How the Green Tech Sector Can Work with MFIs

Observations and Experiences from the DRE Sector

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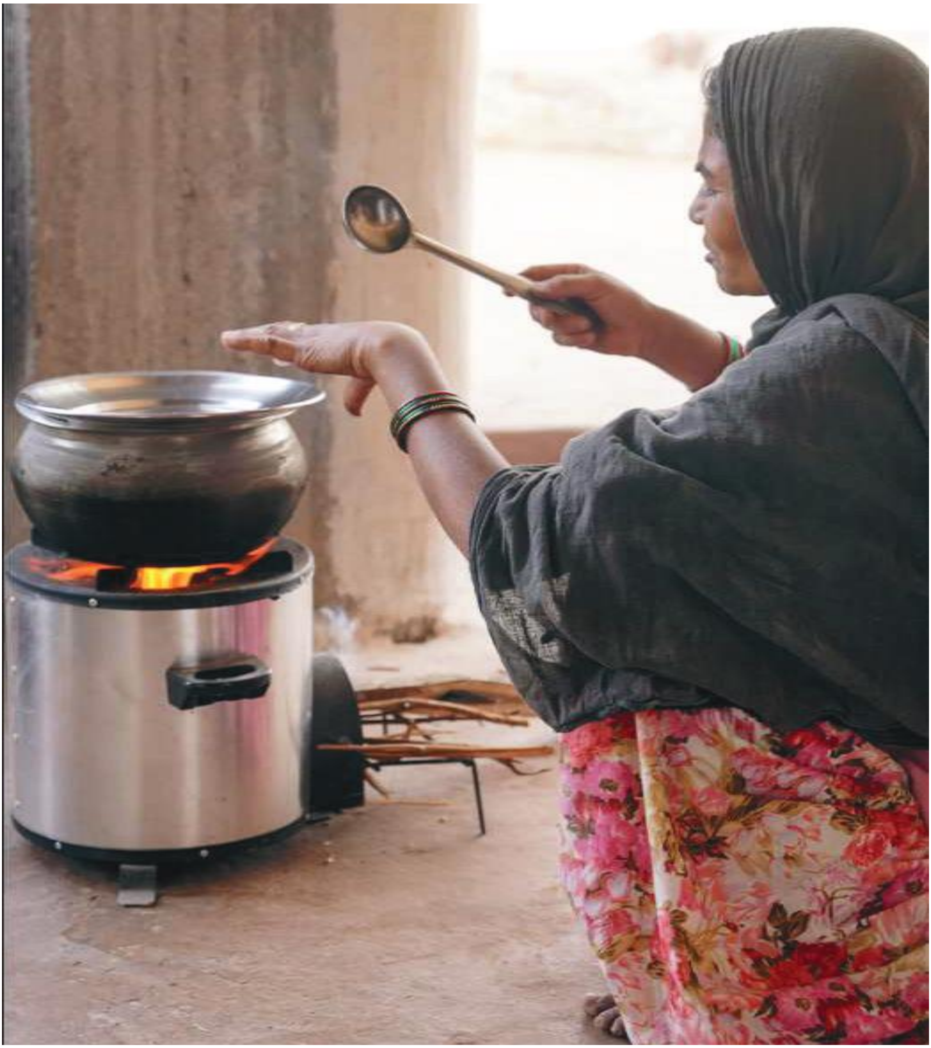
Background

Green and clean-tech products often face several hurdles in the market. One such hurdle revolves around the paying capacity of the customer, including his/her ability to mobilise resources for the outright purchase of a product. Such situations are quite common in the sector and raise the critical issue of providing financial support to those customers in the form of easy loans. Innovative financing solutions can go a long way in resolving this issue. It is in this context that the key role of MFIs (micro finance institutions) comes into play.

GIZ recognises this issue and has been working with technology companies dealing in farm products for enhancing climate resilience. In one such recent effort, GIZ connected these companies with MFIs to enable financing of the technologies/products by making loans accessible to the farming community. GIZ observed that companies dealing in some DRE (decentralised renewable energy) products such as solar lanterns were able to engage with MFIs in this way. As part of its efforts, GIZ approached CLEAN, the industry association for DRE, to get some DRE sector players to share their experiences with regard to MFIs.

