CREDIT TO MERCHANTS

Tienda Pago's Digital Solution for Fast-Moving Consumer Goods

International Finance Corporation
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Credits

Acknowledgments

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About IFC

IFC—a sister organization of the World Bank and member of the World Bank Group—is the largest global development institution focused on the private sector in emerging markets. We work with more than 2,000 businesses worldwide, using our capital, expertise, and influence to create markets and opportunities in the toughest areas of the world. In fiscal year 2018, we delivered more than $23 billion in long-term financing for developing countries, leveraging the power of the private sector to end extreme poverty and boost shared prosperity. For more information, visit www.ifc.org.

About HiFi

Harnessing Innovation for Financial Inclusion (HiFi) is the World Bank Group's program aimed at scaling up financial inclusion on a sustainable basis by harnessing technology and innovation. The HiFi program is funded with UK aid from the UK Government and implemented by the World Bank Group through the International Finance Corporation (IFC), the Finance, Competitiveness and Innovation Global Practice (FCI GP), and the Consultative Group to Assist the Poor (CGAP).

FOREWORD

IFC's Financial Institutions Group (FIG) leverages the financial and capital markets to help achieve the universal aspiration for shared sustainable development—whether those aspirations are represented in the Millenium Development Goals, the 2030 Agenda for Sustainable Development, or the Twin Pillars of World Bank Group—eradicating extreme poverty and increasing shared prosperity.

To achieve shared sustainable development, FIG plays two critical roles in financial markets. One role is to support the support the growth of disruptive technologies and business model innovations to increase the reach and quality of financial services in emerging markets. As technology trends introduces new players and competitive dynamics in these markets, IFC seeks to support innovations capable of reaching un(der)-served segments, and to accompany these markets through the responsible development of new products and services. A second role for FIG is to support financial institutions and financial service providers (new and existing) with capital and advisory services, to help those institutions competitively and profitably serve the needs of clients. In the implementation of our work, FIG aspires to universal financial access and job creation in emerging economies.

At the nexus of market dynamism and job creation lie small businesses that generate jobs and economic growth in many economies. Micro, small, and medium enterprises (MSMEs) comprise the vast majority of business in developing economies,[1] making them critically important for economic growth, innovation, competitiveness, and entrepreneurship. They contribute roughly 40 percent of gross domestic product in emerging economies, providing critical products and services across the economic spectrum. Globally, and in developing countries especially, key industries (such as construction, mobile telecommunications, and fast-moving consumer goods) rely on a network of small merchants in their supply and distribution chains. Beyond being a critical engine for economic growth, MSMEs play an outsized role in job creation and economic inclusion. A recent IFC study finds that access to finance persists as a key obstacle to the growth and sustainability of these enterprises, with an estimated $5.2 trillion financing gap for formal MSMEs and a potential latent demand for finance of $2.9 trillion from informal enterprises.[2]

Digitalization is creating outsized opportunities for narrowing this gap. Beyond the growing digitization and analytical capabilities of financial service providers, the rapid growth of Internet connectivity has led to the digitization of transaction and record data reaching even the smaller enterprises across value chains in emerging markets. This data is creating new opportunities for providers to assess risk and design products to address the needs of underserved segments, particularly micro and small enterprises that lack collateral. Banks and new fintech businesses with innovative and specialized business models are disrupting the landscape of consumer and MSME finance, leveraging data and digital channels to redefine the suite of products and services available to these segments. Tienda Pago is one such emerging fintech business, focusing on leveraging distributor data to extend supply chain finance credit to micro and small merchants for fast moving consumer goods. Because IFC has an interest in the scalability of these innovations, we worked to prepare a case study looking in more depth at the business model and the challenges it proposes to address.

Margarete Biallas

Digital Financial Services Advisory Practice
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International Finance Corporation


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INTRODUCTION

Fast-Moving Consumer Goods (FMCG) are products that are sold quickly and at a relatively low cost. Examples include non-durable goods such as packaged foods, beverages, toiletries, over-the-counter drugs, and other consumables.

Micro, small, and medium enterprises (MSMEs) are among the strongest drivers of economic development, both globally and in Latin America and the Caribbean. However, MSMEs face significant barriers in accessing finance. According to IFC, of the 28 million MSMEs in Latin America and the Caribbean, fully 40 percent are estimated to be partially or fully financially constrained—and most of these are microenterprises. The finance gap for the region, not including informal businesses, is estimated at $1.2 trillion.[3]

Short-term working capital is a significant portion of this gap, and it is particularly important for the survival and growth of small merchants in the region. These stores rely on high turnover and often manage a complex set of relationships with distributors that handle fast-moving consumer goods (FMCG), in which liquidity for the purchase of inventory is paramount. Despite a growing network of franchise convenience stores and supermarket chains, there are a multitude of independent stores in the region. For example, there are an estimated 1.2 million independent stores in Mexico[4] and more than 414,000 in Peru.[5]

The vast majority of these small merchants lack access to formal, short-term working capital. The speed and size of their transactions make it challenging for banks to service this segment, because their transactions tend to be small and largely not traced. To address this need, some FMCG distributors manage their own financing programs for merchants. Indeed, merchants become a part of the value chain of the FMCG distributors. Specifically, the distributors must develop lending and collection functions that go far beyond their core businesses, which can make the provision of credit less efficient and sustainable. The distributors also assume unnecessary risk by providing uncollateralized lending, with limited capability to assess their borrowers' levels of credit risk.

Apart from filling a critical financing gap, providing access to finance for merchants is increasingly recognized as an important catalyst for the uptake and usage of electronic payments, as well as for the wider fintech ecosystem. Small merchants play a central role in the economy because of their proximity to customers and the large volume of payments they process. A World Bank report estimates that merchants make and receive $34 trillion per year worldwide, more than half of which is still processed in cash.[6]

Tienda Pago is an emerging fintech player that provides working capital solutions specifically targeted at merchants in FMCG supply chains. Launched in 2014, and with ongoing operations in Mexico and Peru, Tienda Pago developed a mobile-based platform that specializes in distribution finance and aims to resolve a key challenge in the FMCG retail sector. Merchants often have limited cash availability to pay distributors, which leads them to buy limited inventory, thereby reducing potential sales and requiring smaller and more frequent orders. This, in turn, leads to cash collection issues or the provision of loans that they are not equipped to manage. Tienda Pago's core product proposition is a credit line that allows small merchants to purchase inventory on credit at the time of delivery.

