Innovations in Rural Finance

The Road Ahead

Andhra Pradesh as a state provides an interesting case study of being the host for the most diverse microfinance models in the world, all thriving and competing, sometimes unhealthily so, for the client who is poor and disadvantaged.

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The past two and a half decades have been action packed as far as the rural finance scenario is concerned. There have been several innovations; some of the ideas that were thought about in the 1980s have become so intrinsic to the financial system that they no longer look like innovations. As the National Bank for Agriculture and Rural Development (NABARD) celebrates its silver jubilee, it is worth looking at the milestone events that have happened in this field. This is neither an evaluation nor an endorsement of the role of NABARD, and in some of these initiatives, NABARD has had no role whatsoever.

Self-Help Groups

One of the most significant innovations—and now it has been so much embraced by the banking sector and the state that it no longer looks like an innovation—has been the concept of Self-Help Groups (SHGs). Strictly speaking, even SHGs were not as much an innovation as they were an improvization of the informal systems that existed in the society. But, nevertheless, an SHG has to be treated as an innovation from the point of view of the formal financial sector because for the first time something like a group social collateral was accepted by the banking system as a surrogate for the traditional collaterals that they were used to. The reason why I call SHGs an improvization rather than an innovation is because they run on the basic principle of a chit fund or a *bishi*.

The most important piece in all this was that SHGs did not ignore the markets in two most significant ways. They set interest rates on loans near the informal lending rates of their areas (in most places at around 24% per annum), reducing the possibility of arbitrage. Second, they soon linked with the banks and brought the mainstream market players into the operations. Thus, the SHG movement in India, which is uniquely Indian, went much beyond *bishis* and can truly be called the innovation that emerged from the grassroots and later replicated elsewhere.

When SHGs grow: 'Companies' in Alwar

The fallout of the SHG movement in Alwar (Rajasthan) where PRADAN promoted SHGs, may be of interest here. Women, who were enterprising and grew fast, soon realized that their group would not be in a position to meet the increasing needs of their individual enterprise. At the same time, they needed the group for savings and other smaller loans. Some of these women from diverse groups got together to set up what they called a 'company' which was more like a *bishi*, a self-liquidating meta group that operated functionally till the women could meet their needs and constantly liquidated and regrouped with new needs. This is taking lessons out of SHGs and applying them in a different frame, as effectively.

Grameen methodology

India has been quick in absorbing the methodology of the Grameen Bank of Bangladesh. Several Microfinance Institutions (MFIs) have made credit easily accessible to people over the past decade by using this methodology effectively. While the country has been quick at absorbing the external aspects of the methodology and even

improvizing on them, none of the Grameen replicators have imbibed the 'spirit' of Grameen in having community ownership. The entire concept of community ownership seems to be restricted to the SHG model.

However, the Grameen methodology adopted by the MFIs has demonstrated something that was possibly unintended when the entire business started off. The most important lesson that the followers of this methodology have shown is that there is a vibrant market for rural credit. They have demonstrated that high interest rates are not a concern for the borrowers at very low amounts; instead they are actually willing to pay interest rates that are lower than that of moneylenders if the transactions are carried out with dignity and ease. In this way, Grameen methodology demonstrates the arbitrage opportunity that was available in the rural credit markets and has leveraged it to the fullest.

In the process, some MFIs might have made supernormal profits and also invited a range of venture capitalists and investment bankers to wake up and take notice. Whether the entry of venture capitalists in the market that is dealing with the poor to skim profits is desirable or not is a moot point. Nevertheless, this draws attention to the fact that there is a possible intervention of the State. Indeed, there may be some who may argue that the success of microfinance is largely because the State has kept away from it to a large extent.

Two important policy innovations that helped the banks to derive some comfort in dealing not only with SHGs but also with MFIs were: recognition of group collateral as a valid security and, thus, putting all such loans in the 'secured loan' category for prudential provisioning norms and recognizing the loans to MFIs for lending to the poor clients as a part of achievement of priority sector lending targets. This played an important signaling mechanism for the banking sector and provided even more legitimacy to the work done in the microfinance sector.

Beyond the frontier: Andhra Pradesh

One of the most innovative programs at scale that has helped the financial services to move beyond the frontier is the Velugu program of Andhra Pradesh. This is a program, albeit with a large amount of subsidy, driven by the State, but has survived two different and opposing political parties being in power and has continued. The innovation in this program was in the delivery, which insulated the State from the actual roll-out of the program, by creating a separate semi-autonomous body—the Society for Elimination of Poverty—which was largely staffed by non-governmental workers on contract to roll out the program. This, at least, insulated the program from getting to be one of individual patronage dispensation and helped to set up sustainable structures at the village level which have run independent of the State. The beauty of the Andhra Pradesh experiment is that while the State continues to interfere with the affairs of dairy cooperatives and play around with the structure that delivers agricultural loans, it has chosen to implement above-mentioned program under a fairly liberal Mutually Aided Cooperative Societies legislation, which prevents governmental interference.

Velugu demonstrates how finance can be extended to cover some very unconventional areas that benefit the poor. The rice credit line provides the collective bargaining power to purchase rice in bulk for the entire group/village and store, while the payment can be made over a period of time when the earnings come in through wages, thereby providing the necessary food security for the households. Velugu also demonstrates how the State could potentially insulate and institutionalize its developmental program for the poor without a large-scale elite capture. Has this happened by accident or by design we are not sure, but it nevertheless is the microfinance destination in India.