This led CLEAN to organise a webinar involving DRE/clean technology suppliers and MFIs on 4 November 2022 in partnership with GIZ, Sustain Plus, and Sa Dhan. The primary objective of this effort was to sensitise DRE and other clean technology enterprises about the challenges and possible ways to enhance their engagement with MFIs. Through the webinar, DRE enterprises and MFIs shared their experiences of engaging with each other and the lessons learnt. CLEAN also organised one-on-one meetings with more DRE players and MFIs. This document carries the gist of (a) the webinar, (b) subsequent consultations (list of panellists and other persons consulted in Annexure), and (c) a review of relevant literature in the form of FAQs (frequently asked questions). This document would immensely help DRE and other green technology companies that are looking to secure financing to support purchase of their products.



Engagement of MFIs with the DRE sector

Frequently Asked Questions[1]

Q 1. What is the range of loans provided by MFIs for various products including clean energy products?

Ans. Generally, the range of loans provided by MFIs is between INR 1,000 and INR 3,00,000 (current regulatory cap on annual borrowings per household). Among the primary determining factors for securing the loan are the technology for which the loan is sought and the creditworthiness of the borrower.

[1] *This document is based on a webinar conducted by CLEAN (Clean Energy Access Network) with support from GIZ and subsequent one-on-one discussions with additional DRE enterprises and MFIs. The webinar titled Decentralised Renewable Energy (DRE) sector – working with Microfinance Institutions (MFIs) was held on November 4, 2022. The objective of this exercise was to discuss with representatives of the MFI and DRE sectors to gather insights on their interactions and engagement and to draw lessons therefrom. This webinar is part of GIZ's efforts that are based on the role of access to finance in catalysing clean technology sectors like DRE, which are critical to meeting the country's climate goals.*

Q 2. What do borrowers need to do to have their loans approved by MFIs?

Ans. Borrowers must show a form of collateral (generally risk sharing by a group), a credit score, and a savings history in ensuring optimum chances of loan approval. Additionally, banks may also require an operational track record of the technologies to sanction loans for a product. Importantly, the product and product pricing are very important for MFIs to engage with a vendor (as also indicated below).

Q 3. What is the period of loan given to DRE buyers/users for solar lighting devices?

Ans. For such products, loans are generally given by MFIs to DRE buyers for a span of 6 to 12 months. Of course, the loan duration is determined by the size of the loan and the repayment capacity of the borrower.

Q 4. What should a borrower keep in mind while availing a microfinance loan?

Ans. The customer should keep in mind, among others, the following:

- There is no requirement of keeping any deposit/margin/collateral/primary security with the lender at any stage of the microfinance loan.
- Lender is required to provide a loan card to the borrower in a language understood by the borrower, which should have the following information:
    - Information that adequately identifies the borrower;
    - Simplified factsheet on pricing;
    - All other terms and conditions attached to the loan;

- ◦ Acknowledgements by the lender of all repayments including instalments received and the final discharge; and
- ◦ Details of the grievance redress system, including the name and contact number of the nodal officer of the lender.

- Purchase of any non-credit products is purely voluntary. Fee structure for such products shall be explicitly communicated in the loan card.
- Training provided by the lenders is free of cost.

Q 5. What are the charges that a customer is required to pay for a microfinance loan?

Ans. A customer is required to pay only those charges that are explicitly mentioned in the factsheet provided by the lender. Besides this, the customer should also note the following:

- There is no pre-payment penalty on microfinance loans.
- Penalty, if any, for delayed payment can be applied only on the overdue amount and not on the entire loan amount.
- Any change in interest rate or any other charge shall be informed to the borrower in writing well in advance and these changes shall be effective only prospectively.

Q 6. What will be the Standard Operating Procedure (SOP) for a vendor who wants to develop/launch a DRE product with a loan component available? How can they approach MFIs? What will be procedure for an NGO or implementing organisation to introduce such a product with a loan component?

Ans. The processes of on-boarding vendors/distributors/NGOs vary across MFIs. In the case of ESAF Small Finance Bank (ESAF), a vendor or an NGO/implementer/distributor can be on-boarded as an 'aggregator' under ESMACO (ESAF Swasraya Multi State Agro Co-operative Society Ltd)

For instance, take the case of Satin Creditcare Network (Satin). Satin is an institution that works with women and is focused on changing the lives of women. It has found that making products such as solar torches and induction cooking devices available to women through loans has lowered costs and improved their quality of life. Satin Care operates in 90,000 villages in nearly all Indian states. Similarly, there are other MFIs that works with various categories of solar lights, improved chulhas, and induction cooking devices. Their engagement with solar products is largely in Bihar, Uttar Pradesh, and Rajasthan, where electricity reliability is relatively low.

