through short-term loans from either moneylenders or wholesalers at interest rates that range from 1-10 percent per day.[1] These costly sources of credit reduce profits and inhibit business expansion; in
many cases, the high cost of borrowing prevents business owners from accessing credit at all. This is especially problematic for female vendors, who are generally poorer than their male counterparts, meaning that they have less collateral and therefore less access to credit.

India’s government has made financial inclusion a priority, and also recommends that banks working with the traditionally unbanked should offer overdraft protection. However, access to overdraft-based credit for low-income clients in India is still very low. As of March 2014, only 5.9 million out of the 243 million basic savings account holders had used overdraft protection.

Mann Deshi is a cooperative bank founded in 1997 as the first women’s cooperative bank to receive a banking license from the Reserve Bank of India. Mann Deshi is a socially motivated bank, dedicated to supporting underserved women in impoverished areas with a set of accessible financial services that help women earn their livelihood.

**Details of the Intervention**

Researchers are conducting a randomized evaluation in India to test the impact of savings and loan products on female market vendors’ businesses. Researchers will randomly assign 3,200 female market vendors in 40 markets to one of five groups:

1. **Cash credit loan**: Clients will be offered the Mann Deshi Cash Credit product, an overdraft facility (a loan that a bank makes to a business automatically if that business is facing an overdraft). The limit on the loan is 30,000 Indian Rupees (around US$450), with 24 percent annual interest (a significant discount from what informal lenders or wholesalers offer). The product is flexible, allowing borrowers to vary repayment as their circumstances allow over the loan length. Clients can also access additional credit if needed during that time, up to the agreed limit, whether or not they have made progress on repaying the original loan. The product is also designed for increased accessibility, allowing clients to repay or borrow through bank representatives who visit on market days. The cash credit product is available to female vendors with two years track record and with a guarantor, where the guarantor is not related to them and conducts businesses in the same market. To prevent over-indebtedness, Mann Deshi conducts a credit bureau check and a cash-flow analysis, and only offers the product to those borrowers with a demonstrated ability to repay their loans.

2. **Cash credit loan with locked savings account**: Some clients will be offered both a cash credit loan as well as access to a locked savings account. For these clients, the bank will put loan repayments into the locked savings account rather than using the repayments to reduce the clients’ debt burden. Clients’ level of debt, therefore, will remain the same, but the balance in their locked savings account will be used to reduce the interest rate on the outstanding loans. Note that from the clients’ perspective, the cost of borrowing is the same, whether the repayments go into the locked savings account or are used to repay the principal. The client makes free deposits into the account, and while it is a bit more inconvenient for her to withdraw money, she can effectively borrow from herself up to the balance in the account, at a very low interest rate.

3. **Term loan**: Other clients will be offered a typical term loan, which is less flexible. The bank will give money to the borrower in one or more pre-specified installments, and the borrower cannot withdraw
again until the loan is repaid in full. The repayment plan is also pre-specified in the loan agreement.

4. **Term loan with locked savings account**: Mann Deshi will offer some clients both a term loan as well as access to a locked savings account.

5. **Comparison group**: These vendors will not be offered credit through Mann Dashi.

Researchers will use survey and bank data to evaluate whether access to the cash credit product increases microenterprise profit, drives business expansion, and impacts household welfare. They will also assess whether having savings “locked up” in a bank account, but against which clients can borrow, can spur businesses’ capital accumulation and growth. Finally, they will compare the loan repayment rates across the groups, to assess profitability of the cash credit loans and locked savings accounts for the bank.

**Results and Policy Lessons**
Results forthcoming.

**Sources**