

to sustainable enterprise. The second case study on fruit processing is typical of many – i.e. it's a successful pilot project that fails to expand, because further financing arrangements are not available to take the innovation to scale. The tribal

weavers case illustrates the tenacity that NGO's and pro-poor enterprises must have to establish and upscale a viable enterprises in a financing landscape that is simply not designed to support these sorts of organisations and initiatives.

Policy implications for financing rural innovation

1. NGO's play an important role in facilitating the interactions and coalition needed to create the innovations that underpin pro-poor rural enterprise development on a pilot scale. The poor on their own neither have resources, skills or the risk taking ability to do this. This is usually done with grant funding. There are no incentives in the market or in schemes for the private sector to play this role. Expansion of public grant funds for this role would be valuable, but the capabilities of the NGO sector to play this role are largely untested and would probably need strengthening.

2. If pro-poor pilot enterprises are expanded, these can provide quality livelihood opportunities for poor people. Scaling these enterprises and the innovations that underpin this process requires a mix of funding arrangements: grant, loans and revolving working capital funds. While many of the

innovations have been put in place and tested, these can not be taken to scale since appropriate financing arrangements are often missing – both loans for investment and loans for working capital.

Conclusion

While the grant – loan gap is emerging as a major concern for financing innovation in relation to pro-poor enterprise development, more generally financing of rural innovation remains poorly understood. This RIPWiG has highlighted this as an issue that requires further attention. Current doctoral research by Lina Sonne in India is expected to offer more insights on the issue of financing rural innovation (see www.innovationstudies.org/staff.html).

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The next edition of the RIPWiG Reporter will focus on gaps in assessing technology for innovation

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RIPWiG Reporter

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Introduction

The purpose of the RIPWiG reporter is to share discussions from a policy dialogue group known as the Rural Innovation Policy Working Group – RIPWiG –, an expert advisory group established by UNU-MERIT and its partners in India as part of a UNU-MERIT / CRISP project "New insights into promoting rural innovation: Learning from civil society organizations". The mandate of RIPWiG is to facilitate dialogue between the project team and decision makers from Government and civil society organisations with responsibility for planning and implementation of science and technology-based rural development initiatives.

Financing Rural Innovation

In this second edition of the RIPWiG reporter, Dr Rasheed Sulaiman V, Director of the Centre for Research on Innovation and Science Policy (CRISP), synthesises RIPWiG's deliberations on the topic of financing of rural innovation.

In industry, venture capital is just one of a number of financing mechanism available to support the process of innovation. How is financing of innovation done in the rural sector and how can it be made to work for the poor? The answer seems to be that it is not done very well and it has received very little attention either by planners or researchers. Rural financing and micro

financing have certainly received a lot of attention. But, as this edition of the RIPWiG reporter explains, "innovations in rural financing" is not the same as financing rural innovation. Evidence presented in the third RIPWiG meeting suggests that current financing arrangements are simply not designed to support the processes and activities that lead to innovation in the rural development sector. The discussion in the meeting concentrated on financing rural innovation in the context of pro-poor enterprises –enterprises operated by organised groups of poor people facilitated by non-government development organisations.

What do we mean by financing rural innovation?

Not to be confused with innovations in rural finance – which means new financial products for savings and credit -- financing innovation means providing finances for the costs of activities, process and inputs that lead to innovation. In the context of a pro-poor enterprise, this means costs associated with: creating, findings, acquiring and adapting technology and information; acquiring new skills or upgrading existing one; incorporating new technologies and management structures; market analysis and market foresight; developing new products; building networks in order to either acquire information or to access new markets; and advocacy for policy change. These costs are not usually covered by common rural financing arrangements, which usually provide production or working capital credit for established rural enterprises.

What is so different about rural innovation?

Previous discussions of RIPWiG have highlighted the following characteristics of rural innovation.

- Rural innovation is neither research nor invention, but a social process of learning and acquiring knowledge and putting this knowledge into socially and economically productive use.
- In small enterprises, it often involves clustering of different sorts of change: for example, it might involve the introduction of new processing technology such as drying equipment, but also changes in the way production is organized – perhaps larger batches, marketed, packaged and labelled as a higher quality product.

- Successful innovation processes are usually associated with a high degree of interconnectivity as a way of accessing different pieces of information. This concerns the way innovation takes place as a result of technologies, ideas and resources – and the organisations involved -- coming together and creating something new. Innovation is usually a response to triggers, opportunities and threats in the environment in which various organisations are located, For example, changing consumer preferences, quality standards, export opportunities, or competition from other enterprises and even countries. This means that the innovation process is unpredictable and support services such as R&D, financing and training need to be flexible and responsive to changing needs.

