Mahindra Finance

Creating new markets

90 min read / 2 decisions

This case traces the journey of Mahindra Finance, a leading finance company in India, over two decades. During this period, the company had found itself at several crucial decision-making junctures. The strategic choices made by the top management team led the company to achieve exponential growth rates, but not without challenges!

Your learning objectives as you begin this journey are understanding how to create new markets and how to capture growth in a highly competitive environment.

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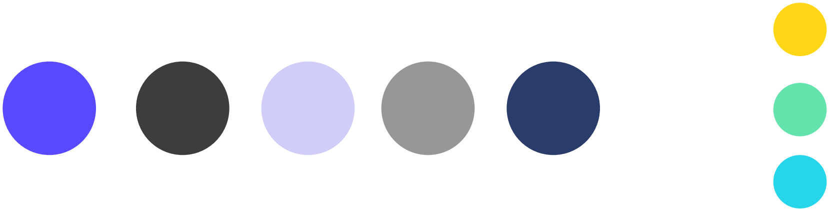

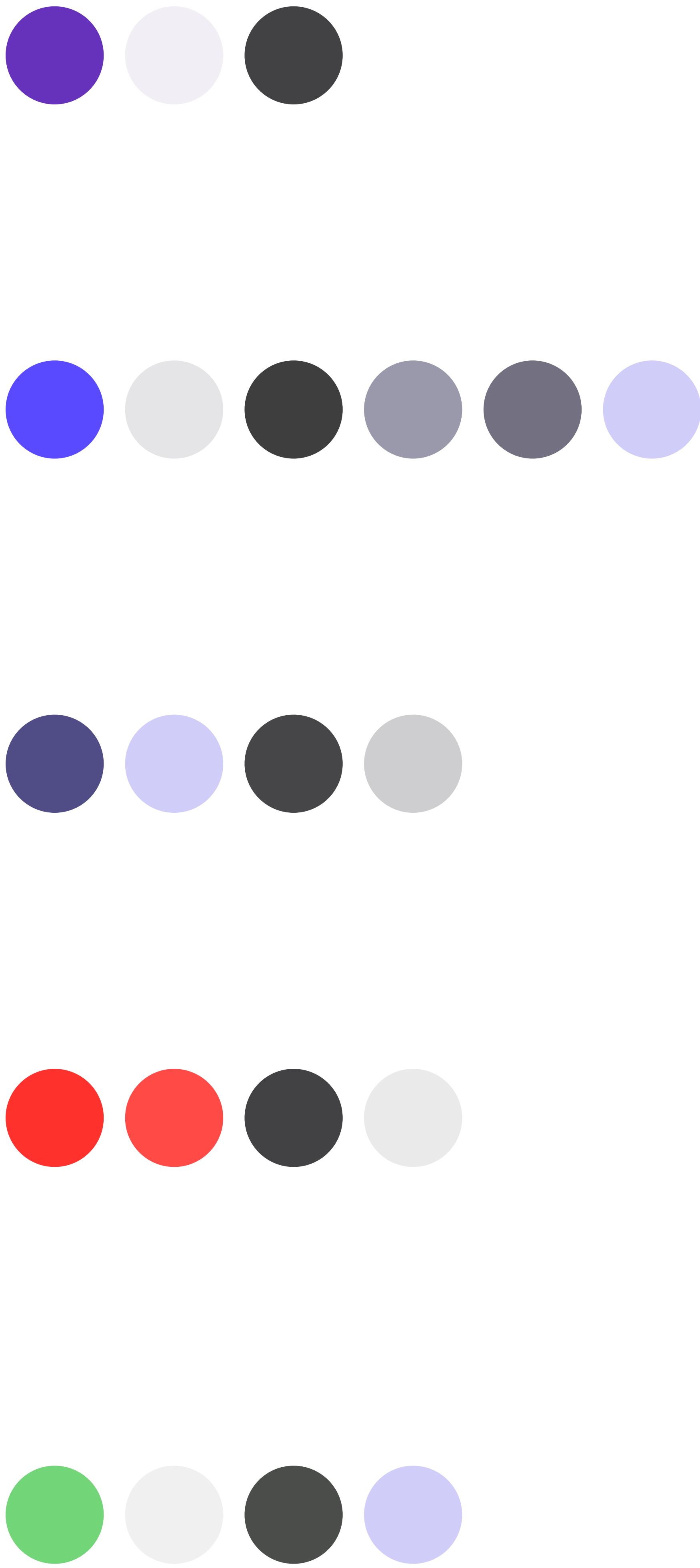

CASE STUDY

Mahindra Finance

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Mahindra & Mahindra Financial Services Limited (Mahindra Finance), a subsidiary of M&M, was established in 1991 as a captive finance arm of the parent company to provide loans for M&M vehicles.