This case study aims to extrapolate some preliminary lessons from Tienda Pago's model, including its challenges and potential for scale. The study is informed by distributor and customer interviews and qualitative research,[7] which sought to map characteristics of merchant clients and analyze both drivers and barriers to product usage and uptake.[8]

THE MERCHANT CHALLENGE: WORKING CAPITAL

Merchants are local, small retail businesses, often informal and owned by an individual or a family. They base their businesses on convenience and established relationships with their customers, conducting cash transactions with both customers and suppliers. In spite of limited room to stock inventory, owners place a high value on having a well-stocked shop, because this is seen to be key to satisfying and retaining their customers.

Insights about the Financial Lives of Fast-Moving Consumer Goods Merchants

FMCG merchants usually rely on their business as the main source of income for their household. Such merchants are typically risk-adverse, preferring cash transactions with both customers and suppliers and selling most of their goods at the counter. In Peru, about 70 percent of these stores are managed and owned by women, located at the owner's primary residence, and have family members involved in running the business. Although social media platforms are relatively common for these stores, the owner's children are the primary users of these services.

Lack of access to financial instruments and low margins create challenges for merchants, limiting opportunities for investments to grow the business and meet expected peaks in demand.

Most of the merchants interviewed are more than 40 years old. However, the research showed that younger merchants are more entrepreneurial and tech-friendly and have plans to grow their businesses. In several cases, younger merchants are only operating the business as a part-time activity and have more than one business. These store owners tend to be more interested in taking on credit, as they seek to grow their businesses.

FMCG merchants interviewed in Mexico and Peru mainly sell five categories of products: groceries, candies, beer, soft drinks, and cleaning products. Alcoholic drinks are among the goods with the highest turnover, and together with soft drinks, can account for as much as 60 percent to 80 percent of their total sales. Their businesses usually are retail shops or establishments that serve food and beverages, such as bars and restaurants. Beverage distributors label these two groups of merchants as closed- and open-bottle stores, respectively. Only restaurants or bars have the ability to freely set the price of goods sold. Although the majority of merchants are small retailers, open-bottle points of sale represent an important share for distributors of alcoholic beverages and soft drinks.

Buying inventory directly from distributors. Merchants tend to prefer buying the bulk of their inventory from FMCG distributors, for several reasons, beginning with the convenience of the door-to-door delivery service that distributors provide. While wholesale retailers may offer competitive promotions and even cheaper prices, interviews indicate that the majority of merchants value their relationships with distributors and the opportunity to rely on their logistics networks. In addition, distributors offer several valuable services, such as replacing items that are defective or nearing expiration. Depending on a merchant's purchase levels, it can also procure branded accessories, or valuable assets such as stands and refrigerators. In Peru, in several instances, distributors have been offering goods on credit, an operationally challenging service for most distributors. See figure 1 for an illustration of the merchant-distributor relationship.

Figure 1: Merchants' Relationship with Distributors

Merchant

1 **Presales visit:** Presales personnel often visit the merchant to offer new products, review the stock, supervise that the items are placed correctly, and offer promotions.

2 **Order placed:** Depending on the supplier, orders can be placed by phone or directly to the distributor presale personnel.

3 **Order processed:** At night, orders are processed, invoices are created, merchandise is loaded in delivery trucks and routes are assigned.

4 **Goods delivered.** The distributor delivers the goods.

5 **Payment:** Most merchants prefer to use cash and pay against delivery. In Peru, for high-value orders, merchants pay directly at the bank and give the voucher as a proof of payment (15% of the cases). If there is a direct loan from the supplier, the payment is usually made in cash and directly paid to the delivery personnel.

Sources: Interviews with Distributors and Merchants. Prepared by IFC.

Limited financial literacy. Market research found that although business owners maintain some written records of their sales and inventory, they largely rely on experience to estimate product turnover. Indeed, they can be quite successful at estimating their needs, as they rely on timely distribution systems to run their businesses. Inventory orders are based on observations of stock levels, the season, and distributor incentives (promotions, points, etc.). Financial literacy is quite low among these microentrepreneurs, who often comingle cash for personal and business purposes. They have limited knowledge of actual earnings. Most measure their gains in nominal value and not as a percentage of cost of goods sold. Furthermore, business owners measure success based on what they have accomplished thanks to shop profits (especially home/store improvements and entertainment). Another common measure is whether they have grown their business in size and have a well-stocked-store. Interviewed merchants maintain a short-time horizon, preferring to pay their daily obligations with that same day's sales.

Merchants are usually reluctant to take short-term working capital loans due to previous bad experiences taking debt.

Limited access to financial services. The majority of merchants interviewed have some experience borrowing from banks or microfinance institutions. Although some merchants have bank accounts, savings in cash or inventory accumulation is also common. Given the convenience of cash, it is the preferred method for paying distributors. For some merchants, cash is the only option they are willing to use. Cash payments are also short and simple transactions, reassuring merchants that they are not accumulating unnecessary debt.

Attitudes regarding debt. Interviews with FMCG merchants reveal a certain reluctance to take short-term working capital loans. Some merchants have difficulties with planning ahead financially and find credit to be stressful on the day of repayment. Others report bad experiences with previous loans as the reason for their reluctance to reengage in lending. Furthermore, several merchants say they already have an outstanding loan and don't want to manage multiple loans. Some find the fees and the stress associated with submitting a loan application to be too great to justify applying for smaller, shorter-term loans.

While some merchants report being willing to take on credit—in case of an emergency, to start a business, or to make personal investments, such as home improvements—fewer see the value of short-term credit as a means of financing inventory purchases and expanding their businesses. In part, this is because of an established concept that business sales must cover inventory purchases. Open-bottle establishments tend to have more interest in credit products for their business, likely due to their bigger margins per product sold.


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THE FAST-MOVING CONSUMER GOODS CHALLENGE: BUILDING EFFICIENT DISTRIBUTION NETWORKS

Merchants' cash constraints can be a significant threat to distributors' efficiency.

A good distribution network is a key factor for success in the FMCG industry, as this network delivers low-price, high-volume products to thousands of merchants each day. Maintaining an efficient network is a priority for distributors, which strive to maximize sales, mitigate operational risks, and minimize costs, including those for cash collection and management.

Merchants' cash constraints is a significant threat to distributors' efficiency, because it can lead to delays or trucks returning to the warehouse with unsold goods. The liquidity constraints also result in a high frequency of orders from stores, which raises costs for distributors. Providers servicing small stores are generally required to plan longer routes because of the small size of each order, and delivery teams have only minutes to fulfill an order and collect payment. Table 1 shows illustrative examples of a typical distributor visit to an FMCG merchant.

