INCLUSIVE INNOVATIONS

Innovative Entrepreneur Finance

Improving access to finance for micro-entrepreneurs at the base of the pyramid

HIGHLIGHTS

- Affordable credit is much needed by base-of-the-pyramid micro-entrepreneurs who do not have access to formal institutions.
- The model provides flexible finance coupled with extra value-added services (e.g., insurance) and allows entrepreneurs to own assets, to control their own source of livelihood, to have job security, and to engage in value chain leading to job creation.

Summary

A large gap exists on affordable credit for micro-entrepreneurs at the base of the pyramid (BoP). Inclusive businesses recognize this, and they are now developing innovative models to provide affordable credit to micro-entrepreneurs. They offer lease-to-own finance schemes for entrepreneurs who struggle to afford their productive assets, setting up online lending platforms and providing finance solutions specifically for distributors of their products.

Development Challenge

The lack of access to affordable credit for low-income people cripples the prospects of entrepreneurs. Low-income entrepreneurs cannot access institutional credit because they lack the formal documentation and resources to do so. They must resort to borrowing money at high rates from moneylenders or make do with their daily earnings to try and grow their business.

Business Model

Components of the Model

Businesses have developed three main models to provide finance to micro-entrepreneurs:

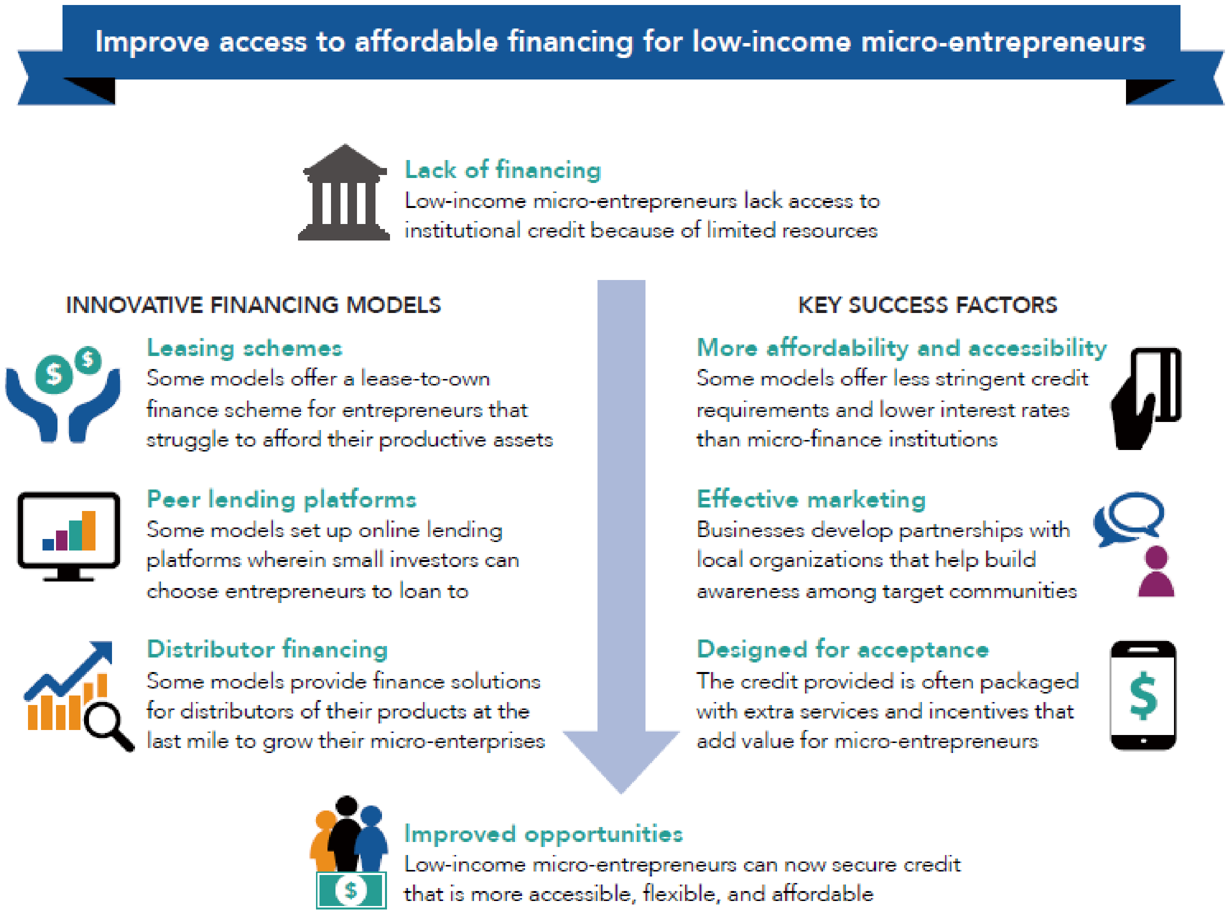
Offering a lease-to-own finance scheme for entrepreneurs who struggle to afford their productive assets. This is fundamentally a financing scheme for customers in a business-to-business (B2B) model. In this model, companies finance the productive assets of self-employed people working at the BoP by setting up a payment scheme that allows them to spread the payment of the asset over a certain period. For example, Tugende, a company that sells vehicles to *boda boda* (motorcycle taxi) drivers in Uganda, offers a scheme whereby drivers can purchase a bike for a down payment of less than US$100 and subsequent weekly installments of approximately US$30 for 18 months. The market price of a new motorbike is US$1,350, which is too costly for low-income youth, who end up renting vehicles from landlords. This model allows the entrepreneurs to get out of the renting cycle and provides them ownership of the bike. At the end of payment cycle, the entrepreneurs own the asset and, as a result, their income significantly increases, and they have the option to either sell the asset to finance another enterprise or they can purchase another asset to grow the business further.

