Financing Inclusive Growth - Experiences and Ideas from IFMR Trust

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Plan of the presentation

- India – A Snapshot
- Finance and Inclusive Growth
- Vision of a Well-functioning Financial System
- Policy and Public Infrastructure
- Community Banking in Rural Remote Areas
- Supply Chain-linked Financing for Enterprises
- Capital Supply: Orderly Transmission of Risk

India – A Snapshot

- Population
  - Over 1.1 billion people
  - About 700 million living in rural areas
  - ‘Demographic dividend’: 41.05% youths
- Economy
  - GDP over $1 trillion, achieved 9% growth in 2007
  - 7.5% GDP growth expected for 2008-2009
- Need for Inclusive Growth
  - Two-thirds of the population lives on under $2/day
  - Almost 50% children under-nourished
  - Increasing informalisation of the economy

Sources: WorldBank.org; UNICEF.org; Census of India 2001, Reserve Bank of India, NFHS 3

Finance and Inclusive Growth

Finance can help in making growth more inclusive

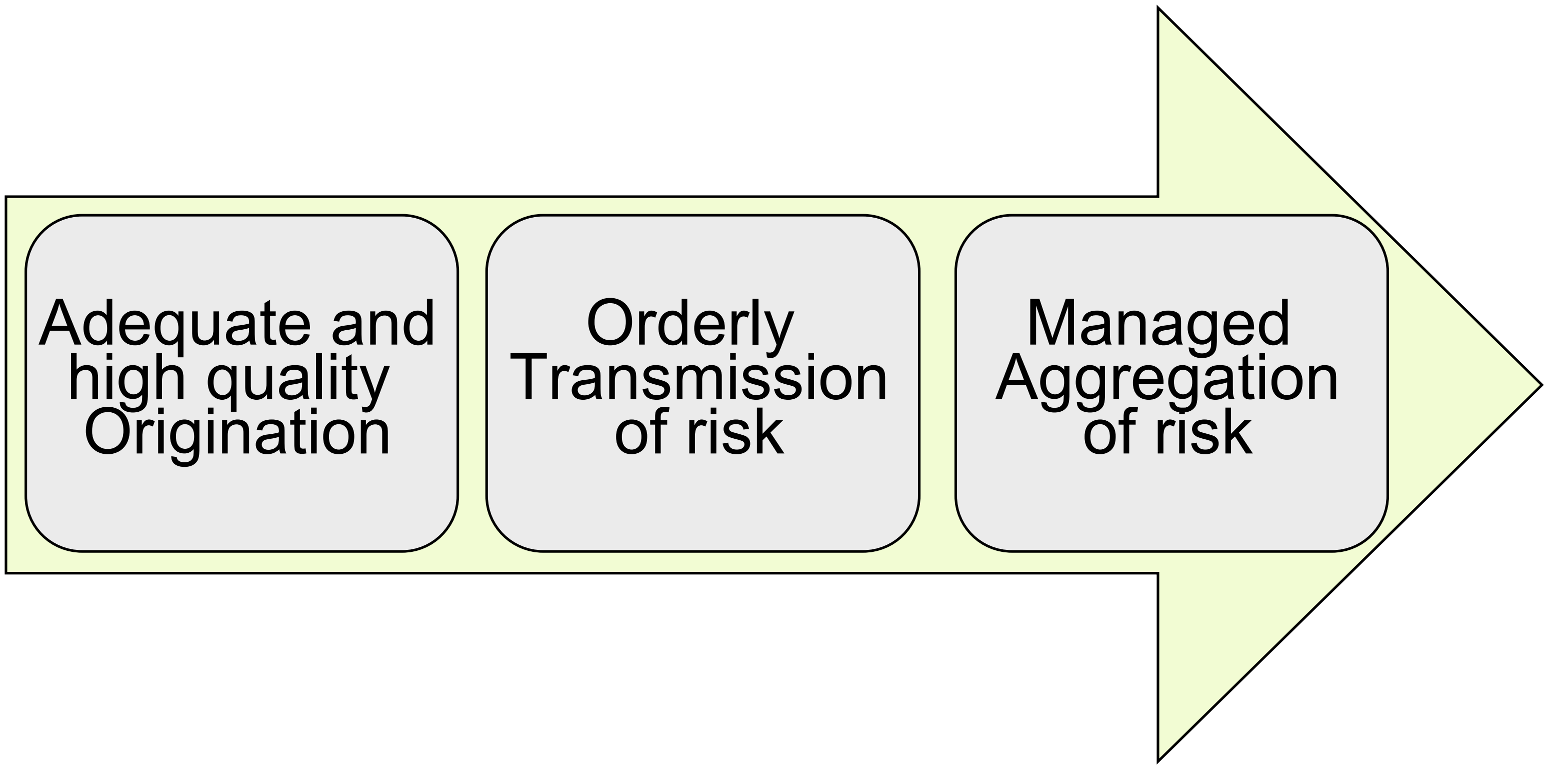
- Financial development reduces income inequality and disproportionately boosts incomes of the poorest
- Emerging evidence that operation of the formal financial system positively affects the economic opportunities of the poor