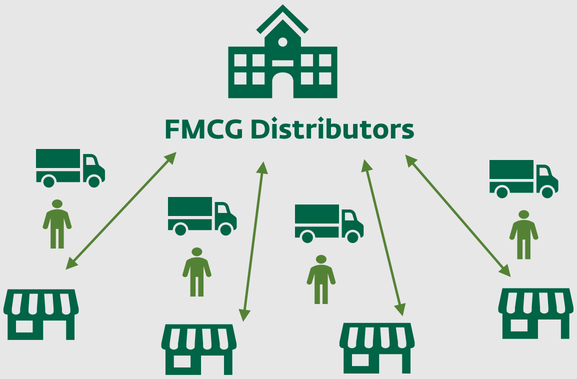
To address these challenges, sometimes distributors revert to direct financing. By providing goods on credit to merchants, they are able to maintain their sales levels, reduce the frequency of visits, and maintain a competitive position with the store. This has been a common practice for several distributors, particularly in Peru, and also benefits merchants that are loyal customers of the distributors. However, FMCG managers interviewed increasingly recognize that the financing and cash collection costs associated with this activity lead to another set of inefficiencies and costs. They look favorably at opportunities to outsource these activities, to focus on their core operations and improve their balance sheets.

TABLE 1. Examples of Visits by Distributor (frequency per product)

2-3 times a week	Weekly	Twice Monthly	Monthly
Non-alcoholic beverages (for example, soft drinks)	Alcoholic beverages (for example, beer)	Groceries, cleaning products and high turnover, nonperishable products	Low turnover, nonperishable products
\$100-150 Weekly (2-3 transactions weekly)	\$200-250 Weekly (1 transaction per weekly)		

Sources: interviews with merchants in Peru.

FIGURE 2. Fast-Moving Consumer Goods Distribution Network



Logistics, operations, and challenges vary between countries and type of FMCG distributors. Depending on the product turnover and average sales tickets, merchants are engaged in different ways. Usually, distributors segment stores into categories, based on the size of the store and sales volume, and tailor the frequency of visits, promotions, and other services accordingly.

Presales Team

- On average, they visit 60 clients daily and each visit averages 5-15 minutes. The frequency of their visits to individual clients varies from 2-3 times weekly, to once monthly.

Delivery Team

- Each truck driver has a portfolio of around 300 stores and can visit an estimated 30 stores daily.
- Some distributors set a maximum amount per store for cash payments.
- According to truck drivers, in about 10% of the cases, merchants have problems producing the total cash owed for the order. When this happens, the driver usually returns later to see whether the merchant raised the money.

Source: Interviews with FMCG Distributors.

Insights into Fast-Moving Consumer Goods Operations

To understand the implications of the liquidity challenge for FMCG distributor operations, IFC conducted a series of qualitative interviews with managers and presales and delivery staff from a number of FMCG distributors in Mexico and Peru. Understanding their roles and incentives is important in developing and designing a solution that addresses the cash constraints of the distribution chain. To that end, management aims to establish efficient delivery routes. The presales and delivery staff teams are key players in the distribution chain, since they maintain the relationship with merchants and are responsible for the sale and delivery of products .

FMCG distributors typically have two main functions:

- **Presales**—placing the product in the market and submitting orders. Distributors make presales visits to merchants on a regular basis to assess needs, inform about promotions, take orders (or pre-orders, as sometimes the order is placed by phone), and advise merchants on product placement. Presales staff are the relationship managers, possessing deep knowledge of the merchants' needs. They are key to introducing innovative products and services.

- **Deliveries**—delivering orders to the stores, collecting payments, and reconciling operations at the end of the day. Usually a delivery team consists of a driver who is also the cashier, with one or two people helping the driver deliver the products to the merchants. This team takes payments, often in cash, recording the transactions and receipts on a digital device. Prepayments through bank accounts are recorded at the time of delivery, as well.

The presales and delivery staff teams maintain a close relationship with merchants so they become key players in the distribution chain.

FIGURE 3. Distributor Staff Incentives

	Presales Team	Delivery Team
Performance Indicators	• Sales • Number of point-of-sale visits • Equipment reviews (for refrigerators) • Direct credit tracking • Correct display of products in stores • Time spent in each store	• Number of merchant visits • Number of merchandise returns
Incentives	• High motivation to increase sales • New product placement in the market	• Motivation to deliver on time to all stores and complete all orders • Reduced likelihood of canceled transactions because of merchant liquidity constraints • Less handling of cash, to mitigate security risks

Source: IFC Interviews.

Both presales and delivery staff typically operate on tight daily schedules. Often, this affects their ability and willingness to adopt new processes that may require additional time with merchants. Figure 3 lists typical incentives for presales and delivery teams.

Interviews confirmed that most merchants pay in cash and directly to the truck driver. However, in Peru, one in five merchants make their payments at a bank or at an agent ahead of delivery. For delivery drivers, a bank deposit is the most convenient payment method, since they consider it the easiest, fastest, and safest method. From management's point of view, cashless transactions mean additional security for their employees and a lower chance of assaults, and reduce the time needed to reconcile cash along the various steps of the delivery chain. In addition, several delivery staff raised issues related to cash payments, such as miscounting of the payments, and also merchant liquidity constraints that force them to return to the warehouses with unsold goods at the end of the day.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TIENDA PAGO'S INTEGRATED SOLUTION

Tienda Pago provides merchants and distributors with a simple, integrated solution to relieve merchant liquidity constraints and bring efficiencies to the distribution chain. The core product proposition is a credit line that allows small merchants to purchase inventory on credit at the time of delivery.

