INNOVATIVE ACTIVITY PROFILE 4

The Supply Response to New Sources of Demand for Financial and Other Services in Rural Andhra Pradesh

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SYNOPSIS

Self-help groups and their federations at the village, subdistrict, and district levels represent a new, self-aware client base for providers of financial and other services. By forming groups that effectively demand services, these clients acquire fundamental financial literacy and other competencies (thrift, savings, inter-lending, bookkeeping, and management skills) that strengthen and sustain their capacity to innovate. Government agencies, NGOs, and private companies have designed products and interventions to answer their demand and fulfill their needs in a number of sectors, including agriculture, finance, nonfarm employment, health, and education. Perhaps the most significant practical lesson from this experience is that stronger institutions for the rural poor enable several positive factors to converge. Public agencies gain a new partner capable of collectively asserting its needs, business gains a promising new market for services, and the wider economy gains a foundation for more pro-poor growth and innovation.

CONTEXT

India is one of the world's fastest-growing economies, yet translating rapid economic growth into reduced poverty remains a persistent challenge, particularly in rural areas. Throughout India, only 23 percent of 200 million rural poor are organized into various forms of groups. Individuals who are not in groups can find it challenging to obtain the credit, other services, and market access that offer the means to increase their incomes. The Government of India estimates that it will need to invest about US$20 billion over the next eight to nine years to tackle poverty but plans to invest just over US$10 billion.[1] Over the same period, the poor are projected to require about US$40 billion–US$50 billion in credit.[2]

Self-help groups (SHGs) are the primary source of credit for the rural poor, including small and marginal farmers. In 2007–08, an estimated US$1.7 billion in credit was disbursed to 1.3 million SHGs, but at this rate of flow, a major credit gap is expected. Per capita credit access is equivalent to US$111, which is less than 40 percent of the average expenditure by small and marginal farmers who cultivate their land (US$286).[3] As a result, countless poor people are left with no recourse other than informal moneylenders, who charge usurious interest rates, sometimes as high as 600 percent annually.

Module 1, IAP 4 described social mobilization among SHGs in Andhra Pradesh to develop a new source of effective demand in that state's rural economy. For rural entrepreneurs and other service providers, the size of this new clientele is sufficient in scale to command substantial attention. As of November 2010, nearly 11 million women had organized themselves into SHGs through Indira Kranthi Patham, creating a new, self-aware client base.[4] The potential returns from serving so vast a population of customers are self-evident.

As noted in the overview of this module, accompanying investments in rural finance show strong synergies with investments in agricultural innovation. SHGs have proven highly effective in bringing rural financial services into areas that are traditionally poorly served. They do so by helping commercial lenders to manage risk through joint liability, which brings tremendous pressure to bear on the respective group members to repay loans on time. The SHG strategy lowers transaction costs and addresses lenders' concerns over the potentially high risks of default in poor, remote rural areas (World Bank 2011). The organization of SHGs into larger aggregates at the village, subdistrict, and district levels was designed intentionally to meet sellers and service providers halfway.

OBJECTIVES AND DESCRIPTION

Aside from eliminating some of the barriers that prevented commercial banks from offering services in rural areas, a major goal of linking organized rural groups to formal credit and other services is to accommodate the constraints typical of SHG members, including time constraints. A premium is placed on convenience and on enabling the individual customer to conduct multiple transactions in a single visit. A closely related goal is to provide them with a relatively complete menu of financial services, including credit, insurance, and instruments for poor households to swap burdensome informal debt obligations for new obligations in the formal sector with more stable and reasonable interest rates (a high priority among the poor in the state). The insurance instruments are designed to protect vulnerable clients from the financial effects of events that often leave people in poverty, including pensions that provide security in old age. Figure 6.3 shows how SHGs and their federations create an enabling environment for innovation by empowering the rural poor to acquire the capacities, services, market access, and social safety nets that pave the way for innovation.