Setting up online lending platforms for micro-entrepreneurs. In this model, companies set up an online platform to profile entrepreneurs who need finance. Each profile details information about each entrepreneur's business, the funds they need, what they will use the funds for, and the rate of interest the investor can expect to earn. Individual investors can view these entrepreneur profiles online and make an

This series on Inclusive Innovations explores business models that improve the lives of those living in poverty. Editors are Elaine Tinsley and Natalia Agapitova. Researched and developed by Endeva UG with additional contributions by Niharika Hanglem.

online deposit of any investment amount in the name of a particular entrepreneur. The money is then sent to the company's partner organization in the field, which in turn disburses it as a loan to the particular micro-entrepreneur. Indian business MicroGraam's platform facilitates small yearly loans in the US$150–$800 range for rural entrepreneurs found through its partners that are nonprofit organizations working in its target communities. The entrepreneurs pay the loan back to the partner organizations in monthly installments at an interest rate of 16–18 percent. The partner repays MicroGraam, which in turn returns the money to the original online investor on a quarterly basis at the agreed interest rate (between 6 and 10 percent).

This is a small and medium enterprises support model, driven by the aim of supporting entrepreneurship and tapping into willingness of a new type of funder/investor.



Providing finance solutions specifically aimed at distributors of their products. A number of companies that engage entrepreneurs in the distribution of their product at the BoP provide affordable credit to these distributors to set up and grow their micro-enterprises. This model is fundamentally driven by the challenge of last mile distribution faced by businesses catering to BoP markets.

- Many companies provide finance in the form of a consignment loan, whereby entrepreneurs are given the product to sell by the company and once they have sold the product they get a share of the profit. Clean energy business Pollinate Energy operates on this model in India. It provides local entrepreneurs with a "business in a bag," which includes solar lights for them to sell in urban slum communities. Entrepreneurs receive half the profit the company makes on each light and are paid on the basis of their monthly sales.