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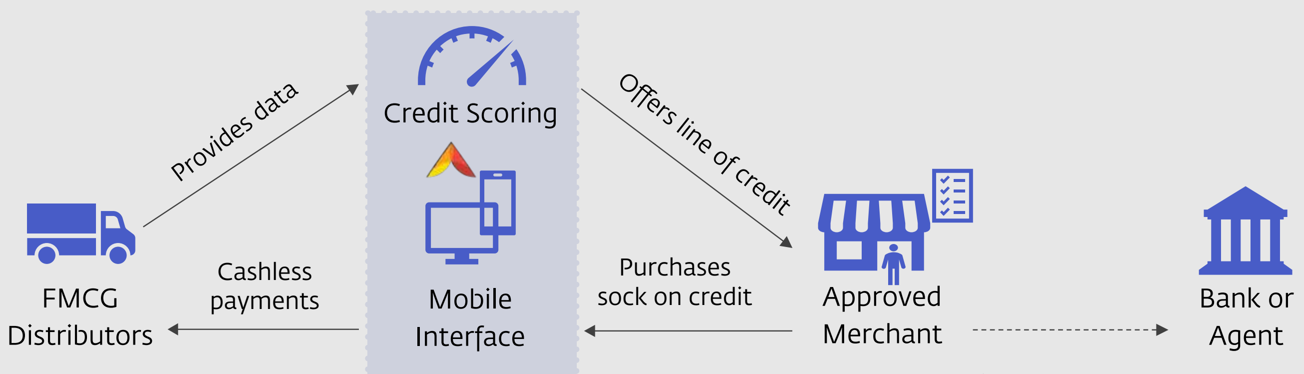
It offers instant, uncollateralized working capital loans, by integrating a mobile platform with the operations of FMCG distributors. Merchants can use a credit line to purchase goods from any FMCG company affiliated with Tienda Pago. As of December 2018, Tienda Pago offered a seven-day loan with a fixed fee of 2.5 percent in Mexico and between 1.5 percent and 2 percent in Peru.[9]

By leveraging FMCG partnerships and using inventory purchases to assess the creditworthiness of merchants, Tienda Pago creates a small ecosystem designed to give both distributors and merchants the opportunity to grow their businesses. This system limits transaction costs for both distributors and merchants, by embedding credit in the existing distribution process. Also, both the merchant and the delivery truck driver can manage the credit line through their cell phones, which provides a closed credit loop in which the line of credit can be only used to buy inventory.

Figure 4 offers a representation of the Tienda Pago ecosystem, which connects distributors and merchants using a credit scoring algorithm and a mobile interface. This integrated solution has significant potential for scale, because it does not require ownership of a bank account. Also, it does not require merchants or delivery staff to have access to a smartphone or a point-of-sale device, because it works with regular text messages, which both limits operating costs and maximizes accessibility. The system relies on the ability of merchants to access a fast-growing network of agents and bank branches to conveniently process loan repayments.

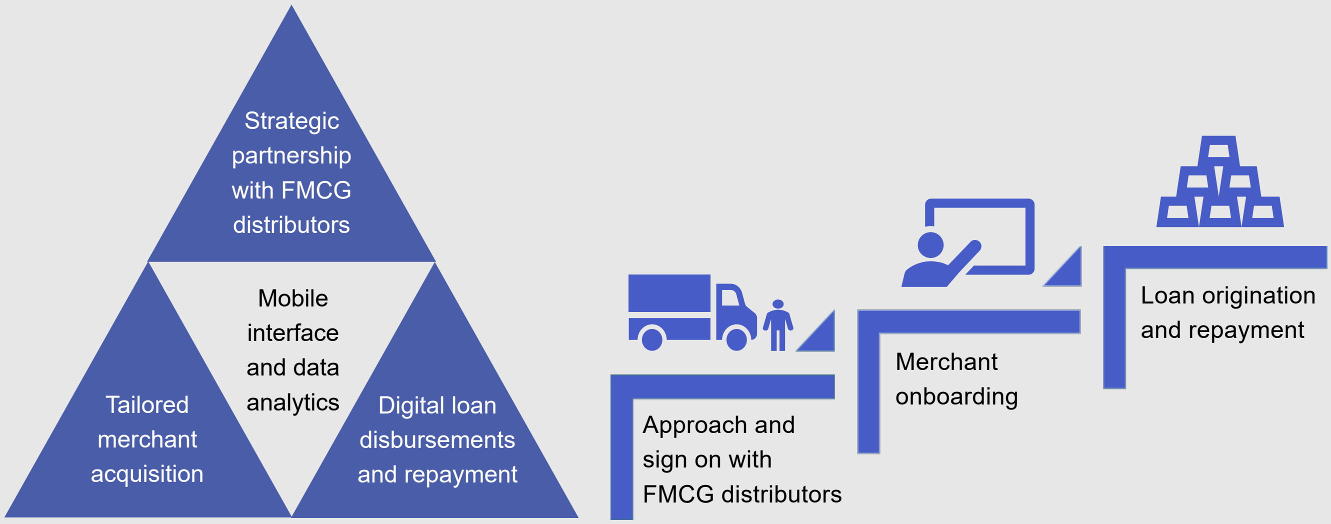
FIGURE 4. Tienda Pago's Ecosystem Model



Source: Tienda Pago. Prepared by IFC

Tienda Pago has a unique business model (figure 5) aimed at expanding digital credit access in underserved markets and decreasing reliance on cash. Both merchants and distributors benefit from a secure and efficient connection, which allows them to increase sales and reduce costs.

FIGURE 5. **Tienda Pago's Business Model**



Source: Prepared by IFC.

Tienda Pago's early experiences highlight the importance of the incentives and economics of each component. The enabling factors for each component, as gathered from the interviews and qualitative research, are examined next.

Mobile Interface and Data Analytics

Tienda Pago's ecosystem is grounded in its relationship with FMCG distributors, to optimize the costs of onboarding, processing, and collecting loans. The company bases its credit decisions largely on an analysis of merchants' purchase histories within the distribution network, as well as alternative data, such as information from credit bureaus. Through the platform, loans are linked to transactions with the same FMCG distributors and settled daily.

Through the platform, loans are linked to transactions with the same FMCG distributors and settled daily.

FMCG distributors share access to electronic records of recent purchases and basic information about their client stores. Tienda Pago uses this data to assess risk and identify creditworthy businesses in the distributors' networks. While external sources, such as credit bureau data, are also incorporated in the final assessment, Tienda Pago's proprietary credit scoring tool can independently determine a credit profile, thereby enabling access to merchants that previously lacked access to banks or other financial services.

Currently, more than 80 percent of merchants working with Tienda Pago distributors qualify for a loan. The starting credit line offer is equal to the merchant's weekly sales (calculated on a three-month average). Tienda Pago increases the credit line by 20 percent when merchants reach four or more consecutive on-time payments. Just over half of merchants fall into this category. Excluded merchants typically have an average weekly purchase of less than $50 (because they do not justify the acquisition and processing costs involved) or have been recently reported to the country's credit bureau.

Tienda Pago's scoring model monitors ongoing transactions with distributors to continuously develop the predictive capacity of its algorithm. It does so by adding data sources and developing behavioral scoring dimensions, to improve merchants' ability and willingness to repay the loans. This also allows Tienda Pago to make decisions about whether to increase or decrease the credit limit of a particular merchant.