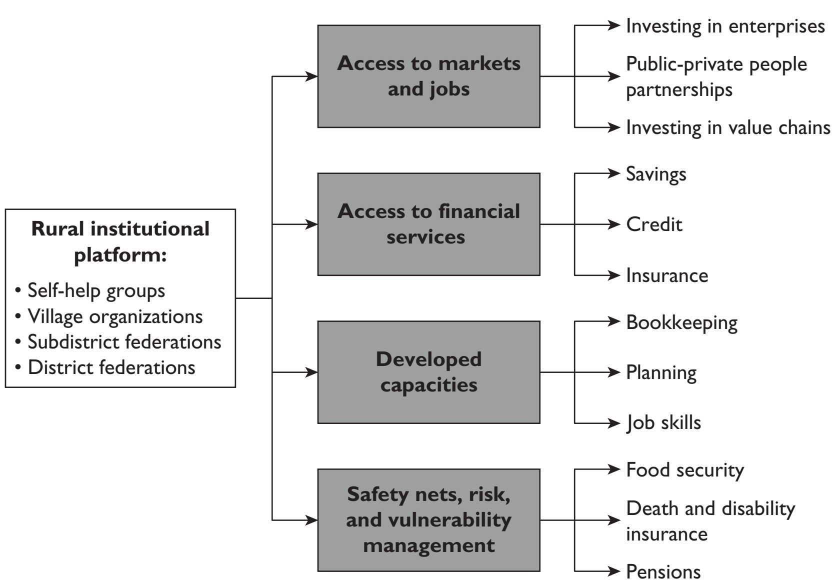
INNOVATIVE ELEMENTS

As the rural poor have organized, saved, accessed credit, and built skills and assets, they have more effectively voiced their demand for goods and services. In response, government agencies, NGOs, and private companies have designed products and interventions to answer their demand and fulfill their needs in a number of sectors, including agriculture, finance, nonfarm employment, health, and education.

In many instances, these service providers use a coproduction model in which the institutions of the poor become agents or franchises of an agency or business to extend its outreach and deliver services more cost-effectively. This practice not only provides services but generates employment within rural areas. In some instances, the Village Organization operates a commodity procurement center where agricultural inputs are sold. The approach builds capacity in the institutions, provides employment, and helps poor clients become more integrated with the value chain (for example, the procurement center will buy their produce and sell them inputs to improve yields in the next cycle).

In other instances, the poor have innovated by developing their own enterprises in response to program-supported activities. Some community members sell biopesticides and biofertilizers to farmers in response to the community-

Figure 6.3 Self-Help Groups Constitute a Rural Institutional Platform That Enables the Rural Poor to Acquire the Capacities, Services, Market Access, and Social Safety Nets That Pave the Way for Innovation



Source: Authors.

managed sustainable agriculture initiative (see module 1, IAP 4). Others provide public services that have not reached their location, such as preschools or nutrition centers for pregnant women and young children. These services are especially important in the tribal areas.

The foundation of this entrepreneurial innovation is access to financial services. These services enable the poor to accumulate assets and create a less risky environment in which they can capitalize on livelihood opportunities.

BENEFITS AND IMPACTS

The benefits and impacts of providing formal financial services to clients previously regarded as too risky to serve have ranged from the tangible benefits that people obtain from the services themselves to less tangible effects such as financial discipline or the sense of security derived from savings and insurance plans. Commercial banks have benefited from innovative business models that make it possible to tap into a vast and underserved rural market. The successes of the program in Andhra Pradesh and other states, and the benefits of the products, services, and new models developed expressly for a large base of very poor clients, inspired the Government of India to establish a National Rural Livelihoods Mission. The Rural Livelihoods Mission will apply the strategies developed through this program at the national level.

Building a bridge to formal credit

The savings, thrift, and inter-lending activities around which SHGs are organized provide members with experience in financial discipline, money management, and in conducting transactions and repaying loans. Over time, these competencies enable people to establish a history of repayment, obtain a credit rating, and then engage with banks or microfinance institutions. As a result, bank lending has increased from Rs 1.97 billion (US$48 million) in 2001–02 to Rs 65 billion (US$1.6 billion) in 2009–10. By early 2010, banks had extended loans of Rs 251 billion (US$6 billion) to SHGs without any collateral.

Total financial inclusion

As banks began to see the rural poor as customers, they altered their business model to accommodate this new source of demand. Rural households generally require working capital to support their current activities, capital to invest in new income-generating activities, and cash to meet basic consumption needs and social obligations, such as health, marriage, and home repair. The banks offered products and services in all these areas, including support for long-term investment in land. Because escaping from debt has been a major priority for many rural households in Andhra Pradesh, banks also arranged debt swaps and provided credit with which to retire costly informal loans. Even better, the new services enabled poor people to avoid the situations that had made them easy prey for informal moneylenders. Lending is based on household investment plans that are vetted by the SHGs and Village Organizations. Community-based recovery mechanisms ensure repayment rates of 95 percent or higher to the banks.