Over the next decade, Mahindra Finance was led by the managing director, Ramesh Iyer, who successfully grew the company to meet the financing needsnof M&M dealers and their customers.

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SECTION 1

Section 1 title

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Decision 2

Identify 3 initiatives you would undertake to resolve the issues facing home finance options at Mahindra.

Option 1
Invest in marketing to educate the customer to take bigger loans to build their home

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SUBMIT

DECISION 2

Identify 3 initiatives you would undertake to resolve the issues facing home finance options at Mahindra.

- **Option1:** Invest in marketing to educate the customer to take bigger loans to build their home
- **Option2:** Focus only on those customers who are willing to take larger loans
- **Option3:** Hire experienced real estate sales people and relocate them in rural areas to sell to locals
- **Option4:** Change the loan consideration to get rid of the upfront 40% commitment from the customer
- **Option5:** Reorganize the sales network to focus on a wider customer network anchored around vehicle finance cusomter's neighbors and friends
- **Option6:** Other: Write your answer here

Submit

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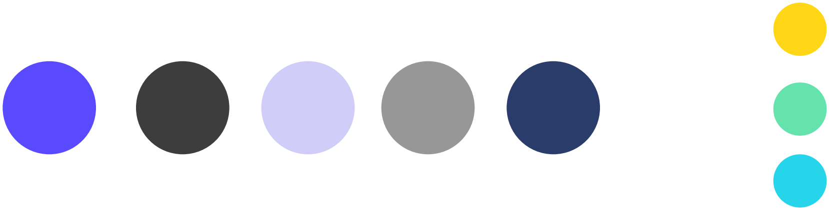

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eidos

First name

Last name

Email

Password

Confirm password

Forgot password

SIGN UP

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Mahindra Finance

Creating new markets

90 min read / 2 decisions

Overview

This case traces the journey of Mahindra Finance, a leading finance company in India, over two decades. During this period, the company had found itself at several crucial decision-making junctures. The strategic choices made by the top management team led the company to achieve exponential growth rates, but not without challenges!

Your learning objectives as you begin this journey are understanding how to create new markets and how to capture growth in a highly competitive environment.

Start reading →

01 Setting the Scene

In 2002, the Mumbai-based INR 62 billion Mahindra group was among the largest industrial houses in India. Its flagship company – Mahindra & Mahindra Limited (M&M) – was a pioneer and leader in the tractor and utility vehicle market in the country.

Mahindra & Mahindra Financial Services Limited (Mahindra Finance), a subsidiary of M&M, was established in 1991 as a captive finance arm of the parent company to provide loans for M&M vehicles.

Over the next decade, Mahindra Finance was led by the managing director, Ramesh Iyer, who successfully grew the company to meet the financing needs of M&M dealers and their customers.

In 2002 Ramesh was at a decision-making juncture:
"What will be the next engine of growth for the company?"

History of M&M

M&M was founded in 1945 as a steel-trading company by two brothers, Jagdish Chandra Mahindra and Kailash Chandra Mahindra. In 1947 it entered auto manufacturing to bring the iconic Willy's Jeep (under license) to Indian roads. The founders believed that introducing new modes of transportation held the key to India's prosperity, so one of their first goals was to build durable, rugged vehicles that could handle the rough Indian terrain. During the 1950s and 1960s, the group consolidated its position by adding businesses like steelmaking, light commercial vehicles and tractor manufacturing to its portfolio. Over the next five decades, the M&M group became the domestic market leader in farm and utility vehicles and also emerged as one of the leading tractor brands in the world, competing with the likes of John Deere.

An organizational restructuring exercise in 1994 resulted in two core manufacturing activities (1) utility and light commercial vehicles and (2) agricultural tractors. All other activities were spun off into separate entities and organized under business groups in the areas of Hospitality, Trade and Financial Services, Automotive Components, Information Technology, Telecom and Infrastructure Development. M&M was structured as a federation of empowered companies that enjoyed entrepreneurial independence while leveraging group-wide synergies.