Strategic Partnerships with Fast-Moving Consumer Goods Distributors

A solid partnership with FMCG distributors is at the core of Tienda Pago's business model: indeed, it is essential for the sustainability and scalability of the service. First, Tienda Pago gains access to merchants' purchase histories with distributors. Second, the company offers an attractive business proposition to distributors. By providing payment-linked, short-term working capital loans for merchants, Tienda Pago allows distributors to:

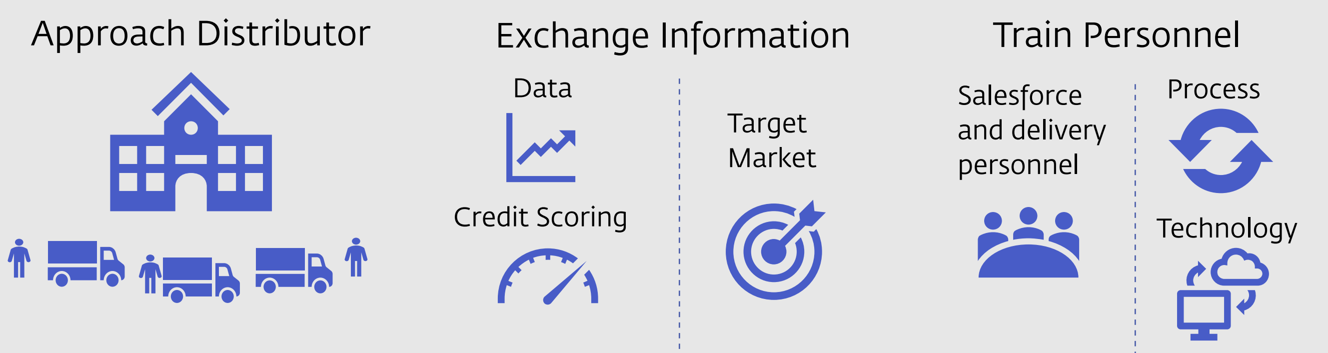
- Increase sales, by enabling access to digital finance for merchants. FMCG distributor experiences predict a 15 percent to 25 percent increase in sales for merchants that regularly use Tienda Pago.
- Transfer credit risk and cash collection costs away from self-financed distribution credit plans
- Improve their balance sheets, by reducing accounts receivable payments and freeing up capital for investments

As the proportion of payments facilitated by Tienda Pago increases, FMCG distributors can also mitigate risks related to cash collection (for example, through theft and fraud), lower operational expenses related to cash management, manage costs by consolidating receivables payments, and redesign logistics routes by reducing needed visits to merchants.

Partnering with FMCG distributors is the first key step of the overall process. As of December 2018, Tienda Pago had partnerships with nine distributors, 2 in Mexico and seven in Peru. Tienda Pago conducts a business review and coordinates with each distributor to synchronize access to transaction data for credit scoring. It also sets up a system for daily settlements. Tienda Pago trains distributor personnel (sales, delivery, and call center teams) about the benefits of the product and ways of encouraging product usage. The training is especially important, because sales and loan utilization depend on the capacity of distributor personnel to encourage active product use. The process of approaching and selecting FMCG distributors is shown in Figure 6.

FMCG distributor experiences predict a 15 percent to 25 percent increase in sales for merchants that regularly use Tienda Pago.

FIGURE 6. Signing Up Fast-Moving Consumer Goods Distributors



Tienda Pago approaches a big brand distributor to demonstrate the benefits of its model.

The distributor shares its merchant data and Tienda Pago assesses the merchants' creditworthiness, to obtain its target

Tienda Pago trains the distributor's personnel, to onboard them to its program.

Source: Prepared by IFC, based on Tienda Pago information.

BOX1. Distributor Perspectives on Tienda Pago

- It is a useful digital solution for cash-constrained merchants in case of an emergency or no direct credit line from the supplier.
- It serves as a sales tool for new merchants and for selling more promotions.
- Merchants generally borrow $150 to $1,000. Restaurant and bar merchants can set product prices. In Mexico, Tienda Pago products are more viable for merchants that buy more than $250 worth of inventory.
- Distributors still have a long way to go to realize the full benefits of the product. For presales teams, this would include a significant increase in sales and a tool to improve relationships with merchants. For delivery teams, it would entail shorter and more efficient delivery routes.

Interviewed staff of distributors say they value the Tienda Pago product and are aware of its benefits for merchants. At the same time, the staff members recognize that distributors themselves need to more fully integrate the product into their own operations and benefit from it. Box 1 lists the distributors' perspectives on using Tienda Pago, as collected from the study interviews.

Tailored Acquiring of Merchants

The third component in the business model is acquiring merchants. This is typically one of the most challenging and costly aspects for financial service providers seeking to launch a merchant platform. Tienda Pago's model addresses this challenge by establishing symbiotic partnerships with distributors, relying on their infrastructure for screening of and affiliation with merchants.

Relying on these partnerships, Tienda Pago offers an attractive value proposition to merchants. By providing simple and fast access to credit—based on easy-to-use technology that doesn't require smartphones—merchants can:

- Increase their business sales, because they are not cash constrained
- Improve their business income, by freeing up capital for higher-margin products or other uses

The success of this component rests on Tienda Pago's ability to target merchants through a detailed analysis of their purchase patterns, as well as to communicate the right value proposition to the merchants using an appropriate sales pitch. This component relies on both Tienda Pago's salesforce and the distributors' presales teams. Using a collaborative approach, they leverage existing relationships between the distributors and merchants to affiliate the merchants with Tienda Pago. Distributors bring trust to the model, and Tienda Pago staff help merchants understand the benefits of digital credit, while also supervising the overall process. Figure 7 outlines the targeted merchant onboarding and affiliation process.

FIGURE 7. Targeted Merchant Affiliation and Onboarding

Engagement

A distributor's sales team approaches a preapproved merchant during a regular visit, offers a credit line, and encourages the merchant to sign up for a Tienda Pago loan.

Activation

The merchant calls Tienda Pago, which activates the credit line (this can only be done as a pull request). The activation also can be done at the time of a presales visit.

Documentation and Training

Tienda Pago's sales team visits the merchant and explains the loan terms and conditions. The merchant provides demographic information and signs the loan agreement.

Generate Sales

Tienda Pago is exploring using social media as an optional channel for affiliation.

