Street vendor loans an uncharted turf for big banks- Analysis

Commercial banks have no experience extending such loans; small finance banks, MFIs with speedy disbursal could help

The recent announcement by the government to offer loans to street vendors has caught commercial banks of the country off guard. The reason is simple: hardly any such loans were extended by these banks in the past.

Issues and Imp points

- They have virtually no experience in extending loans of that size and to this sector, who are mostly in the urban clusters.
- The scheme, which was announced by Finance Minister, proposes bank credit facility for initial working capital up to ₹10,000 for each vendor.
- There was no business for these street vendors for the last 50 days with the nationwide lockdown in place. This scheme will cover urban as well as rural vendors doing business in the adjoining urban areas.
- Extending a loan of ₹10,000 does not excite a mainstream banker.
- It is expected that 50 lakh street vendors (data collected from state governments) will be benefited under this scheme and a credit of ₹5,000 crore would flow to these sector, the finance ministry said adding that use of digital payments and timely repayments will be incentivised through monetary rewards.
- Only a fraction of these 50 lakh may have a credit history with commercial banks.
- The question is how to do the credit appraisal for an entity without a credit history.

Suggestions

- Some bankers suggested the self help group model which are followed to extend loans in the rural areas. Under this model, a group comprising women borrowers mostly, is formed with 10-12 individuals of a neighbourhood in a rural area, where individuals of the group take responsibility for timely repayment by other members.
- These groups are required to show savings habit, for at least six months, before lending can start.
- “The problem is that it may not be feasible to form such a group in urban areas as people there are apprehensive to be a guarantor of another borrower in the group,”
- “Also, there is no time to build savings habit as the vendor requires the loan immediately,” the official added.
- In such a scenario, the micro-lenders and small finance banks that focus on lending to the urban poor could emerge as the key player to make the scheme a success.
- SFBs and micro-finance institutions have customers who belong to these community, and have expertise in extending small ticket loans.
- For the scheme to become acceptable for lenders, certain key aspects should be kept in mind while formulating the scheme, bankers said.
- “First is about the interest rate. Yes, there is a need for an interest cap for such loans, but that should be linked to the cost of funds.
- Ideally, it should be linked to the MCLR [marginal cost of funds based lending rate] rather than the government prescribing a particular rate,” said the chief executive of a small
Another important issue that would determine the success of the scheme is the speed at which the loan is delivered. For that, the first thing is to keep documentation short and simple. "It should be a one-page document. The purpose of this loan is speed and the convenience at which it is delivered. If you make the borrower run around for a week, he will lose interest. Customer delight is key for the scheme to be a success".

The other issue is with the credit guarantee part. Loans under this scheme are likely to be under the Mudra scheme. Mudra loans are guaranteed by Credit Guarantee Trust for Micro And Small Enterprises (CGTMSE). According to bankers, it is not easy to get claims for CGTMSE in case there is a default. "So many questions are asked for settling claims. They want to see the loan appraisal report. Everyone is wiser in hindsight…it is easy to say the appraisal was not proper once a loan turns non-performing,"

"Rather than leaving it to be rear ended, CGTMSE should clearly state the claim settlement criteria upfront. They should not dig it up during the time of claim. They should also specify a deadline within which a claim should be paid and if not, then interest should accrue,"

The finance ministry is expected to detail the contours of the scheme in a month.