Automotive division

- Utility vehicles
- Light commercial vehicles
- Three wheelers

Farm equipment division

- Agricultural tractors
- Implements used with tractors
- Industrial engines

SALES

Total income	FY 2001-02: INR 39,967 million (US$ 815 million) FY 2000-01: INR 43,528 million (US$ 888 million)
Profit after tax	FY 2001-02: INR 1,026 million (US$ 21 million) FY 2000-01: INR 12 million (US$ 25 million)
Employee strength	12,000 people
Manufacturing facilities	6 for Auto 6 for Tractor
Sales organization	49 sales offices supported by a network of over 650 dealers across the country

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02 Entry into the rural market ›

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Parent M&M's vehicles – tractors, farm application equipment and passenger vehicles – brought Mahindra Finance to the rural market.

> **We entered the rural market by force and not by design because that is where Mahindra tractors were sold. We entered the rural market by force and not by design because that is where Mahindra tractors were sold.**
>
> Ramesh Iyer
> Managing Director

Rural India

Further reading

Five year financial highlights

Competitors

Automotive industry players

Villas remain at the heart of India. In 2002 about 75% of India's population, or 746 million people (i.e. 12.5% of the world population), comprising 135 million households, lived in approximately 638,000 villages. Rural India generated more than half of the national income. However, the per capita annual income in rural areas, at INR 9,481, was less than half that of urban areas, which stood at INR 19,407.

Nearly 55% of rural income came from the agriculture sector and 70% of the rural population was employed in small-scale agricultural and related occupations. In the recent past there had been a gradual reduction in dependence on agriculture as other sectors started playing a more significant role in the rural economy. About 70% of the rural poor dit not have a bank account and 43% of rural households continued to rely on informal finance (moneylenders and relatives).

03 What are the challenges?

04 Operationalizing a rural market strategy

“One of the key challenges in this business is the seasonality of cash flow, which is driven by often unpredictable crop harvests. So, we cannot ask clients for monthly payments. We designed special balloon payments to match with their harvest timing. As we interacted with some of the tractor clients, contrary to our expectations, we realized that about 40% of the cash flow for tractor owners came from non-farm applications (such as haulage by attaching trailers, loaders or excavator equipment) and 40% of the tractors were contracted out. In such cases, we designed quarterly repayment schedules in line with the contractor payments.” - Ramesh Iyer, Managing director

Rural finance was a highly effort-intensive business and vastly different from urban models in terms of branch locations, channel development, delivery, service standards and product design. Mahindra Finance had to adapt to the earning cycles of rural customers who were typically engaged in agriculture and related activities. While the M&M dealers' staff advised on size, type, operation and maintenance of tractors, clients were referred to Mahindra Finance for loans. The close coordination with dealers helped to reduce the lead-time for transactions.

Loan appraisals generally entailed client visits and interviews to understand their income sources and the farming cycles. Collecting this information required reviewing documents and checking credits records. The Mahindra Finance team decided to rely on neighborhood and village authorities to judge credit-worthiness. Thereafter, tailor-made loans with tenure, interest rates and repayment schedules suited to the client were issued. Customers paid 25% of the vehicle price upfront, while Mahindra Finance provided 75%. Based on the assessment of cash flow and deployment of assets, Mahindra Finance developed customized loans, which were not offered by the commercial banks.

As rural customers were often first-time owners of an asset, the company realized that it could not force-fit a standard product on them. Mahindra Finance also employed local people, who were familiar with the situation on the ground, as field executives. Given the limitations of the rural infrastructure, the field staff personally visited customer's premises to offer loans and to collect cash repayments. Systems were put in place so that the company could approve a loan within two days via a decentralized process that met predetermined criteria. Such face-to-face interactions allowed it to be more responsive to local market demands. Furthermore, about 80% of the monthly receipts was in cash and the company had to establish a robust cash management system to transfer the money on a daily basis to banks cross the country.