MFIs typically lend for purposes of income generation such as micro business, agriculture or livestock. Occasionally, MFIs also lend for social development such as water and sanitation or education and also very rarely for consumption.

Q 7. What will be the Standard Operating Procedure (SOP) for an individual farmer or a Farmer Producer Organisation (FPO) that wishes to get a loan from an MFI?

Ans. A farmer will have to contact an MFI branch as an individual borrower, but an FPO would be an institutional/organisational borrower. The processes vary from MFI to MFI. MFI branches are quite proactive and it is common for MFI branch officials to reach out to existing and prospective clients in the area that they serve (generally about 30 km radius). During such outreach exercises, they spread awareness about their financial products. They also focus on spreading awareness among local influencers (for example, village headmen) about the benefits of loan and the concept of JLG (Joint Liability Group) while also gauging the needs and aspirations of the local people.

In the case of ESAF, for instance, an individual farmer can avail of the loan from any of the branches. For FPO, similar to NGO or vendor, they are on-boarded as aggregator under ESMACO.

In general, discussions with MFIs indicate that JLG is emerging as a preferred route with MFIs. In a JLG, 5–15 individuals form a group and collectively guarantee the credit facility given to each member of the group. All the members of a group generally hail from the same locality, and understand each other's cash flows, household requirements, and repayment capacity. In the event of any member failing to pay an instalment, the other members of the group must pool in and pay the defaulting member's instalment. The JLG model replaces physical collateral with social collateral. It may be noted that, as pointed out by some MFIs such as Pahal Finance, the loan amounts under the JLG are typically smaller (INR 30,000–70,000) than for individual loans (INR 1 lakh to 3 lakh as capped by regulation annually for a household).

In some cases, farmers form JLGs among themselves and each JLG borrows from a financial institution. The borrowings of all the JLGs are pooled to form equity of the FPO. The FPO then borrows a higher quantum of money from the financial institution by providing their equity as a collateral. The farmers/end-users benefit by pooling their borrowings, which will strengthen the corpus of the FPO, which, in turn, can leverage the money to raise debt. The FPO is also able to leverage and build an equity base.

Q 8. What are the goals of MFIs?

Ans. MFIs have been gaining popularity in the recent years and are now considered as effective tools for alleviating poverty. The primary goals of MFIs are as listed below.

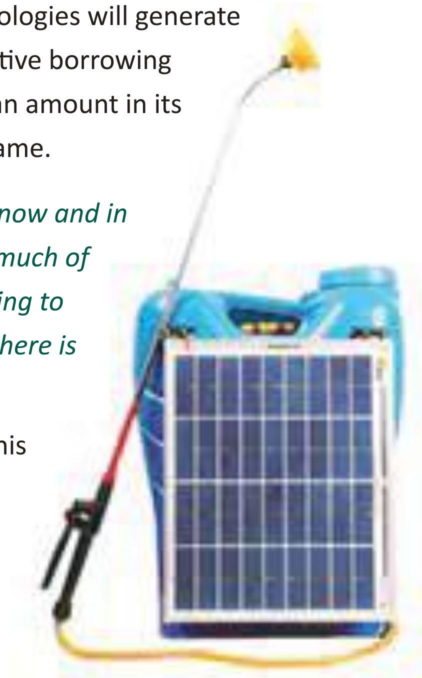
1. Transform into a financial institution that assists in the development of communities that are sustainable.
2. Help in the provision of resources that offer support to the lower sections of the society. There is special focus on women in this regard, as they have emerged successful in setting up income generation enterprises.

3. Evaluate the options available to help eradicate poverty at a faster rate.
4. Mobilise self-employment opportunities for the underprivileged.
5. Empowering rural people by training them in simple skills so that they are capable of setting up income generation businesses.

Q 9. What are some of the problems faced by MFIs in facilitating loans for DRE products?

Ans. MFIs have been providing loans for established products such as solar lanterns; they have also been lending for products such as mobile phones, which have wide acceptance. MFIs perceive higher risks in lending for clean technology products such as solar-powered livelihood appliances. The relatively novel nature of these technologies, lack of familiarity, knowledge about and experience with these products make it challenging for MFIs to fully trust these products and the enterprises that sell these products. Lack of market data and/or research reports on the feasibility, performance, and impact of new productive-use DRE technologies, combined with lack of history of the borrower, are barriers for MFI engagement. Essentially, MFIs are largely un-

aware/unsure whether these technologies will generate sufficient net income for the respective borrowing enterprise for them to repay the loan amount in its entirety within the allocated timeframe.