Insurance services to reduce vulnerability

Illness and death can plunge or further entrench a family in poverty. Private companies had often viewed the transaction costs of providing health, disability, and life insurance as prohibitive in rural areas, but community-managed structures dramatically reduce those costs by taking on tasks such as enrolling members and verifying, documenting, and processing claims. In Andhra Pradesh, community resource persons (*bima mithras*) are trained to fulfill these responsibilities on behalf of the Life Insurance Corporation of India (more information on community resource persons appears below). District federations have established call centers and developed a web portal to process transactions. The resource persons and call center make insurance services far more economical to provide and far more accessible to the rural poor, reducing the time to deliver insurance benefits by half.

Throughout Andhra Pradesh, more than 1.5 million SHGs were organized during the first ten years of the Indira Kranthi Patham program. During that period, SHG members accessed more than US$6 billion in credit from commercial banks. More than 11 million members and their families paid for death and disability and health insurance coverage, and over US$100 million worth of claims have been settled. Over 1 million SHG members have a separate health savings account, and as many as 3,000 villages have dedicated health risk funds to mitigate the shocks of health emergencies. More than 3,000 villages have nutrition centers for pregnant and lactating mothers and children under five.

The use of procurement center

Procurement centers operated through Indira Kranthi Patham are an important convening venue for small-scale producers and prospective investors. Small-scale producers, whose sales were previously dispersed widely among informal buyers, command better prices for their produce and buy inputs at lower prices. Procurement centers offer a forum for learning about new crops and growing methods, some of which have been developed locally. Producers are also better positioned to learn about developments in consumer and other markets, because they interact directly with buyers in the value chain. These venues also reduce the costs of outreach to interested investors by assembling a critical mass of potential clients whose purchasing power offsets any discounts they may negotiate. Linking producers to corporate and cooperative partners such as ITC Ltd., APMARKFED, and Olam International became one of the great legacies of Indira Kranthi Patham, and the quest for additional partners continues.

Co-contributory pension scheme

The government of Andhra Pradesh devised a co-contributory pension scheme targeting SHG members over 18, all of them women. The members contribute Re 1 per day, which is matched by the government. The Life Insurance Corporation of India invests the contributions in the market to get higher returns. When the member turns 60 she receives a pension of Rs 500 a month and health insurance coverage. Thus far, about 4.5 million SHG members have individual co-contributory pension accounts, and more than 400,000 are receiving pensions.

Other benefits

In addition to these specific instruments, Village Organizations bundle entitlements from public distribution systems, grain banks, and bulk purchases from the open market in a food security system that benefits as many as three million households. Village Organizations also operate “bridge schools” that offer incentives to ensure high levels of enrollment among girls. Among the more than 600,000 farmers who adopted community-managed sustainable agriculture in its first four years, the use of nonpesticide management caused a dramatic resurgence in local biodiversity in addition to reducing input costs and enabling farmers to escape from debt.

LESSONS LEARNED AND ISSUES FOR WIDER APPLICATION

Some of the most significant practical lessons to emerge from the rural livelihoods program in Andhra Pradesh relate to institutional development. When institutions of the rural poor become strong, they establish the basis for a convergence of factors. Public agencies gain a new partner that articulates the aspirations and concerns of its membership. Private businesses gain clients capable of collectively asserting demand as a market. The wider economy gains a foundation for more inclusive, pro-poor growth and innovation based on improved capacities and access to services. In the case of community-managed sustainable agriculture, stronger institutions for the rural poor create a foundation for dialogue on alternative agriculture in India’s semiarid tropics.

The cost advantages of using coproduction models to deliver insurance services and agricultural inputs offset many of the disincentives of investing in rural areas. The organization of a new client base provides businesses with local partners capable of assuming many functions that were once centrally performed. The reduced costs greatly extend the reach of government services and private companies. The transaction costs for poor rural clients also fall dramatically through the use of one-stop shops where they can conveniently conduct multiple transactions. Located close to home, these service points provide complete “end-to-end” financial services including credit, insurance, procurement of inputs, and marketing of produce.

Like most problem-solving efforts, the experience described here has cautionary as well as positive lessons. In seven districts of Andhra Pradesh, the easy availability of credit from commercial banks and microfinance institutions encouraged borrowing well in excess of households’ ability to repay, and about 20 percent of participating households began accumulating serious debt. The resulting microfinance crisis points to the ongoing need for building financial literacy among the poor and for discipline in lending. The abusive collection processes employed by some of these institutions emphasizes the need for discretion in selecting which institutions may participate in rural livelihoods programs and to the need for well-defined channels for recourse when borrowers default.