Common forms of financing rural innovation in India

One member of RIPWiG, Mr. D. Raghunandan, who heads a technology and development organization - the Centre for Technology and Development (CTD) –, and has over 20 years experience of setting up pro-poor rural enterprises, shared his experience on current arrangements for financing rural

innovation. This experience comes from CTD's activities in establishing agro-based enterprises in a number of states in India. These enterprises have focused on fruit processing for drinks, jams and jellies; and leather processing. The business model involves organizing the poor to operate small / medium

scale processing/ manufacturing units to produce goods that service different markets in India. Mr Raghunandan gave the following overview of financing:

Rural credit. Agricultural credit for production inputs such as seed and fertilizer are often available. Similarly arrangements are in place for micro-financing for self help groups – usually consumption credits for food or working capital for petty trading. However, funding in general is not available for the different activities related to rural innovation. For instance, developing new “inventions” gets enough public attention and financial support, often by way of grants (core and competitive) to R&D organisations, but its adaptation, commercialization and use (i.e. innovation) receive only very limited attention.

Government schemes. Grants, subsidies, loans and revolving funds are the common forms of financing mechanisms in rural development. Government departments/programmes do provide grants and subsidies as part of some schemes promoting new technologies (inputs, machinery); new information (training) and new products made by the poor (textiles, handicrafts etc). The Government through some schemes does provide subsidies and grants for purchase of machinery or capital equipment by the poor, but the inability to obtain enough working capital is often a constraint in otherwise

potentially viable enterprises. Some grants are also available for market promotion activities.

Bank loans. Rural producers and entrepreneurs can access loans from banks for some specific activities that are approved by the financial institutions, provided it conforms to the model project guidelines approved by their head quarters. For example: loans for buying cattle or for growing medicinal plants. While micro-finance agencies are relatively flexible with respect to lending for different activities (unlike commercial banks), the volume of credit they can provide is small. There are also programmes like Swarnajayanti Gram Swaraj Yojana (SGSY) that finances group enterprises, but the financial support provided is inadequate for the emergence of viable small enterprises.

Rural venture capital. Organisations such as Small Farmer Agri-business consortia (SFAC) do provide venture capital, but its availability is restricted to agricultural projects. Moreover, only those organisations or entrepreneurs who can raise significant amount of capital can get support of SFAC. Poor rural entrepreneurs or group enterprises of the poor can not access them. Organisations providing rural venture capital to micro-enterprises are emerging but their numbers are currently limited.

Box 1: ANT: A case of up-grading a traditional weavers group-based enterprise

ANT (the action northeast trust), an NGO at Bongaigaon in Assam, India, started a weaving programme with poor women of the Bodo tribe in 2002. Almost every Bodo woman knows how to weave, but due to lack of new designs and limited market links beyond the community, weaving remained a largely non-commercial activity. ANT realised that to commercialise this activity, weavers would need handholding right from designing, to selection of raw materials and identification and development of markets. This is also important to ensure that weavers benefited from this – rather than intermediaries – and that they would get at least the equivalent government minimum wage. With no project or donor funds, ANT used the services of a student designer who joined the organisation for a diploma project to document the craft, prepare samples and to identify and link to a suitable market.

Intervention and innovation facilitated by the ANT included: using market surveys at the beginning of the design diploma project; holding motivational meetings with the weavers; and seeking market feedback on prices and fabric quality before launching the products with the new designs. With no project grant funds, ANT used its own corpus funds to do these. In December 2002, it launched the ANT brand of its weaves in the national capital New Delhi. After studying the market, it had identified a niche market for its products – the “affordable” segment of women’s western apparel market in major cities. This was viewed as a better option than trying to compete with the already crowded hand woven traditional apparel sector – i.e. Kurtas and salwar suits. ANT used its own staff to explore and monitor market as it couldn’t afford a marketing professional. It formed a weaver administered trust called the Aagor Daagra Afad and started selling products under the brand name “Aagor” and set up a design support centre called “Ishaan”. It also began to monitor trends in the market (costs, preferences) and used this information to plan its production cycles.

Starting with a capital of just 2 lakh Rupees (US\$ 4000) and 25 weavers in the first year, through design and marketing innovation, the enterprise expanded so that by 2006, ANT was working with 150 women weavers across 18 villages. This was generating wages of more than 16 lakh Rupees (US\$32000) per year for the weavers – i.e. about US\$ 213 per weaver.

ANT had to address a number of financing issues. As soon as it was able to establish the potential viability of this initiative, it got 2 lakh Rupees (US\$ 4000) from Rashtriya Grameen Vikas Nidhi (RGVN) as a loan. With expansion in number of weavers and volume of production, it needed at least 5 lakh Rupees (US\$ 10,000) to meet working capital needs. To qualify for further lending, however, it has to return the existing loan. Banks were not willing to provide more than 20% of the value of output of the previous year as loan. As the time gap between purchase of raw material (yarn) and eventual sale of the garment takes almost six months, it needed revolving funds – i.e. working capital. ANT realised that it is easier to get grants than to get loans, but a business model based on grants is not sustainable as it becomes dependant on what in effect is a subsidy from the grant giver. With increase in sales every year, the need for working capital grew. To keep the enterprise going, ANT is currently trying to partner with financial organizations (for working capital), design schools (for new designs and designer inputs) and management institutes (for management trainees and personnel who might be interested to work with them).