- Some companies provide start-up finance directly to the entrepreneurs. Zoona, a mobile money transfer service in Zambia, offers working capital finance to its entrepreneur agents, providing them with up-front loans that can be paid back over time, along with short-term financing facilities that allow them to purchase more stock and grow their businesses.

- Other companies facilitate access to finance through partner institutions. East African sanitation company Sanergy partners with the nonprofit micro-lending website Kiva to facilitate access to finance for entrepreneurs who want to set up and operate its low-cost toilets.

In many cases, businesses offer a lot more than just a simple start-up loan. In the case of Jibu—a drinking water business in Sub-Saharan Africa that provides a business in a bag to its micro-franchisees—entrepreneurs are given an "end to end solution" to run their micro-enterprise that includes seed finance and training. Jibu trains the entrepreneurs in sales and marketing, customer service, and quality control. These additional skills not only improve the sales for the business, but also help the entrepreneurs grow their business more quickly and lead to additional income-earning opportunities.

Another example is Banapads. This Ugandan social business provides working capital finance in the form of an inventory loan to women micro-entrepreneurs to sell affordable, eco-friendly sanitary pads to low-income communities. Banapads couples the financial support it gives with a two-week business training course as well as continuous market, field mentoring support, and performance monitoring.

Cost Factors

The costs to the end users vary greatly across the different entrepreneur finance models adopted by the businesses. Table 1 compares the finance offered and the end-user cost, with the alternative available in the market, across the models. The comparison demonstrates the long-term financial benefit of all of these models to micro-entrepreneurs. They are able to buy assets on favorable payment schemes rather than be out of pocket by paying the full amount of the product up front or by taking unfavorable loans from local moneylenders.

Table 1. Comparison of end-user costs of the entrepreneur finance models with alternatives

Business	Model	Financing offered	Alternative
Tugende, Uganda	Lease to own	An 18-month payment scheme that allows motorcycle taxi drivers to own a motorcycle by paying for it in small weekly installments. Down payment of US$96; weekly payments of US$30. Total cost across 18 months is approximately US$2,250.	--Buy a new motorcycle up front for US$1,350. --Rent the motorcycle from local landlords at a weekly rent that is 15 percent less than the Tugende weekly installment but ownership is never gained.
Rickshaw Bank, India	Lease to own	An 18-month payment scheme that allows rickshaw drivers to own their own vehicles. Customers pay a daily rental of around US$0.40 for 18 months, after which they have paid off the full cost of the rickshaw and now own it.	--Pay the up-front cost of a rickshaw, which is above their means. --Rent the rickshaw from a local landlord for a daily rent of US$0.40 to US$0.60 without gaining ownership of the vehicle.
MicroGraam, India	Online lending	Crowdfunded online scheme that allows individuals to provide small loans (US$150–$800) to micro-entrepreneurs over the Internet. The borrower is charged an interest rate of 16–18 percent by the company's on-ground partner.	--Loans from MFIs that charge an average interest rate of 24 percent.
Sanergy, Kenya	Financing micro-franchisees through partner	Facilitate financing through a partnership with micro-lending platform Kiva or a local MFI. Micro-entrepreneurs purchase the first toilet, business support services, and servicing for the first year for US$600 using a 12- or 24-month loan.	--Pay the US$500 up-front cost of the toilet and first year's servicing.

Pollinate Energy, India	Financing micro-franchisees	Business-in-a-bag scheme that provides solar lights as a consignment loan to entrepreneurs, who sell them and earn half of the profits. Each solar light costs US$25. The entrepreneurs sell it for US$39 on a payment plan; they earn approx. US$7 per light.	--Find other forms of employment, often casual and low-paying.

Revenue Streams
For most of the businesses, particularly those with their own credit facility, revenue is generated by the interest rate charged on each loan. Tugende, for example, buys the motorbikes it sells to entrepreneurs for US$1,350 but earns approximately US$2,250 in gross cash flow per bike due to the interest rate it charges on the 18-month finance plan.