05 Growth trajectory

1991 Incorporated as Maxi Motors Financial Services Limited

1992 Name changed to Mahindra & Mahindra Financial Services Limited

1993 Began financing M&M utility vehicles

1996 Began financing M&M dealers for purchase of tractors

1999 Started tractor retail financing in rural and semi-urban areas

2001 Total assets under management exceed INR 10 billion

2002 International Finance Corporation granted Mahindra Finance Tier II debt

Learning as an Entreprenurial business

From inception, Mahindra Finance had a profit orientation and the main KPI for Ramesh was ROE. Parent M&M did not dictate where or how Mahindra Finance would expand. Channels, product design and branch locations were all decided by the subsidiary. As a consequence of not being able to control the repayment schedule, the company stumbled in the initial years with an asset-liability mismatch. Mahindra Finance held a retail deposit license and mobilized deposits by borrowing from banks, insurance companies or institutional investors. However, the company did not know whether it would be more effective to borrow for one year or for five years.

Further reading

Five year financial highlights

Competitors

Automotive industry players

"We made the mistake of borrowing for one year because it was cheaper. But when we lent, we did not recover for four years. At every stage that we changed our liability, the cost kept going up. We have to be aware that while the entire strategy is on the asset side, what will let us down is the liability side. After this experience, we decided that we will never again have an asset-liability mismatch. Currently, we have 29 months of asset book and 30 months of liability book."

As it scaled up, the company banked on the customer's willingness to put up 25% of the money upfront; the resale price of the collateral, which was able to cover the principal at all times for a three-year loan; and the existence of a second-hand market such that the vehicle could be sold off within 30 days, if necessary. The company understood the difference between intentional default and circumstantial default. Mahindra Finance had gross non-performing assets of 5%, but after adjusting for seasonality impacts, net credit write-off was about 1%.

Ramesh explained that this business could not be run through policies set at headquarters:

"I can't send out an instruction to repossess the vehicle after three defaults. We cannot repossess a vehicle because we are an enabler for the manufacturer. No manufacturer would like to be associated with a company that first helps to sell the vehicle, then repossesses it, and finally resells the vehicle at a throwaway price, thereby killing the brand."

Review

In 2002 Mahindra Finance remained a captive finance arm of parent M&M. Ramesh had to set the company on its next growth trajectory. What should he do?

- (selected) **Status Quo**
  Continue as a support function for M&M vehicle sales
- **Move to Urban**
  Similar to competing non-banking finance companies
- **Go deeper into the rural**
  Finance competitor vehicles

Hint text

SUBMIT

01 Entry into new business segments

In this section you will follow Mahindra Finance's journey from 2002 to 2010. During this period the company diversified into two new products:

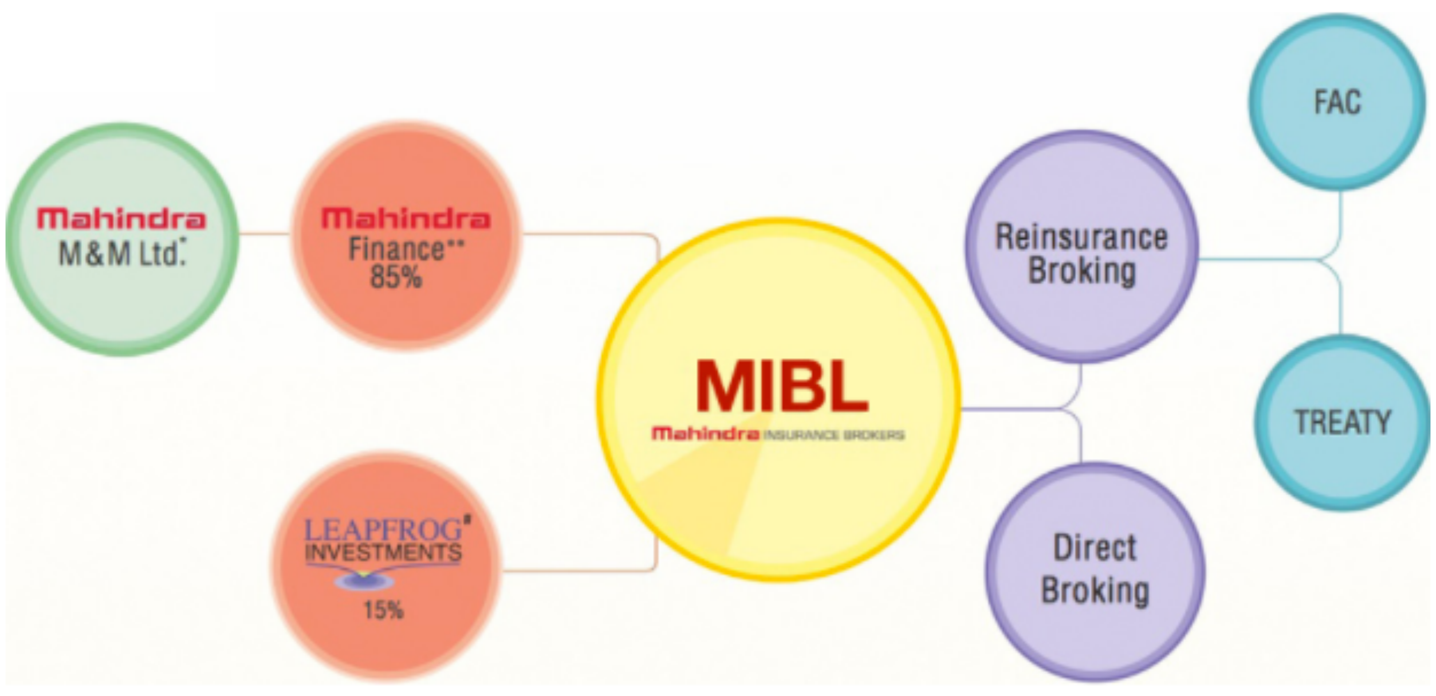
1. Insurance broking > where it succeeded
2. Housing finance > where it stumbled

