

By NISHANT LALWANI / Senior Manager/ Monitor

# Lending to People, Not Paper



Ramesh wants to buy a house. As an autorickshaw driver in Ahmedabad, he earns less than Rs 9,000 a month, but with a mortgage could afford a home in DBS' new development on the outskirts of the city, where prices start at Rs 3.2 lakh per flat. However, he has no proof of his income or even his address. He does have a bank account but barely uses it. He needs a loan of Rs 2.5 lakh and has savings of Rs 70,000.

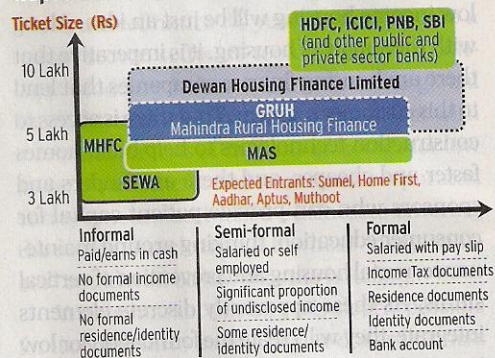
Without salary slips or income tax returns, Ramesh would never get a loan from conventional lenders. To quote the CMD of a large Indian bank, "my staff can only interact with paper, not people." However, new companies such as Micro Housing Finance Company (MHFC) and MAS Financial Services, and longer term pioneers such as Dewan Housing Finance and Gruh Finance are among the few housing finance companies (HFCs) who serve home financing demand from low income, informal sector customers.

Ramesh has found his way to MHFC in Ahmedabad, where Ashish Kothari is the loan officer who evaluates his application. The first step is to "storyboard" Ramesh's life. Initial questions are about his family, living situation, his income, previous loans and assets. While the output of this process is always the same — understanding the customer's ability to meet the requisite monthly repayments on a loan — the process itself must be tailored to each applicant. Kothari has interviewed many autorickshaw drivers and asks all the right questions: How long are your rides on average? Do you work at night? Do you own your autorickshaw or do you rent it?

More important than gathering this customer information is verifying it. Kothari will spend a full day ensuring that the data the autorickshaw driver gave is correct. He will visit his potential customer's house, speak to his family and check the condition of his autorickshaw. He

New companies such as MHFC and MAS Financial Services, and longer term pioneers such as Dewan Housing Finance and Gruh Finance, are among the few housing finance firms who serve home financing demand from low income, informal sector customers.

## Representative HFC Market Map—India, 2010



will talk to his fellow auto-wallahs, to understand whether the average income of those drivers is in the same ballpark. He will call up the three references furnished, including the garage where the autorickshaw is repaired to check if maintenance payments are made on time.

These are just some of the elements of MHFC's verification process. The risk associated with a customer does not decrease in the process; it is simply better understood. Low income, informal sector customers are often considered "high risk" by conventional HFCs, but in reality they are often simply "unknown risk". However, low income customers can sometimes carry greater risk than their middle and high-income counterparts. For example, a customer with very little savings is more likely to default on mortgage payments in case of a medical emergency. But the loan is secured, and any extra transaction cost and credit risk can be accounted for through appropriate pricing. That is why MHFC (and the other companies operating in this segment) often charge between 12 and 14 per cent interest to their customers — rates that are 2-4 per cent higher than conventional HFCs. But it seems these prices still appeal to their customers. "I am so happy that I am getting a loan," says Ramesh. "I tried with my bank first, but they wouldn't even look at my application." ☺