Merchant Training

If the merchant does not activate the offered credit line, the distributor's sales team repeats the offer during their next visit, and then Tienda Pago's sales team follows up, sometimes in combination with the distributor's sales team.

Source: Prepared by IFC, based on Tienda Pago information.

According to interviews, both FMCG presales teams and Tienda Pago's sales team describe the product offering as an opportunity for merchants to increase their inventory, take advantage of promotions, and maintain available credit in case of an emergency. Market research observed that the focus on emergencies leads a number of merchants to use the product infrequently. A smaller share of merchants understands how using credit lines can free up liquidity, giving them the opportunity to increase their stock of higher-margin products or add new products to grow their business.

The research has facilitated the identification of several variables that can influence the uptake of a loan from Tienda Pago (table 2). These variables highlight some interesting implications for Tienda Pago, as well as other businesses seeking to scale short-term digital credit for merchants.

TABLE 2. Determinants of Loan Uptake

Size of merchants	• Nearly all stores in Tienda Pago's distribution network are microenterprises.[10] Among them, merchants that purchase more than $300 of inventory weekly from a partner distributor are more likely to use Tienda Pago to obtain a working capital loan to increase sales. Tienda Pago targets this type of merchant. • More than 60 percent of these small merchants process transactions in cash and do not have or actively use a bank account. • Larger stores usually have bank accounts and other financial options, such as bank loans or credit cards.
Weekly sales and loan pricing	• Loans disbursed for orders larger than $50 are charged a fee of 1.8 percent to 2.5 percent at disbursement. Smaller loans are charged a minimum fee of $1.50 to cover processing and banking costs. Tienda Pago charges under a fixed fee arrangement so that stores can easily understand fees and avoid calculating interest or percentage costs. For example, the cost for a loan between $150 and $170 is $3.30.
Frequency of distributor visits	• For smaller stores that receive several visits each week from a distributor, it is less attractive to apply for a loan if the individual transactions are below $50. Distributors often make frequent visits because it is easier for merchants to pay smaller amounts in cash than to accumulate a larger lump sum. In the medium term, access to credit would create efficiencies in the system by allowing distributors to reduce the frequency of their visits.
Product margins	• Businesses that can freely set the price of drinks find the Tienda Pago solution more attractive, whereas businesses that have limited discretion on pricing see a potential negative impact from the fees on their sales margins.
Financial literacy	• Merchants that lack a clear understanding of the added value of the Tienda Pago product find it difficult to use the service even after initial activation of the credit line. This is because they have limited financial literacy or negative perceptions toward lending. This is a limitation of Tienda Pago's current approach for merchant acquiring and engagement. • Microentrepreneurs generally prefer loan pricing that is expressed using a fixed fee rather than an interest rate.
Risk aversion	• Country context matters: in Peru, merchants display a general aversion toward credit, resulting in lower use of the Tienda Pago product. • Some stores like to have the digital credit line available in case of an emergency or to take advantage of promotions/opportunities. This gives them security when they experience cash constraints. In the case of promotions, they believe that the cost of the loan is compensated for by the increase in margin for sold goods.
Responsibility for finances	• If a store manager relies on other household members or business partners to manage the store finances, use of the Tienda Pago product becomes more challenging.
Network connectivity and access to finance	• Lack of network connectivity is a reality in many parts of Mexico and Peru, and even in some areas of their respective capitals. • The availability of agent banking in both Mexico and Peru addresses the well-known challenges of bank branches: limited hours of operation, accessibility, and long processing times. However, the higher fees associated with making repayments to an agent can still be a significant deterrent to usage of the service.

Digital Loan Disbursement and Repayment

The fourth component of the Tienda Pago business model is providing a fully digital loan disbursement and repayment process.[11] Through this digitized process, Tienda Pago seeks to offer merchants and distributors a seamless user experience, by embedding loan disbursement in the payment of goods delivered by the distributor.

The Tienda Pago order and payment processes are illustrated in figure 8. Establishing a relationship with both sides of the transaction allows Tienda Pago to process the payment through a simple solution, whereby the merchant requests a token through a conventional SMS text messaging system. The request is then analyzed and processed automatically by Tienda Pago's system, allowing the client to receive a confirmation within seconds of the request. The token number is recorded by the delivery staff of the distributor, which recognizes it as a proof of payment. At the end of each day, Tienda Pago settles and pays the FMCG distributors through a bank transfer.

FIGURE 8. Loan Disbursement and Repayment

Order Entry

Merchant places order of goods through pre-sales staff or by phone.

Order Payment and Loan Origination

1 Distributor truck delivers order.

2 Merchant gives authorization number (token) to delivery personnel. Loan is originated.

3 Delivery staff enters number in its system to confirm receipt of token and payment of goods.

Settlement

At the end of the day, Tienda Pago clears and settles all payments with FMCG distributors.

Loan Repayment

1 Merchant pays loan and fees at a bank or agent

2 Merchant informs Tienda Pago that the payment has been made.

Merchants request an authorization number (token) through SMS that confirms credit line sufficiency. The token is valid for 1 week. Merchants can request a new token after repaying the loan.

Characteristics of the loan

Term: 7 days
Fee: 2.5% of the loan amount
(Minimum $1.5 per loan)

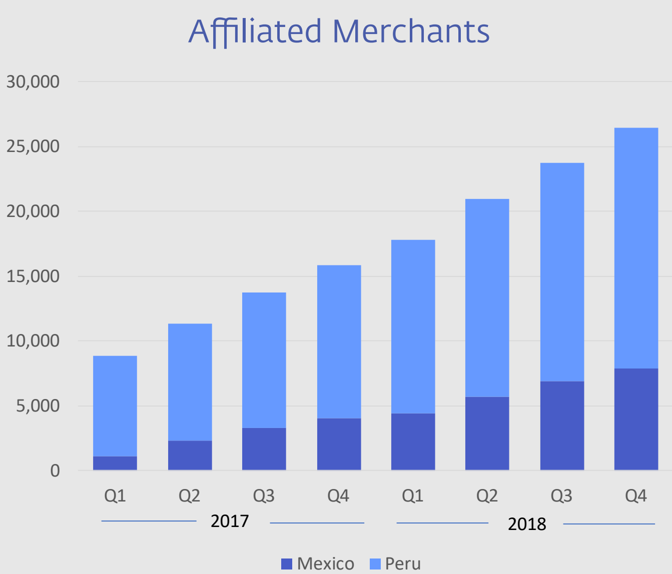
Source: Prepared by IFC based on Tienda Pago information.