Financial Viability
The capital costs of this model are high in most cases, and many of the models have not reached financial viability yet. Most companies rely on equity investment, debt capital, and grants. Tugende and Zoona, which started operations in 2010 and 2011, respectively, both report they are profitable. Sanergy aims to reach profitability by mid-2016. All three companies have received substantial investment from impact investors. Tugende raised US$780,000 from multiple investors. Sanergy has received investment from Acumen and Novastar Ventures, among others.

Partnerships
A critical stakeholder in this model is the entity providing the funding that enables companies to offer affordable credit to micro-entrepreneurs. In the case of many of the businesses, where the credit is offered by the company itself, banks and equity investors provide the necessary capital. This could be for a supplier relationship or a B2B productive asset sale. Companies that do not have an in-house credit facility partner with microfinance institutions (MFIs) to provide the finance while they provide the productive assets to the entrepreneur.

For the online lending platforms, small individual investors or donors are the main financiers of credit. The finance flows from the investors to the online platform and then to the entrepreneur through an on-ground partner institution.

Implementation: Delivering Value to the Poor
Awareness
Businesses develop partnerships with local organizations that help build awareness among target communities. MicroGraam uses its network of partner organizations to market its service to low-income entrepreneurs. Because MicroGraam is an Internet platform that the entrepreneurs may not be able to access, the partner NGOs do extensive marketing in villages where they meet potential clients and explain how the system works.

Acceptance
The finance offered in this model is more flexible than the alternatives available to low-income entrepreneurs. While businesses conduct screening and basic due diligence, they do not have the same strict requirements of MFIs. Tugende, for example, does not ask for collateral from its customers or even guarantors. It only ensures that each customer provides reliable references. It also allows customers some leeway on late payments and will only repossess a bike when customers do not provide valid reasons for non-payment.

The credit provided is often packaged with extra services that add value for micro-entrepreneurs. Rickshaw Bank, for example, runs a rent-to-own scheme for rickshaw drivers in India, and also provides insurance to its clients. This is an added incentive for the rickshaw drivers whose meager savings mean they cannot afford to skip a day of work if they get injured while driving.

Accessibility

The use of information communication technology is integrated into a number of these models to help reach more entrepreneurs. Both Jibu and Pollinate Energy provide smartphones or tablets to their micro-franchisees to allow the companies to monitor sales and payments in real time. This is a cost-efficient way to ensure quality and compliance by the entrepreneur, and it also means the company can engage more entrepreneurs in different areas without having to increase their operating costs.

Affordability

The key success factor of this model is that businesses are able to offer credit that is more accessible and affordable to low-income clients than the alternatives available elsewhere. The average interest rate offered by MFIs in India is 24.1 percent,[1] while MicroGraam's online lending platform offers loans to its clients at an interest rate of 16–18 percent. Its online model helps keep operating costs low, and avoiding the stringent requirements of MFIs allows MicroGraam to keep the interest rates in check. The weekly installment of US$30 that Tugende's clients pay for their motorcycles is 15 percent more than a local motorbike landlord charges for renting, but in the long run, Tugende's offer of ownership after 18 months of payments as opposed to continuous rent payments is a more viable—and enticing—option for micro-entrepreneurs.

Results and Cost-Effectiveness

Scale and Reach

Looking solely at micro-entrepreneurs reached by businesses operating this model, the numbers are relatively small. The online micro-lending platforms reach the most number of people. Kiva is the outlier, having funded more than US$979 million to 2.4 million borrowers through its platform since it began operations in 2005. Businesses providing micro-franchisees with finance have impacted considerably fewer people as entrepreneurs. Sanergy has engaged more than 480 local people as micro-franchisees, who in turn employ an additional 175 people. The 1,000 Fresh Life toilets run by Sanergy's micro-franchisees are used more than 47,000 times a day.