Insurance broking

Insurance penetration in rural India was abysmally low. M&M management believed that insurance solutions would add value for its rural customers. A new subsidiary, Mahindra Insurance Brokers Ltd (MIBL), was established in 2004 after acquiring a Direct Broker License in life and non-life businesses. MIBL started with equity capital of INR 5 million ($100,000) and 14 people. Instead of developing or underwriting insurance products, MIBL decided to become a strong broker. Jaideep Devare was appointed managing director.

As the net surplus left in the hands of a rural customer was often not enough for two days, they were not motivated to invest in the future. In India insurance products were typically designed for investment and not as a security product. Since Mahindra customers were owner-drivers – often the sole breadwinner – in the case of accident or death the company repossessed the vehicle, which was the source of livelihood.

MIBL worked with insurance companies as a representative of customers. It shared the data on the history of write-offs due to death as well as the customers' ability to pay and suggested designing a customized solution – Mahindra Loan Suraksha. The plan was designed as a group term insurance whereby the customer's life was insured to the value of the loan. The premium kept declining in line with the reduction in the loan value. MIBL was a profit-making and dividend-paying company from year one.



Decision 2

In 2002 Mahindra Finance remained a captive finance arm of parent M&M. Ramesh had to set the company on its next growth trajectory. Choose three options.

- [x] **Option 1**
  Invest in marketing to educate the customer to take bigger loans to build their home
- [ ] **Option 2**
  Focus only on those customers who are willing to take larger loans
- [x] **Option 3**
  Hire experienced real estate sales people and relocate them in rural areas to sell to locals
- [x] **Option 4**
  Change the loan consideration to get rid of the upfront 40% commitment from the customer
- [ ] **Option 5**
  Reorganize the sales network to focus on a wider cust omer network anchored around vehicle finance cusomter's neighbors and friends
- [ ] **Option 6**
  Other: Write your answer here

SUBMIT

Ramesh Iyer
Managing Director

Rural India

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Profile of the rural customer

- No bank account
- No proof of identity
- No proof of income, agri-business depends on the rains
- Need to arrange 40% of the loan
- No collateral – vehicle will be the collateral
- Future cash flow will be derived from the vehicle

(moneylenders and relatives).

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Sales chart/ table here

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Video Title

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Automotive industry players

Source: Adapted from "The Indian Automotive Industry: Evolving Dynamics." KPMG India, 2010.