Growth as mantra: ICICI Bank

One of the most unlikely players that has dominated the mind space of the microfinance market has been the new generation ICICI Bank. Three of its initiatives can be truly called innovative. The Bank took SHG banking to a different plane through its intervention in Madurai district, following the takeover of Bank of Madura. The underlying feature of ICICI Bank's push was that the portfolio had to grow in order to be a profit center. If it had to grow, the loans had to be large in size; thus, one had to break the barriers of the loan multiple on the savings base given. The idea was that unless there is substantial capital infusion, there would be no vibrant economic activity. ICICI Bank was also perhaps the first bank that not only understood its limitation in 'group formation' but also recognized that the group formation costs/efforts needed to be compensated. This was the first sign of microfinance movement giving up the apron strings of development and moving towards commercialization.

ICICI Bank quickly recognized that the last mile problem had to be tackled in microfinance. Banks were not oriented to do extension banking and, thus, this had to be outsourced. However, the organizations that were providing the last mile service were undercapitalized. One way to increase their turnover (and thus ICICI Bank's turnover in this sector) was to remove the bottlenecks faced by these institutions. Since they were weakly capitalized, two options existed. One, buy out their portfolio through a securitization deal so that they get more headroom to build further assets. Two, enter into a partnership with the organization. Both these removed the constraint of capital adequacy for the MFIs. This was the most aggressive innovation that almost changed the face of microfinance in the new millennium.This was an inspired effort, ultimately recognized by the policy-makers when the business correspondent and business facilitator model was recognized as a valid way of doing lending business and etched into the policy documents. The innovation in microfinance will hopefully benefit even other sectors as this arrangement could be generic in nature. ICICI Bank used a

similar methodology to disburse agricultural loans using intermediary institutions such as sugar mills, rice mills and natural aggregators of the output.

Innovations imported

While we mentioned SHG as an improvement of the basic concept of chit fund, there were other aspects that rural financial sector picked up from the existing body of practices which have had limited or moderate success. Two such concepts pertain to agricultural credit. The Kisan Credit Card (KCC) tried to bring in the classic credit card model into agriculture by providing a generalized line of credit to agriculturists who had a track record with the bank. The interest rates, however, were moderate and did not adopt the logic of classic credit cards. The good thing about KCC was that it factored in some element of consumption requirements also in deriving the loan limits. However, a foray into a risky enterprise of agriculture where the known default rates are high, with limited risk premium in pricing meant that the growth of this product would not meet with the required enthusiasm that a typical product that fetches profits. This product was rolled out more as an obligation than as an opportunity. The other concept was imported from Thailand's Bank for Agriculture and Agricultural Cooperatives (BAAC)—the concept of Joint Liability Groups. This concept was not only adopted by BASIX in its agricultural loans but also experimented by Andhra Pradesh Government through its 'Rytu Mitra' scheme. Both the experiments did not pick-up the momentum that would be needed for the rest of the country to take notice.

Risk mitigation

Breaking up of the comprehensive risk of fall in yields into smaller measurable components was something that ICICI Lombard did as an illustration for others to follow. The components had objective measurability and could be compensated without much of a moral hazard. The risk elements that were thus covered included rainfall and temperature. What was not covered and could have been included are: the risk of germination (particularly with the use of bought out seeds than saved seeds) and other elements that contribute to yields. Of course some of the elements such as compensation for pests are difficult to verify and would cost a lot given the farm size and distances. However, the most important aspect was that at least some elements could be effectively and objectively covered. On the price risk though the benefits are yet to percolate to the small farmer, the basic backbone of a commodity exchange has been established and more and more products are getting added. If the lot and transaction sizes can be rationalized, there could be more action on this front.

The Importance of SHGs

- The major part of the innovation was that the initiative came not from the target-driven banking sector, but from an articulated need of the community.
- The rules of the game were not 'given' but articulated in a participative manner with the groups. There was no 'scheme'.
- The linkage with the bank was sought and, thus, a fair amount of effort was spent in convincing the banks as to why they had to do this.
- They concentrated on women. This was a new market segment that was being addressed, which was not catered to earlier, and helped to tap the 'slack' time in the family to do something productive with capital infusion.
- They insisted on regularity; this meant that cash had to be found in order to attend a meeting, whether it was for savings or repayment of loan. This meant that people had to find some source of income that generated cash with this regularity, and with greater circulation of cash within the household, the vulnerability was reduced.
- It started with the base of women's savings. For the first time, there was an intervention in the rural financial markets which was savings-driven and not credit-driven.

Conclusion

If we take an overview of the major interventions and innovations that were made, there are two stark features that strike us. Apart from SHGs, there have literally been no interventions in the way one can offer savings services to the rural areas. Not only are we saying that the innovations are not visible, even the theoretical opportunity of saving with Residuary Non-Banking Finance Companies (such as Sahara and Peerless) is being withdrawn. It is also evident that most of the successful, scalable and sustainable innovations/interventions have come either from the private sector or the non-profit sector. Clearly, when the State has innovated, it has not scaled fast enough. This might have some lessons for policy-making in terms of who owns the 'idea' and who facilitates its scaling up. NABARD's singular success in these years has been in the missionary zeal with which it embraced the SHG-Bank Linkage program.

Before concluding, I should record one of the most interesting innovations I came across in the field, which was neither replicated nor scaled. This was thought of by a small SHG in Ananthapur District where the women collectively decided to take a large endowment policy for each member of the group. The policy involved annual premium payments, which were hefty. The group decided that 50% of the premium would be funded from a common group fund and the other 50% would be paid by the group, but would be in the form of a loan from the individuals. This amount is repayable in 12 equal installments. So, the individual had a self-subsidy of 50% and staggered the other 50% over a year. This not only ensured that the women had a life cover, had a pot of money at the end of the saving period, but also that the group would not disintegrate till at least the final premium payment was due. Obviously, the most robust design principles were internalized through common sense of some very thoughtful women and not thought about on the laptop of a development professional or an academic.■

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