Improving Outcomes

Capacity to invest—and thus increased income—is the most tangible benefit of this model. By providing its micro-franchisees with the consignment loan to start selling solar lights in India's urban slums, Pollinate Energy is increasing their income-earning potential. If these "Pollinators" hit the ideal monthly sales target of 40 lights, they earn US$280 a month, which is significantly more than they would earn in alternative forms of employment in the same communities. The ownership of a productive asset and full control over the source of livelihood provides improved earning opportunities and job security. Many of Tugende's customers who successfully completed the lease-to-own scheme for a motorbike have either sold the motorbike for a relatively large sum of money (US$700–$800), which they have then invested in setting up another enterprise, or they have purchased another bike on the same scheme and hired another driver to grow their existing enterprise.

Providing entrepreneurs with finance to set up their micro-enterprises and engaging them in the value chain leads to job creation. Zoona's mobile payments business has more than 650 entrepreneur agents in East Africa who receive and send money transfers. As their businesses grow, micro-entrepreneurs also often employ others from the community. Some of these entrepreneurs could grow sufficiently to join the formal economy and contribute to their country's tax base.[2]

Scaling Up

Challenges

With a large proportion of low-income people in developing countries engaged in self-employment, the demand for credit is high, but the supply is limited. These people do not have access to formal institutions, and informal credit routes are unreliable and costly. Affordable credit is, therefore, much needed by BoP micro-entrepreneurs. The flexibility of the finance offered by these companies has also helped build demand.

A core constraint of this model is that low-income people working as micro-entrepreneurs at the BoP lack basic business skills; therefore, many companies spend considerable resources offering training and other business support as well as putting systems in place to monitor quality and performance. It is particularly critical in the micro-franchisee model because these entrepreneurs are the distributors of the product or service that the business is providing; thus, the success of the business depends on the performance of the micro-franchisees.

Access to affordable capital for the lender is a challenge. Because of the capital-intensive nature of its model, Tugende is constantly fund-raising for debt and equity capital. While Tugende has been relatively successful getting equity investment in recent funding rounds, raising debt capital from local sources has been difficult because Ugandan banks offer loans at high rates.

Another driver is social impact finance at below-market rates that is available for companies to provide credit to entrepreneurs, either because they are distributing socially beneficial goods and services, or because entrepreneurial growth is a social objective in itself. Hence, finance from individual investors and donors online, or impact investment capital and grants for the parent company, are available that can help to make these models viable.

Role of Government and Public Policy

Companies operating in this space are neither formal banking institutions nor MFIs, yet they offer or facilitate financing. This model presents a challenge in developing countries where the regulations concerning such provision of finance is unclear or undefined. In Uganda, Tugende has struggled with regulatory compliance because the laws are not transparent and information is difficult to find. When it tried to register as a leasing company under the Financial Institutions Act, Tugende's CEO was told it wasn't possible because the Bank of Uganda did not have the capacity to oversee the process, even though this would have been the most straightforward way for the company to gain legitimacy. The management team is still trying to understand the regulations to work out how Tugende should be registered.

Pollinate Energy has had similar problems doing business in India. The Australian founders have had to spend a lot of time and resources on understanding what they need to do to comply with local regulation. Setting up bank accounts when the company expands to a new state is a struggle because banks operate differently in different parts of the country. Additionally, banking is expensive: the company is charged a fee every time money is deposited into its accounts, which means it loses some money every time one of its micro-franchisees deposits the payment of a customer. Banking transaction fees are detrimental to a model that relies on multiple small transactions.