Q 10. With the increasing rate of interest now and in the future to control inflation, how much of the interest rate are the MFIs planning to increase compared to banks and if there is an upper cap that has been set?

Ans. For MFIs and small finance banks, this is linked to the MCLR (marginal cost of fund-based lending rate) determined by RBI policies.

Q 11. What is the minimum number of consumers MFIs require to lend loans in a particular location?

Ans. This varies from MFI to MFI and also on their presence in and around the location. Generally, it is seen that MFIs seek a minimum outreach of 5000 loan accounts and/or 3000 borrowers (through individual lending/SHGs/partner NGOs or MFIs) or the capability to reach this scale within a period of 12 months. Of course, these numbers are subject to expected growth.

As an example, for ESAF, if there is a branch in the location already, there is no minimum number required. However, if there is no branch, the minimum number of consumers is usually 1000.

Q 12. What are the challenges faced by a new DRE/clean technology product buyer? How can MFIs help?

Ans. Amongst the many challenges faced by a new DRE/clean technology product buyer, the most prominent is found to be the high capital cost of appliances. DRE technologies, especially solar dryers, solar cold storages, solar textile machines, solar water pumps, etc. cost tens of thousands of rupees; for small/marginal farmers, this is seen to be a very high upfront cost that they cannot afford.

MFIs can play a vital role in ensuring that these technologies are financed at relatively lower interest rates. Financing can promote a greater use of these technologies and will reduce the burden of a high initial investment on the buyer.

Q 13. Have DRE enterprises been able to work easily with MFIs?

Ans. There are examples of DRE products that have been found to be interesting by MFIs. These include well-established products such as solar lanterns and solar home systems and also some higher-value products such as biogas plants. The engagement process is straightforward as long as the product being financed is seen to be attractive for the MFI as mentioned above.

However, the process of connection between an MFI and a DRE enterprise is a long-drawn one when the product is new and/or when the location is new. An important challenge faced by DRE enterprises when trying to secure MFI loans for their product buyers is the lack of documentation among the adopter/user groups. Also, the end-users often do not have an understanding of business processes, profitability, etc. Making the borrowers financing-ready is an important part of the engagement process. Once there is a financing history, data collection and reporting, liaisoning and documentation must continue through established processes. On the other side, MFIs also need to be convinced about the quality, performance, and pricing of the product; they need to see evidence of it adding value to the end-user.

The solar dryer company, S4S Technologies, reported that they needed to work persistently and systematically with the end-users and the MFIs over a period of nearly two years to make their end-users credit-ready.

Smart Power India employed digital technology – an app – to facilitate this engagement. This app connects the consumer, the installer, and the financier and is dynamic. For instance, changes in the cost of the technology are reflected in the app and there is full transparency, which is highly valued by the financier community.

Q 14. What kind of products do MFIs finance?

Ans. MFIs are not grant makers and are not in a position to fund 'experiments'. However, the process of enlisting a product with an MFI is easy if it is a well-demonstrated product. Typically, 'plug-and-play' type of products finds good traction with MFIs. Products that involve customisation or design for each customer or location are difficult to get MFI interest. MFIs are also often able to combine products with existing loan products that involve home improvement or farm mechanisation. Importantly, the MFIs have to know that the product is worthy. It is important to also engage with the MFIs to find out what is the 'sweet spot' for them in terms of pricing as they understand the borrowing capacity and affordability among their borrower base.

Some MFIs are involved in ‘third party sell’ or cross-sell where they partner with vendors of products to bundle these products to their existing clients/customers along with micro credit. Typically, such products are chosen based on demand from customers though MFIs also guide customers in choosing products that are beneficial to their target group. MFIs may also work with vendors for a margin fee per product and they may also be involved in training and marketing for the product. In this model, the entire billing is cleared with the vendor by the MFI, while the end-user pays in instalments (like loan repayments) to the MFI.