Within a week, the merchant goes to a bank branch or agent to repay the loan and the associated fees. Tienda Pago does not require merchants to have a bank account. In fact, more than two of every three payments are processed through agents, including convenience stores and local pharmacies in the case of Mexico and Peru, respectively. While agents typically charge a transaction fee, the longer opening hours, ease of access, and ability to make payments on weekends make them preferable to bank branches for Tienda Pago merchants. The remaining payments that are processed through banks are mainly cash payments at a branch. To waive transaction costs for merchants, Tienda Pago has accounts with several banks in Mexico and Peru (box 2).

BOX 2. Tienda Pago's Operations and Activity Trends

Tienda Pago started operations with two distributors in Peru in 2014, then expanded to Mexico in 2016. Since its launch, the company has built partnerships with seven major FMCG distributors in Peru and two in Mexico. Tienda Pago believes these two markets present opportunities to evolve and mature its business model, and it hopes to expand further in the region and beyond.

As of December 2018, Tienda Pago had 18,621 merchants registered in Peru and 7,869 in Mexico. Tienda Pago expects that both numbers will continue to grow as it partners with more FMCG distributors and expands its markets. Active users of its product have shown the potential to grow and scale as a result of access to capital. However, Tienda Pago is continuing to improve its platform and communication to encourage a larger share of merchants to shift from using the service occasionally for casual needs or emergencies, to using it as a tool for cash flow and business management.



Peru	Mexico
• Active since September 2014 • Number of affiliated merchants: 18,621 • Number of affiliated FMCG distributors: 7 • Average loan amount: $332 (15% of merchants take a loan totaling $50-150) • Average frequency of use per active merchant: 2.8-3.3 times monthly • Average retention rate in 2018: 41% • 45.8% of registered merchants never made a transaction	• Active since November 2016 • Number of affiliated merchants: 7,869 • Number of affiliated FMCG distributors: 2 • Average loan amount: US$ 214 (21% of merchants take a loan totaling $50-150) • Average frequency of use per active merchant: 2.8-3.3 times monthly • Average activity rate in 2018: 38% • 44% of registered merchants never made a transaction.

Sources: Tienda Pago.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Closing Gaps

Despite only a few years on the market, Tienda Pago's digital credit business model is addressing a relevant financial need for small merchants embedded in FMCG value chains. The Tienda Pago experience offers interesting insights on the critical factors needed to scale such a model to its full potential.

No other financial institution in Mexico and Peru offers a similar product. While there are other models that provide upstream finance to small merchants, to our knowledge, none offer a solution to small merchants in the distribution chain. Usage rates have not yet reached their potential, but interviews reveal that the service is building trust and value among its regular users. For merchants, this product offers access to short-term, digital working capital to fund inventory purchases and nurture their growth. For distributors, the product offers the ease of operating in a cashless manner, improves the efficiency of distribution, and grows sales. Tienda Pago estimates that FMCG distributors see a jump of 15 percent to 25 percent in the value of sales to regular Tienda Pago users.

However, research shows that Tienda Pago needs to address key gaps in financial education among users and increase its efforts to explain its value proposition. Lessons from the interviews with Tienda Pago's sales force, presales team, and delivery team are presented here.

Incentives. Tienda Pago relies on distributor presales and delivery staff for processing day-to-day transactions. While this is efficient, the relationship between the distributor personnel and the merchants is vital for merchant acquiring and usage of the Tienda Pago service, therefore incentives need to align. Tienda Pago must motivate its own staff to promote directly to merchants and distributors. Through new incentives and communication strategies, distributor personnel can adopt the model. In addition, FMCG distributors' incentives and job performance indicators must be fully integrated and aligned into new solutions and processes to see tangible benefits.

Capacity building. Standardized training for both merchants and FMCG distributor staff can help strengthen their relationship and mitigate the impact of turnover. Training can also make the process more efficient, reducing time at the point of sale. In addition, merchants value a clear understanding of loan fees and conditions. If merchants do not fully understand the product or what they signed up for, they will not use the product. Initial follow-up visits to merchants can drive usage by ensuring that merchants understand how the credit line works and how to maximize its benefits. This ensures that they have available liquidity when a supply truck arrives and also helps them repay loans on time.

Communication channels. The primary communication channel between Tienda Pago and the merchants is via SMS (used for payment reminders, remaining credit checks, etc.). Connectivity and a reliable technology platform are necessary to ensure a smooth process. Since this can be a challenge in some regions, Tienda Pago is working on an offline solution that updates data when cellular range is available. Social media is potentially another important channel for communication: Tienda Pago estimates that 75 percent of its clients own a smartphone and 60 percent have a Facebook account and log in on a regular basis.

Loan repayment. A convenient and low-cost cash-in network and payment system is necessary for merchants. Tienda Pago relies on merchant ability to access agents or partner bank branches to conveniently process loan repayments. For some merchants, this means extra effort, cost, and time. Addressing this issue depends on the region and the financial access points available. The growth of agent banking networks and the growing trend of payment digitization through cards or mobile phones are key complements to the growth and success of Tienda Pago and other financing solutions.

The growth of agent banking networks and the growing trend of payment digitization are key complements to the growth and success of Tienda Pago and other financing solutions.

Increasing usage. Usually, overall activity trends remain a challenge for financial services providers. When merchants see Tienda Pago only as a means of obtaining cash for an emergency loan, or lack perception that a working capital loan can be used as a tangible benefit to increase sales, this can limit their usage of the product. Therefore, financial education for merchants is relevant for uptake and usage of Tienda Pago's product.

Customer engagement. Bundling, promotions, and loyalty programs can help create a more consistent customer base of merchants that use Tienda Pago's product. In this context, an active costumer engagement program can lower the numbers of poor experiences and increase the numbers of retentions.

MERCHANT CREDIT AT SCALE

Tienda Pago's business case for merchants and distributors is developing and will continue to evolve. The use of technology allows Tienda Pago to address barriers to access to finance for small merchants. However, the research highlights the complexities of implementing a solution that is fully integrated in the FMCG distribution chain and that maintains minimal operating costs.

Scaling will be critical to financial sustainability, not only for cost-effectiveness, but also to offset risks.

As Tienda Pago continues to expand its reach, it will need to adapt to the unique characteristics and aspects of different regions or countries. Factors that may affect communications and incentives needed to scale the service include connectivity, access to finance, payment system fees (direct and indirect), financial literacy, perceptions, risk aversion, and culture. Scaling will be critical to financial sustainability, not only for cost-effectiveness, but also to offset risks.