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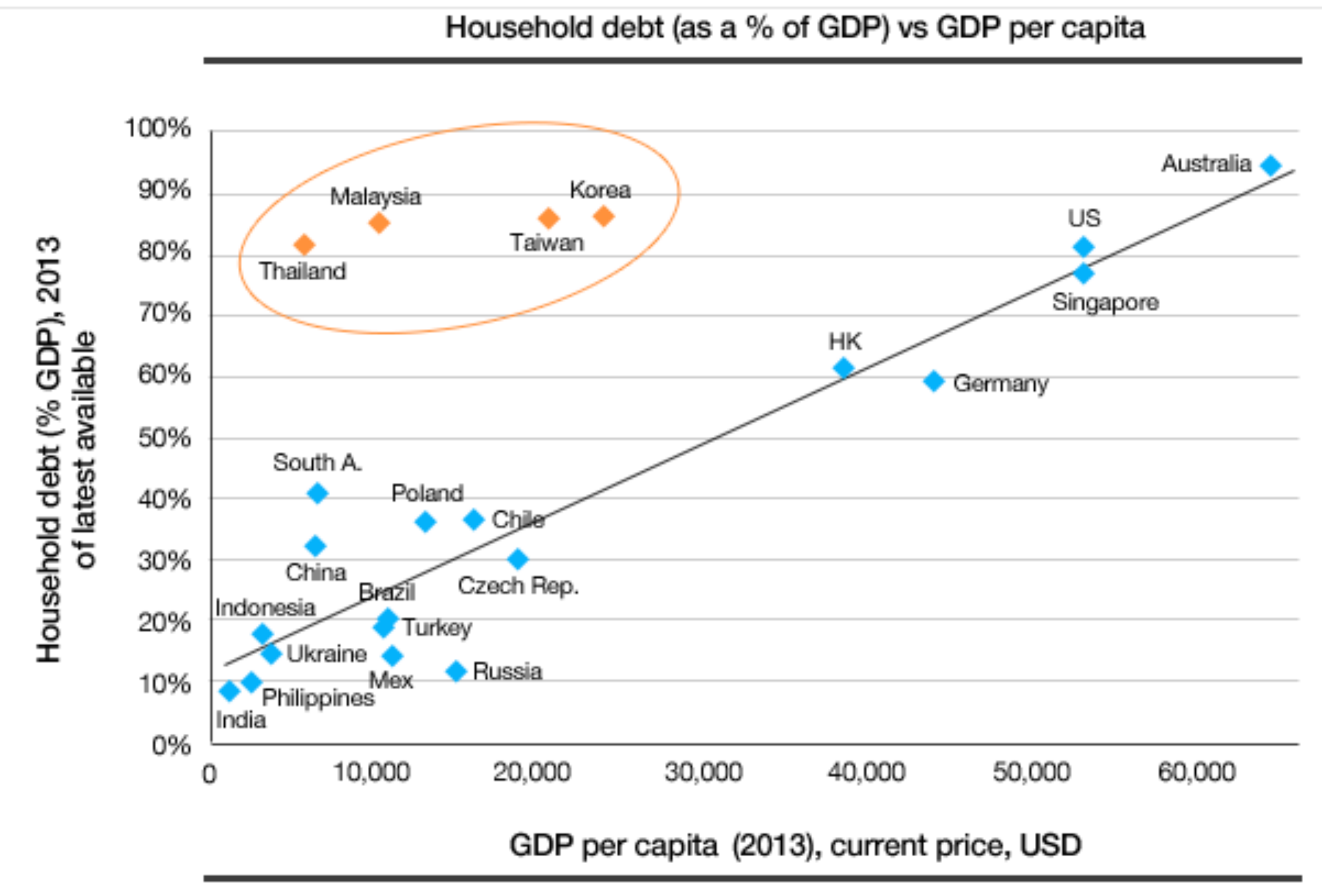
05 Housing finance

A new subsidiary – Mahindra Rural Housing Finance Ltd – was established in 2007 to provide a wide base of "under banked" customers with access to timely, cost-effective and flexible home loans. Given that India's mortgage profile as a percentage of gross domestic product (GDP) was 9%, one of the lowest worldwide, the company saw considerable room for growth.



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Mahindra Housing Finance: Unable to replicate former success

The first shock came when Mahindra Finance came forward to provide credit but there were no takers.

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With the realization that most rural customers built their homes incrementally, in a piecemeal manner, the most striking insight was that customers did not need home loans, instead they needed home completion loans. Therefore the actual loan requirement ranged from INR 50,000 to INR 90,000 – predominantly for repairs or extensions to an existing home. Mahindra Home Finance faced a tough start, with high operating costs and net losses in the first two years. The top management was perplexed and tried to identify what was going wrong.

"It appears that there is no win-win initially. Are we willing to lose first to learn? We have huge experience in successfully running a vehicle financing company for the same customer segment in the same geographies. Why should we fail in providing housing finance? After all, it is only the collateral that has changed. A customer's cash flows remain the same as they were for buying a tractor or a jeep. Is there a design weakness in the product? Are there cost inefficiencies? How should we modify our strategy?"

Ramesh Iyer Managing Director

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