Sources: Beck et al 2007; Demirgüç-Kunt and Levine 2007

Access to Finance - Status

- 17.7% in the lowest income quartile have a bank account
- Less than 10% have any insurance
- 50% of loans taken by the lowest income quartile have annual interest rates > 36%
- Micro-enterprises with investments below USD 10,000 get 2% of net bank credit
- One bank branch per 18,000 population (rural)

Vision of a Well-functioning Financial System



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How do we get there?

- Core Strategy: Advocacy for an enabling policy environment and supply of public infrastructure
- Effective operating models for
  - Origination working at scale
    - Community banking to provide high quality financial services for rural remote India
    - Supply chain linked financing for enterprises
  - Supply of Market Infrastructure, particularly for transmission to risk aggregators

Policy and Public Infrastructure

- Policy constraints
  - Licensing of non-deposit taking institutions and rural banks / bank branches.
  - Use of agents and branchless banking models
  - Returns on savings and investments
  - AML norms (KYC)
- Public Infrastructure
  - National identity cards and biometric identification systems
  - Rural credit bureaus
  - Payment and settlement systems reaching the last mile

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Community Banking in Rural Remote Areas

- Kshetriya Gramin Financial Services (KGFS): Regional rural financial institutions with following characteristics
  - Limited geographical focus - serving all households/enterprises
  - Economies of scope - offering multiple ‘basic’ financial services
  - Thin front-end branches with process standardization, and backed by robust banking software and connectivity
  - Biometric technology - lower transaction costs & build client history

Community Banking in Rural Remote Areas

- KGFS ‘Wealth Manager’
  - Understands the features, benefits and limitations of services being offered
  - Advises the households/enterprises based on an understanding of their needs and risks
  - Incentivised to maximise the clients’ ‘financial wellbeing’
- Core assumption: In the long run, KGFS’s returns depend on the community’s financial wellbeing

Systemic Supply Chain Risks

- Rural households and enterprises - opportunities and strengths as consumers and producers
- Consumption and production affected by ‘systemic’ risks in supply chains. Therefore…
  - Limited success of direct lending to SMEs
  - Direct equity investment in SMEs not scalable
- Need for a supply chain-linked model of financing
  - Supply chain thinking to uncover the complete picture
  - ‘Fixing’ the supply chain: understand and address the systemic supply chain risks

Supply Chain-linked Financing for Enterprises

- The Network Enterprise (NE) Approach
  - Network Enterprise Fund: a ‘fund-of-funds’ investing in NEs
  - NE: a supply chain-specific investment fund
    - Use of equity capital higher up in the supply chain to estimate and reduce the risks - reduce/obviate the need for equity (risk capital)
    - Directed investments in model enterprises and common back-ends
    - Accelerate the supply chain and unlock debt capacity of individual enterprises in it

The Case of Rural Tourism

The Gap

The Traveller

How do I find these destinations?

What is the level of quality?

Are rooms available?

Can I reserve one?

How can we reach more travelers?

How do we compare to our competition?

What improvements should we make?

Rural Tourism Operator

- Indian tourism market growing at 9%, highest globally
- 400-500mm domestic tourists, 5mm international / year

Result:

- Lower occupancy for rural operators
- Traveller visits higher priced, more common destination or forgoes trip

- 10,000 holiday accommodations, many in the hinterland
- Provide travellers with a unique experience at lower price point