In the case of third party sell, the decision to work with a product is based on a number of factors:

- Most importantly, the products have to be useful and relevant for the MFI’s target customer segment. A product being categorised as ‘clean tech’ or ‘eco-friendly’ alone will not suffice.
- It is preferred that the customers themselves voice an interest in the product (so it is demand-driven).
- The product quality is tested based on samples in various markets in which the MFI operates and the feedback is satisfactory. Self-reporting by vendors about their products is not taken as valid proof of quality or performance.
- The product has to have a reliable servicing arrangement – having a helpline number is not adequate to show this. There has to be evidence of a proper servicing arrangement by the original equipment manufacturer/vendor or a third party. In fact, in third party sell, MFIs also get involved in training and helping build service networks in the local markets. In general, MFIs work with branded and well-recognised products and vendors.

- Large, well-established MFIs will work only with vendors who have in place proper sales forecasting and stocking capability. It is seen that if a product is seen as useful and value-for-money, demand for it picks up very fast and at that time the MFI does not want to be faced with supply uncertainty for the product.

Q 15. Overall, what do MFIs look for while evaluating the vendors/products they associate with? How can clean tech product manufacturers and distributors tie up with them?

Ans. MFIs – being very ground-level organisations – work to a great extent on the basis of relationships and on leads from local influencers or customers. This is also why the nature of an MFI's business, including products supported, may vary considerably from one state to another. For instance, an MFI may choose to partner with a certain vendor/ product in Rajasthan but may not do so in Kerala – this decision they will take based on the feedback from the local community.

As shared above, the experience of DRE enterprises with MFIs shows that a programmatic engagement with an MFI can take a long time and a strong understanding of what MFIs look for. MFIs facilitate cross-selling of livelihood products to their members along with their micro-loans. Different MFIs have different loan-products, which are combined with a range of livelihood products. A few specialised ones focus on low-carbon or clean tech products. As MFIs are regulated by RBI, the rules around product sales to MFI members change from time to time.

Further, financiers need to understand the business model of the enterprise and the paybacks and cash flows/savings from the product because that way they lower the risk around loan EMI repayment at any stage of the loan period. This is also the reason why MFIs look for intensive return/replacement and service-level agreements from their product vendors; there must be demonstrated proficiency of the service technicians or service network. We must understand that MFIs look for products with a strong pull factor, high user demand. Here we must understand that even though products such as solar lanterns appear to be not expensive in the context of other DRE appliances, they also have competitors. This is because solar lanterns compete with products such as dinner set and mixer-grinder for the household budget. So the products must have a clear and demonstrated 'pull' at the household level.

Distribution of products is to the bottom-of-the-pyramid population strata, at the same time, the cost of delivery is quite high. Hence the cost structure of the product needs to support the same. Product selection by MFI is strictly based upon the utility and demand from a large section of their members. It also depends on the ease of distribution of the products. It takes effort in getting the product listed with the MFIs. It takes a long time – the process of learning, trial and error, and getting the distribution right.

Some organisations have followed a model where MFIs are an integral part of the business, linking the company with the end-user. The role of an MFI is integral because their need is organic. The product pricing is such that it is not affordable at upfront cost. However, once the MFI steps in, EMIs make the product affordable and so the MFI inclusion is a very productive and necessary aspect. Organisations such as Gloworld can support those who are interested in finding out ways to engage with MFIs (for more details, contact mukul.kumar@gloworld.in)

Frequently used terms in discussions around MFIs' engagement with the DRE sector

MFI: Microfinance Institution

Microfinance Institutions (MFIs) are financial companies that provide small loans, in the range of INR 1,000 to INR 10,00,00 to people who do not have any access to banking facilities. These institutions offer services similar to that of a bank. They charge interest on loans but the interest rate is lower than that charged by most banks in the country. They help small- and medium-sized businesses scale up with access to funds at the right time.

DRE: Decentralised Renewable Energy

A decentralised energy system is characterised by locating of energy production facilities closer to the site of consumption. Decentralised systems typically use renewable energy sources such as solar, small hydro, biomass, and wind power. A decentralised energy system can increase security of supply, reduce transmission losses, and lower carbon emissions. DRE technologies typically include appliances that increase livelihoods and can be used in areas with limited grid connectivity. Some of these appliances/technologies are solar dryer, solar cold storage, solar lantern, solar streetlight, solar cooker, solar water pump, solar water heater, biomass cookstoves, etc.

FI: Financial Institution

A financial institution (FI) is a company engaged in the business of dealing with financial and monetary transactions such as deposits, loans, and investments. Financial institutions encompass a broad range of business operations within the financial services sector, including banks, trust companies, insurance companies, brokerage firms, and investment dealers.