Box 2: Piloting a self-help based enterprise in the horticulture value chain

This case deals with a 2 year donor funded project of an NGO, International Development Enterprise, India (IDEI). The focus of the project was on linking poor tribal horticultural producers in the state of Orissa, through value addition, to high value markets. The tribals grow a number of fruits suitable for processing. – pineapple, oranges, jack fruit, mangos and lemon. Physical distance from markets, perishability of the produce, trader exploitation, lack of bargaining power, and lack of value addition opportunities (skills, technology, infrastructure, buyer) have placed the poor tribal in a disadvantage position at the end of a long marketing chain.

IDEI began by under taking a pineapple sub-sector market assessment. The project examined the whole value chain (from farmers, traders, processors and markets for processed products) to understand the nature of relationships, demand and supply; explored opportunities for value addition at the producer or decentralized level; and assessed the market potential for these products. It learnt that value addition is a potential option, but this would require developing strong linkages at various levels; between technology suppliers, local NGOs, manufacturers of value added products, intermediaries in packaging and retailing, and consumers of value added products. To address this, IDEI facilitated the development of a coalition of these organisations to bring together expertise, resources and technology; and to organise them in such a way that a pro-poor enterprise could be established as part of a horticultural products value chain. Members of this coalition included: an NGO – the Centre for Community Development (CCD); Orissa University of Agriculture and Technology (OUAT); and later equipment manufactures and medium scale enterprises and traders involved in the manufacture and sale of processed fruit.

Initially the project concentrated on pineapple. Post-harvest expertise of OUAT was used to adapt existing technologies, to develop new fruit drying equipment and for training the women self help groups (SHGs). The products produced were tested for quality, product standards and consumer preference. Processing and product adaptations were made accordingly. During this process, the project interacted and worked with about 25 different organisations: SHG federations; Orissa Marketing Federation, commonly known as OMFED (public sector); Aaren Foods; Mamta Agro-foods; and several manufacturers of processing and packaging equipments (private sector). OMFED began procuring pineapple juice from the SHGs in 2005, changing its own procedures in order to procure and pay SHGs. In July 2006, OMFED gave an order for 4000 Kgs of pineapple juice to the SHG groups through CCD.

Trials continued during 2006 to find other potential markets for value added products. A proposal for establishing a processing plant by CCD in partnership with the SHG federation was prepared and submitted to the Department of Science and Technology and the Council for the Advancement of Peoples Action and Rural Technology (CAPART) for grant funding. By the end of 2006 neither grant funding or bank credit was available to take this promising pilot intervention to scale and its prospects for maturing into a viable pro-poor enterprise seem limited.

The grant – loan gap in financing rural innovation: examples.

Boxes 1 and 2 present two case studies to illustrate some of the points Mr Raghunandan made about financing innovation in pro-poor rural enterprises and in particular the grant – loan financing gap.

The first case illustrates the different forms of innovation required to make a tribal weaving enterprise viable: These included design innovations; marketing innovation – where the product was marketed, how product was marketed and how market information was accessed. In parallel, the NGO supporting the weavers had to find sources of financing to support different stages of development of the enterprise and innovations required at each stage. In the process, the NGO encountered difficulties in accessing credit because of the particular nature of the pro-poor enterprise – for instance its credit – cash ratio in the years when the enterprise was trying to expand its scale. Similarly it had particular financing needs as a pro-poor enterprise – for instance, the need to pay the weavers regularly, rather than waiting for revenue from sales.

The second case also concerns the experience of an NGO trying to establish a pro-poor enterprise, this time on fruit processing. Two points stand out. The key innovation was organisational, whereby the NGO facilitated the development of a coalition of organisations – R&D, self-help groups, larger

scale enterprises and local NGO’s to try and establish a value chain linking poor producers of horticultural products to high value markets. It required the adaptation of existing food processing and packaging technology, and subsequently new marketing strategies, but the main innovation was connecting the various pieces of a functioning value chain around self-help groups to create a pro-poor enterprise on pilot basis.

The initiative succeeded, but failed to expand beyond the pilot project, but not because the product was inferior, or the pro-poor enterprise was not viable. Rather it failed because financing was not available to take the pilot pro-poor enterprise to scale and establish full scale manufacturing supported by the coalition of organisations – and with them technology and information – that the NGO has brought together.

The two cases together illustrate a more important point in relation to financing and innovation associated with pro-poor enterprises. It is clear that intermediary organisations such as NGO’s and project funding – i.e. grants – are necessary to establish pilot scale, pro-poor enterprise models. Without the NGOs – and the grants they use – the innovations needed for pro-poor enterprises to emerge and grow would not take place. The problems really start, however, when the pro-poor enterprise has to make the transition from pilot project