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How Does Zero Cost EMI work?

What is the catch here? How do Companies involved make money here?

A Thread■■

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1/ You are looking for a mobile phone worth Rs.10,000 on Amazon and as you move ahead to place the order, you are offered an option to pay that amount spread across 6 months. 6 EMIs of Rs.1667. No interest charges or processing fees.

2/ The next thought you have is - ‘obviously there is some catch here’. Why would someone give me an option to pay over 6 months? That too without any fees/charges!?

The catch is - it is more to do with marketing and sales than finance.

3/ There are 3 entities involved in this transaction. The platform (Amazon), Mobile Brand (Samsung), and the finance company (Bajaj Finance).

4/ Imagine you are a student who just got an internship with a stipend of Rs.5000. Shelling out Rs.10000 may not be possible for you. But if you have to pay Rs.1667 a month for 6 months, you feel like you have got a deal! Samsung gets to sell more. Amazon gets more commission.

5/ But what about Bajaj Finance?? How will it make money and get compensated for taking on credit risk?

Samsung will cut out a deal with Bajaj Finance. It will provide a 5% discount to Bajaj Fin. So Bajaj Fin will pay Samsung Rs.9500 while it will receive 10k from the customer

6/ So, Bajaj Fin earns Rs.500 only? NO!

Here comes the Cash Flow Wizardry:

As months pass by, Bajaj receives EMIs, the outstanding amount decreases and so does the interest on it. It deploys these EMIs to give another loan and so on. On annualized basis, it earns 19.44% !!

Bajaj Fin to Samsung	Rs.9,500
EMI Tenure	6 months
Time	EMI
0	-9500
1	1667
2	1667
3	1667
4	1667
5	1667
6	1667
Total Amount Paid-	Rs.10002
Annualised Interest Rate	19.44%

7/ Compared to the cost of funds of 10%, this translates to Net Interest Margin(NIMs) of 9%. Not that bad. Plus Bajaj Fin gets to acquire the customer and cross-sell other products in the future.

8/ When does this turn into a gimmick? If say Amazon foregoes the discount it would have given you or Samsung adds the cost of interest to the price of the product. Not much you can do here.

9/ So to sum it up, Samsung sells more products, Amazon gets more commission, Bajaj Finance gets good NIMs & a customer to cross-sell and the customer gets a flexible payment option to buy the mobile phone by not having to pay the full amount upfront.

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