It offers instant, uncollateralized working capital loans, by integrating a mobile platform with the operations of FMCG distributors. Merchants can use a credit line to purchase goods from any FMCG company affiliated with Tienda Pago. As of December 2018, Tienda Pago offered a seven-day loan with a fixed fee of 2.5 percent in Mexico and between 1.5 percent and 2 percent in Peru.

By leveraging FMCG partnerships and using inventory purchases to assess the creditworthiness of merchants, Tienda Pago creates a small ecosystem designed to give both distributors and merchants the opportunity to grow their businesses. This system limits transaction costs for both distributors and merchants, by embedding credit in the existing distribution process. Also, both the merchant and the delivery truck driver can manage the credit line through their cell phones, which provides a closed credit loop in which the line of credit can be only used to buy inventory.

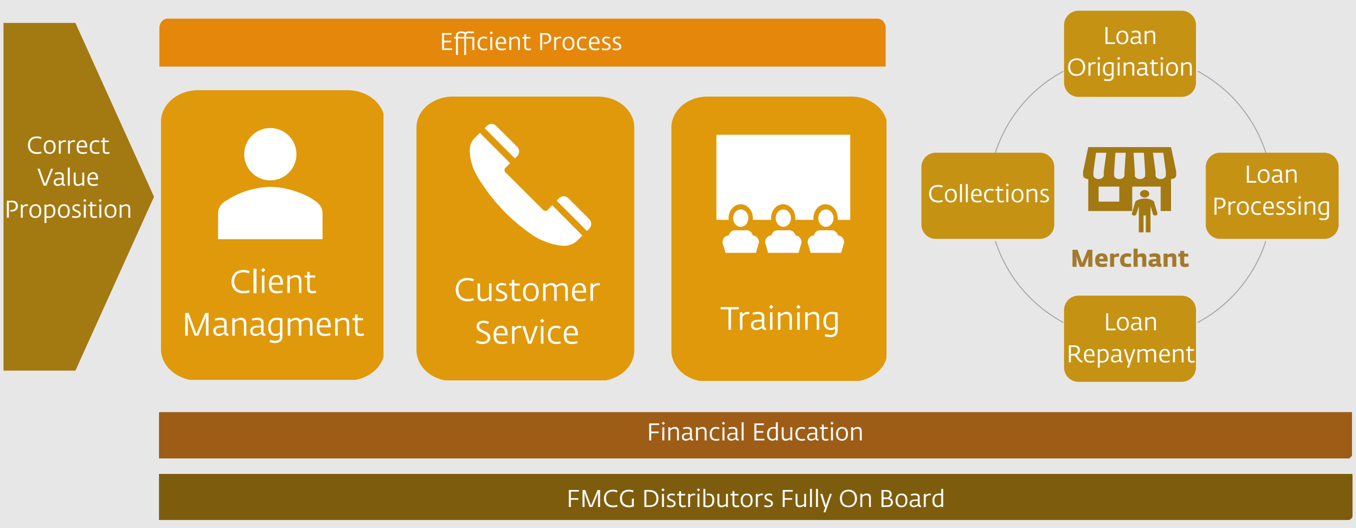
Figure 4 offers a representation of the Tienda Pago ecosystem, which connects distributors and merchants using a credit scoring algorithm and a mobile interface. This integrated solution has significant potential for scale, because it does not require ownership of a bank account. Also, it does not require merchants or delivery staff to have access to a smartphone or a point-of-sale device, because it works with regular text messages, which both limits operating costs and maximizes accessibility. The system relies on the ability of merchants to access a fast-growing network of agents and bank branches to conveniently process loan repayments.

As noted, the technology platform, credit scoring, data analysis, and cashless collections are core aspects of Tienda Pago's value proposition for both FMCG distributors and merchants. While technological barriers to entry may not be very high, there are significant barriers and costs related to building relationships with FMCG distributors. That said, Tienda Pago has developed credibility for its model, which has helped bring additional FMCG distributors on board. In addition, its existing relationships with multinational FMCG distributors offer the opportunity for the company to quickly enter new markets and grow.

The small business segment is chronically financially underserved, and there is significant potential to support Tienda Pago's growth. The financial needs of small merchants are typically broader than just credit. In the future, a model such as Tienda Pago's could be leveraged to offer a wider range of payment services (e.g., insurance payments, utility services, and electronic wallets), and offer nonfinancial services to its merchants. Transaction and repayment data could be leveraged to offer additional, longer term credit for merchants and be leveraged for other services.

Tienda Pago recognizes the importance of leveraging technology and partnerships in order to reach scale. It is consistently trying to build its capacity to learn from the market, refine its processes, and establish sound relationships in the FMCG market. In the current construct, FMCG distributors realize the greatest benefits from using the Tienda Pago product: they incur no credit risk and benefit from increased sales and cost efficiencies. For Tienda Pago to reach scale, the remaining challenge is how to make the product part of core FMCG processes so that Tienda Pago can rapidly grow and lower costs for itself and its partners. Although the model is still evolving and maturing, Tienda Pago is fully committed to supporting small merchants and their surrounding communities. As the company further solidifies its strategy, it is likely to improve its scale and market positioning. Eventually, in partnership with FMCG distributors, it may become a key player in developing an ecosystem in which merchants play an important role in financial inclusion.

FIGURE 9. Key Elements for Scaling



Source: Prepared by IFC.

Endnotes

1. IFC-McKinsey, Two Trillion and Counting (2010).
2. IFC, MSME Finance Gap: Assessment of the Shortfalls and Opportunities in Financing Micro, Small, and Medium Enterprises in Emerging Markets (2017).
3. Ibid.
4. Interviews with industry experts.
5. Asociación de Bodegueros del Perú, Estudio de Impacto Económico en Bodegas (Economic Impact Study of Merchants) (2015).
6. The World Bank Group, Cash vs. Electronic Payments in Small Retailing (2016).
7. The research was conducted in Mexico City, Mexico, and Lima, Peru, and comprised focus groups or interviews with FMCG personnel engaged in taking orders, as well as with delivery personnel and regional managers.
8. The interviews were undertaken in 2016 in partnership with the market research firm Madison MK and a local consultant.
9. The minimum fee paid for a loan is $1.50.
10. The World Bank Group define a business as a microenterprise when it fits at least two of the following three criteria: (1) fewer than 10 employees, (2) fewer than $100,000 in total assets, and (3) fewer than $100,000 in annual sales.
11. Repayment of a loan to Tienda Pago.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