Table 2. List of case studies in this profile

Company	Country	Description
Banapads	Tanzania	Banapads provides affordable, eco-friendly sanitary pads to low-income women through a network of micro-entrepreneurs who are provided with an inventory loan to start a micro-franchise.
Jibu	Uganda	Jibu provides a business in a box for entrepreneurs to provide safe, packaged drinking water that is affordable.
Kiva	Global	Kiva is an online crowdfunding platform that connects individual lenders with borrowers in need of loans for services and products. Lenders select borrowers through their online profile and disburse the loan capital (US$25 or more) to Kiva, which passes on the full amount to borrowers through its network of field partners, MFIs, and nonprofit organizations.
MicroGraam	India	Using an online platform, associated analytics, and processes to bring together borrowers, lenders, and grassroots organizations, MicroGraam generates greater income

		opportunities for the poor in northeast India. It has a network of partner organizations to help expand entrepreneurship and livelihood opportunities throughout the region.
Milaap	India	Milaap is a crowd-sourcing online platform enabling individuals to lend to Indian individuals from low-income backgrounds so they can access education, clean water, energy, and other services. Milaap provides loans to prequalified individuals and small businesses through a network of community partners who specialize in providing and managing micro-loans to these local communities.
Pollinate Energy	India	A social business that provides affordable clean energy products to slum communities in India through a distribution network of local entrepreneurs. Entrepreneurs are provided start-up capital through a business in a box.
Rang De	India	Rang De enables individuals to become social investors and lend small sums of money to borrowers from low-income households through an online portal.
Rent to Own	Zambia	Rent to Own helps rural entrepreneurs in Zambia to increase their income by supplying productive assets along with the necessary financing, training, and aftermarket services.
Rickshaw Bank	India	Rickshaw Bank provides a means of self-employment to the poor and marginalized rickshaw community by offering a rent-to-own financing option to purchase a new rickshaw, along with insurance, a license, and a uniform.
Sanergy	Kenya	Sanergy has developed a low-cost toilet that it rents/sells to micro-entrepreneurs in areas without access to piped sewage systems. The toilets are used by the community at an affordable price.
Tugende	Uganda	Tugende is a for-profit social enterprise in Uganda that helps motorcycle taxi drivers buy their own motorcycles with an innovative finance scheme, giving them the means to control their own tools of employment.
Zoona	Zambia	Zoona's core product is a mobile-based Zoona Account. Transactions are processed through a network of Zoona Entrepreneurs, enabling them to process money transfers, pay suppliers, and access working capital financing. These Zoona Entrepreneurs provide members of the public—the service's end users—with a quick and safe money transfer service, along with third-party cash-in/cash-out services.

Notes

[1] M-CRIL (2014).

[2] Chandy (2011).

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PROFILE: Pollinate Energy

Employing slum dwellers to sell solar-powered lights to poor urban residents in India

Challenge

Two of India's greatest challenges are lack of electricity in urban slums and youth unemployment, particularly in cities. Pollinate Energy seeks to address both challenges simultaneously.

Innovation

Founded in 2012, Pollinate Energy (www.pollinateenergy.com) equips low-income people in Indian cities with the business acumen and financing to set up microenterprises that provide residents in urban slum communities with solar lights. It hires and trains "Pollinators," equipping them with a "business in a bag" made up of solar lights, which they sell in their communities; a bank account set up in their name; and a smartphone set up with an app to track payments. Pollinators go door-to-door selling the lights, collect and follow up on payments, handle cash, and use the smartphone to track their sales.

Each light costs the company about US$25. It sells the lights to customers for US$39, financed over five weeks. Pollinators collect each weekly payment and deposit it into the bank account set up for them by the company. They receive half of the profit on each light they sell; the rest covers the company's operating costs. An incentive structure encourages the Pollinators to reach a monthly sales target of 40 lights.

Pollinators sell the lights in three or four urban slums near where they live. Every micro-entrepreneur is thus familiar with the area and is often selling to friends and family. Once the first few customers of each Pollinator are happy with the product, word spreads quickly, increasing sales.