Potential Rural Tourism "Backend" Investment

<u>Result</u>

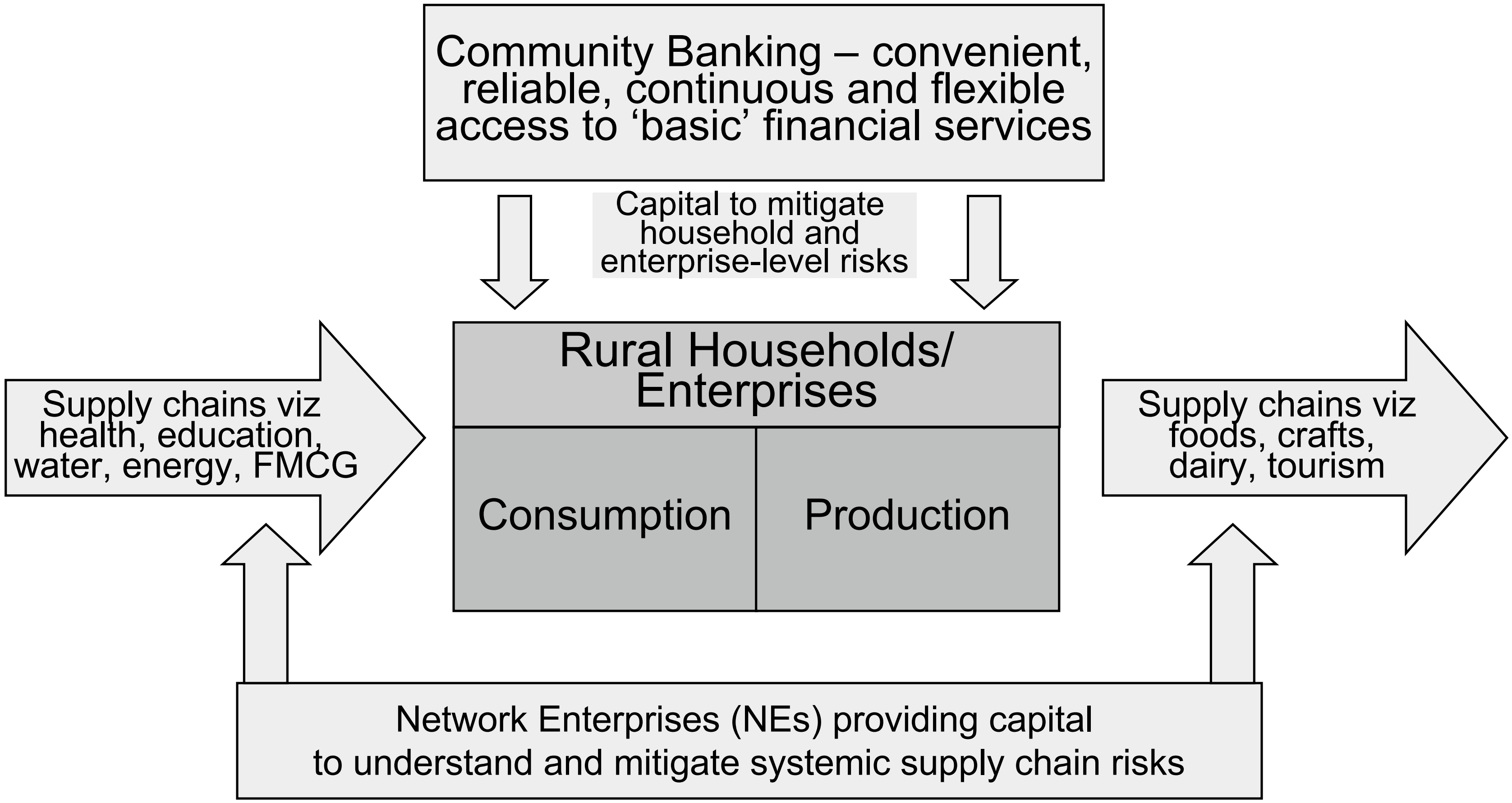
- Architecture for multiple players along the supply chain to leverage
- Information asymmetries reduced
- Income guarantees for enterprises through confirmed reservations
- Incentive to provide quality because of strong quality signalling

Network Enterprises Created

Network Enterprises TM

1. Vocational Training	7. Rural Channels
2. Rural Tourism	8. Emerging Channels
3. Rural Energy	9. Fast Moving Consumer Goods
4. Rural Drinking Water	10. Rural Private Schools
5. Dairy	11. Crafts, Apparel and Furnishings
6. Rural BPO	12. Agricultural Terminal Markets

Directing Capital Where it is Required



Need for Capital

- Micro credit in India: Almost 90% demand unmet
- Municipalities: major gaps between required and available funding
- Enterprise financing gap
- The challenge of ensuring 'orderly' enhancement in supply of capital

Capital Supply: Orderly Transmission of Risk

- Model of a secondary agency: A Guarantee Company (ITGC) ensuring orderly, efficient and reliable access to capital
    - Focus on underserved asset classes (eg micro finance, municipal finance)
    - Ensuring supply of efficiently priced capital by structuring, guarantees and market making
    - Working with rating agencies to develop appropriate rating methodologies for new asset classes
    - Incentivising quality standards in originated assets
    - Ensuring prudent and active risk management practices at every level

Thank you