NBFC: Non-Banking Financial Company

A Non-Banking Financial Company (NBFC) is a company engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.

SLBC: State Level Bankers' Committee

SLBC came into existence under Lead Bank Scheme as per RBI guidelines. SLBC is an inter-institutional forum at the state level ensuring coordination between Government and banks on matters pertaining to banking development. SLBC facilitates effective implementation of development programmes in the areas of poverty alleviation, employment to the unemployed, providing banking outlet in non-banking areas, training, financial literacy, etc.

DLCC: District Level Consultative Committee

DLCC is an inter-institutional forum at the district level for coordination and joint implementation of development programmes by all banks and financial institutions on the one hand and Government departments on the other.

MUDRA Loan: Micro Units Development and Refinance Agency Ltd

Pradhan Mantri MUDRA Yojana (PMMY) is a scheme launched by the Honourable Prime Minister in April 2015 for providing loans up to INR 10 lakh to the non-corporate, non-farm small/micro enterprises. These loans are classified as MUDRA loans under PMMY. These loans are given by commercial banks, RRBs (regional rural banks), small finance banks, MFIs, and NBFCs. Under the aegis of PMMY, MUDRA has created three products namely 'Shishu', 'Kishore', and 'Tarun' to signify the stage of growth/development and funding needs of the beneficiary micro unit/entrepreneur and also provide a reference point for the next phase of graduation/growth.

FLDG: First Loan Default Guarantee

FLDG is an arrangement between a financial technology or fintech company and a regulated entity (RE), including banks and NBFCs, wherein the fintech compensates the RE to a certain extent if the borrower defaults. In accordance with these contracts, the fintech issues a loan and guarantees to reimburse the partners up to a predetermined proportion in the event of consumer default.

RE: Regulated Entity

All types of banks, financial institutions, non-banking finance companies, and authorised persons are collectively known as regulated entities.

FPO: Farmer Producer Organisation

It is a type of producer organisation (PO) that is a legal entity where the members are farmers. FPOs aim to increase farmers' advantage in emerging market opportunities and their competitiveness. The primary operations of FPOs include the supply of seed, market linkages, fertiliser, machinery, training, and financial and technical advice. These are voluntary organisations controlled by farmer members who actively participate in making decisions and setting policies.

SFAC: Small Farmers Agribusiness Consortium

SFAC is an autonomous society promoted by the Ministry of Agriculture, Cooperation, and Farmers' Welfare, Government of India. It implements the central schemes of the Government of India for economic inclusions of small and marginal farmers in agribusiness activities. It is an exclusive society focused on increasing incomes of small and marginal farmers through aggregation and development of agribusinesses. SFAC is progressing towards establishing an ecosystem for FPOs/FPCs to make them sustainable and viable in the long run.

NABARD: National Bank for Agriculture and Rural Development

NABARD is a development bank with a mandate for providing and regulating credit and other facilities for the promotion and development of agriculture, small-scale industries, cottage and village industries, handicrafts, other rural crafts, and other allied economic activities in rural areas with a view to promoting integrated rural development and securing prosperity for rural areas.

CSR: Corporate Social Responsibility

Corporate social responsibility (CSR) is a self-regulating business model that helps a company be socially accountable to itself, its stakeholders, and the public. By practising CSR, also called corporate citizenship, companies can be conscious of the kind of impact they are having on all aspects of society, including economic, social, and environmental.

To engage in CSR means that, in the ordinary course of business, a company is operating in ways that enhance society and the environment instead of contributing negatively to them.

Annexure: List of persons consulted

Webinar panellists

1. Manoj Rawat, ValueFin (Moderator)
2. Satya Choubey, Smart Power India – Rooftop solar for livelihoods
3. Nidhi Pant, S4S Technologies – Solar dryer
4. Mukul Kumar, Glosolar – Solar lanterns and solar home systems
5. Gaurav Mahto, Khethworks – Micro irrigation pumps
6. Prashanth, B, ESAF – MFI

Additional consultations

- Prantik Mitra, Micro Energy Credits – Socially responsible carbon credits
- Anshu Katiyar, dLight – solar products
- One-on-one follow-up consultation with ESAF team
- Anil Gupta, Satin Credit Care (MFI)
- Ujjaval Vaidya, Pahal Finance

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