Impact

Pollinators have sold 8,000 lights to 40,000 households in the slums of the three cities where the company operates (Bangalore, Hyderabad, and Kolkata). Each light saves customers US$86 a year. The switch away from kerosene or firewood also improves health (through the reduction in indoor air pollution) and reduces the damage to the environment. The company estimates that more than 670,000 liters of kerosene have been saved, leading to a significant reduction in carbon emissions. Pollinators also typically earn more per month than they would in casual employment. The skills they acquire open avenues to grow their microenterprise or obtain higher-paying jobs outside the company.

Scaling Up

Consumer demand for alternatives to kerosene is high, because it is expensive and recognized as harmful to health. The low cost and available financing make solar lights an attractive proposition.

Distribution of the product by micro-entrepreneurs is integral to the model. Hiring Pollinators who speak the local language and are members of the community has helped build trust and increased reach among target communities. The use of a smartphone application to track sales and payments has helped keep operating costs low and reduced the potential for theft.

Recruiting Pollinators has been a challenge, however, because the job is not easy or immediately appealing. Working in the slums is not considered respectable, and it takes time for new Pollinators to make their first sales. The company is trying to find recruitment channels that will connect them to the right people. It is also exploring ways to make the payment structure more attractive.

PROFILE: SolarNow

Providing energy to off-grid communities through innovative asset financing

Challenge

More than 60 percent of people in Sub-Saharan Africa lack access to electricity, according to the World Development Indicators. Most of them live in rural areas off the grid, relying on primitive sources of energy such as biomass and kerosene, which are expensive, harmful to health, and polluting. With the slow pace of grid expansion, solar energy is the most viable option for them. However, the cost of a good-quality solar energy system is beyond the means of most villagers.

Innovation

SolarNow (www.solarnow.eu) has developed 50- to 2,500-watt solar home systems, priced from US$400 to US$10,000. Its products provide more power than simple solar lamps and last 10–20 years, depending on usage. To make its products affordable to base-of-the-pyramid consumers, SolarNow offers a 24-month credit facility, called PayPlan. Customers deposit 15–20 percent of the purchase price, paying the rest in monthly installments at an annual interest rate of 30 percent. To qualify for the plan, a buyer must pay US$130 up front and have a monthly household income of US$75. Once the deposit is paid, the system is installed within 14 days. Afterward, a service team makes regular calls and visits to monitor quality and ensure that customers are aware of repayment terms; a two-year service guarantee is also provided. Ownership of the system incentivizes proper usage and maintenance by the customer, as does the ability to upgrade their system and purchase other electrical products after completing the 24-month plan. Product upgrades—TVs, refrigerators, and other electrical appliances—are a key source of revenue for the company.

SolarNow has had to write off less than 0.4 percent of its loans, and less than 2 percent of PayPlan customers have repayments pending more than 30 days. Payment discipline is a constant focus: SolarNow has invested in monitoring repayments, sending timely reminders to customers.

Impact

Founded in 2010, SolarNow has sold 7,000 solar home systems, reaching about 50,000 people. A company investor's impact study found that about half of all consumers live below the US$2.50 per person per day poverty line. A third of the customers are institutions, including clinics and schools, which also reach the bottom of the pyramid. Customers experience multiple benefits: cost savings; cleaner indoor air; increased productivity, as a result of lighting at night; and access to information, through radios, TVs, and phones. Use of the 7,000 systems is estimated to reduce carbon emissions by about 70,000 tons over a 10-year period.

Scaling Up

SolarNow has been selling solar home systems to off-grid consumers in Uganda since 2011. A major driver has been the company's in-house consumer credit facility. It also sells a high-quality product, which has built trust among consumers previously wary of investing in solar systems.

SolarNow has found it difficult to find equity investment: investors find the proposition too risky and are confused by the fact that the company combines solar home system sales with asset financing. Working capital has also been a constant issue. Cash constraints have reduced margins and caused stock-outs, making it difficult for franchises and sales staff. Despite these difficulties, SolarNow raised €2 million in equity investment in 2014.