

PRODUCT PROCEDURE DESCRIPTIONS

GROUP COST-PLUS SALE WITH DEFERRED PAYMENTS

Based on murabaha

OVERVIEW

Client indicates need for a good (e.g. kerosene) that she will resell in smaller quantities at a mark-up. We buy the good on behalf of the customer and disclose the cost of the good and the markup charged to the client. The client will repay the cost-plus-markup over a fixed time period. If the customer cannot repay a payment or multiple payments, we charge a fee corresponding to the actual costs of collection. This fee is assessed for each sequence of consecutive missed payments, does not depend on the financing amount, and is not compounded.

PREPARATION

Preparation for using this type of model begins with determining the range of financing offered, the markup of the sale needed to cover costs, the length of repayment and the items which are eligible for financing. An important factor to consider in determining the markup on the sale is the relative importance of this finance method as a revenue generating product versus a screening device. If the microfinance institution (MFI) is more interested in using cost-plus sale as a primary product, then the markup will have to be higher than if it is primarily a screening device.

As a screening device, the cost-plus sale can be effective because it will have a similar procedure for administration as a conventional MFI loan because there will be a fixed number of repayments with equal payments each period (typically weekly). It differs from a conventional loan because the transaction is one where the MFI acts as a wholesaler as well as a financier and therefore the financing is contingent upon delivery of a tangible good. Because cost-plus sales are easier to monitor than equity-based microfinancing, it is easier to determine the ability of the client to make on-time repayments which should also be a good signal about the client's willingness to report profits accurately if they are given equity-based financing in the future.

The cost-plus sale fits into our microfinance model as either revenue neutral (it generates enough revenue to cover costs of administration and monitoring) or slightly revenue positive, not a major revenue generating product. The equity-based products have a higher potential upside for the microfinance institution because there is no upper limit to the profit-sharing as there is in a cost-plus sale.

GROUP FORMATION

The cost-plus sale will work with a group-financing methodology based on its successful track record in Grameen Bank-style microfinancing. The groups will form without coordination from the MFI in order to ensure that all the members of the group are comfortable with providing social collateral (informal intra-group monitoring) to all other group members. Once the product is explained to the group members, the group members pick one member as a group leader and a different member who is literate to be responsible for helping the other members with recordkeeping.

After picking a group leader and recordkeeping assistant, the MFI walks each group through the process of coming up with a business idea and presenting it to the MFI for approval. This plan will contain information on the product for which financing is requested, how the product will be sold, and how the financing will be repaid. Additional information which can be included in the business plan is information on each member's previous business experience (e.g. whether they have received financing from another MFI in the past). Finally, the MFI will collect information on each member's income, demographic and previous credit experience (either with conventional financial institutions or MFIs). This information will be used alongside the business plan to evaluate whether financing is provided. The evaluation will be more

flexible than a conventional loan procedure because the goal is to reach as many poor clients as feasible (the social mission of the MFI).

APPROVAL

If the group member's business plans and history's are considered to be promising, we will grant the group members financing. Upon approval, we will meet with the group members and describe the parameters of the financing, which will be documented in writing. The agreement will be signed by the MFI and the client (a thumbprint is an alternative). This contract will detail the financing schedule (the order in which group members receive their financing contingent upon repayment), cost of the item, markup amount, payment amount, number and frequency of payments, fee charged if payment(s) are missed and the penalties for fraud.

In addition to providing funding to the clients, we will provide a basic ledger and show clients how to keep track of revenues, expenses, cash draws from the business. One member of the group is selected to assist other members of the group with their basic ledger. Once the financing agreement is signed and the ledger training is complete, we will purchase the items requested by the clients in the first disbursement group and deliver it to them. If the client refuses delivery (e.g. the goods are damaged or of sub-par quality), the MFI will not penalize the clients and will retain possession of the goods.

Financing is provided initially to two members of the group. If these members make repayments on time for eight consecutive weeks, two other members receive financing. If all members make repayments on time for eight consecutive weeks, then the group leader receives funding.

REPAYMENT

Client makes weekly repayments over the length of the loan (between 12 and 15 months). When collecting repayments, representatives of the MFI should ensure that the business is running well and that no repayments will be missed in the next few weeks. If a client misses a repayment, we will charge a flat fee (per sequence of missed payments) to cover the additional costs spent working with the client to restart repayments with the objective of ensuring future repayments and business viability. Upon successful repayment, the client will have the option of additional financing.

SUMMARY

The cost-plus sale product is the most basic microfinancing product we will offer. Although it is not equity-based and resembles a conventional microfinance loan, it provides a way to screen group members to avoid clients who will not make repayments or will deliberately understate profits if given equity-based microfinancing. Although we are designing the product as part of a new model of equity-based microfinance, we also believe that it will also be viewed as halal and be accepted by a wider group of people living in poverty including those not currently served by conventional microfinance.