



Rural Services Sector in India: Structural Changes and Implications for Policy



Institute of Small Enterprises and Development

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by

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A Project of

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PREFACE

Among the emerging economies, India has a distinctive position relating to the services sector. It is the fastest growing sector in India, contributing significantly to GDP growth, employment, trade and investment. The skilled-unskilled mix in manufacturing and services is becoming increasingly similar. Manufacturing ceases to be the main destination of rural-urban migration. The emerging consensus is that, for sustaining economic growth and for raising living standards, shifting labour out of agriculture into both manufacturing and services is needed..

In a 'new economy' setting, both new goods, and services that accompany such new goods,(for servicing or support) occupy the market, thereby making a new operational logic for the market. The market becomes more international than national or local. Considering the above changes in the economy, it is important to examine the structural and directional changes in the rural services sector. Such an examination is vital from the point of view of sharpening our understanding of the subsector, as also for shaping appropriate development policies, including financing policies.

The NABARD, mandated with the financing and development of the rural non farm sector, coordinates various activities for the development of rural services in the country. Considering this mandate, it is important for the Bank to broaden its knowledge base through new research and synchronization of existing knowledge. Such a broadened knowledge base, however, should be based on a timely and continuous flow of feedback from the ground level. A realistic understanding of structural changes in the rural services sector ,therefore, is vital. In view of the above imperative, the objective of this study is to have an understanding of the emerging trend in the rural services sector, in relation to its structural and related aspects.

Institute of Small Enterprises and Development, and me as Project Director, wish to thank NABARD for commissioning this study, and for believing us. A special word of thanks goes to Mr.M.V.Ashok , Chief General Manager, discussions with whom on several occasions has immensely helped the project in many ways. Thanks are also due to Dr.K.J.S.Satyasai, Dr.Gopakumaran Nair, and their colleagues for all their help and useful comments and support.

The Directorate of Industries and Commerce, Government of Kerala, was a source of significant help and the encouragement at various stages of the study. The District Industries Centers and the Gram Panchayaths provided valuable data, information and insights.

A number of persons provided insights into the theme of the study. Had it not been for the active cooperation of the respondent entrepreneurs, this study would not have been completed successfully.

Enterprise development policy in the country has been in a stage of churning, especially in the context of the announcement of various flagship programmes by the government of India, as also the setting up of a High Power Committee on MSME Policy under the chairmanship of Mr .Prabhat Kumar.This project has immensely got benefited by the generous insights provided by Shri.Prabhat Kumar, as also by Mr.K.K.Jalan,Secretary, Ministry of MSME.I would like to express my sincere thanks to both of them.

At the Institute of Small Enterprises and Development, the resources of the ISED Small Enterprises Observatory(ISED-SEO) have immensely provided the background materials for this research. The coordinated work of the research team has ensured the success of the project. K.Jagannathan and Vishnu Vardhanan coped competently with the tasks relating to data analysis. The names of J M I Sait, Yerram Raju deserve special mention for their valuable inputs and suggestions. I would also like to place on record the editorial and logistical support extended by the ISED Team, including, Simi C.D, Liju M.J., Vishnu Sukumaran, Jose Richard, Dhanya M B, and A K Sivadas, Phillips Mathew and Shaji Mathew .

To all others, and to others we may have inadvertently failed to mention, I am most thankful.

Cochin

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Project Director

EXECUTIVE SUMMARY

Among the emerging economies, India has a distinctive position relating to the services sector. It is the fastest growing sector in India, contributing significantly to GDP growth, employment, trade and investment. In a 'new economy' setting, both new goods, and services that accompany such new goods, (for servicing or support) occupy the market. The market becomes increasingly international than national or local. Considering the above changes in the economy, it is important to examine the structural and directional changes in the rural services sector. Such an examination is vital from the point of view of sharpening our understanding of this vital subsector, as also for shaping appropriate development policies, including financing policies.

In this context, it is important to broaden our knowledge base through new research and synchronization of existing knowledge. Such a broadened knowledge base, however, should be based on a timely and continuous flow of feedback from the ground level. A realistic understanding of structural changes in the rural services sector, therefore, is vital. In view of the above imperative, the objective of this study is to have an understanding of the emerging trend in the rural services sector, in relation to its structural and related aspects.

This study, based on earlier literature, various previous studies by the ISED, formal and informal discussions at the peer level, and a field research in four Panchayaths of Kerala, belonging two Districts, provide useful indications on growth, structural changes, policy imperatives, and on the way forward.

The research shows that, unlike other States of the country, Kerala's rural services sector remain largely tiny and with limited innovation and advances, though the opportunities are significant. Though there is a reasonable understanding on the business environment and orientation towards growth and diversification, the practice by entrepreneurs remain far from satisfactory. While the international literature explains such a situation in relation to the subject of 'necessity entrepreneurship', the peculiar Kerala experience can be explained in terms of a *renteer entrepreneurship ratchet*. Available evidences and indications do not allow us to anticipate autonomous efforts by entrepreneurs to move out of this ratchet. It needs external support, wherein, the government and the development finance institutions should play the lead role. Such lead role can give some signals to the rest of the country on policy and strategies. This is because, the State of Kerala is a highly globalized part of the world, where coordinated efforts can catch up and are likely to give results, with a significant demonstrative value addition at the national level.

The ambitious national program 'Make in India', as also the Prime Minister's thrust on a development agenda around the role of the micro private sector, are truly reflective of the needs of Kerala. The challenge is to properly position Kerala's needs against the national canvas for mutual benefit of both the Centre and the State.

The role of public policy at the State level, so far, has been more of patronage and less of ground level capacity creation for enterprise development. Where the State has failed in the past, the time has come for innovative experiments where, the private sector, local governments, and the nongovernmental sector have their respective roles.

The present-day stagnancy in the rural services sector in Kerala need to be examined in relation to a subsector approach, having the following distinguishing features: 1) extent of the market; 2) market concentration; 3) technology and skill levels; and 4) employment effects. Each of these features is critical from the point of view of development strategy and financing. These features are likely to be completely different from one another, and therefore, both the 'real services' and financial needs also may vary significantly. Therefore, a broad "pattern" of assistance, as followed by the banks today, though may be operationally easy for the lender, may not satisfy the needs of the borrower. Hence, enhancing credit flow into this sector requires new strategies. This demands detailed studies.

Some concrete action points deserve further examination. This study advocates a strategy approach with focus on two critical areas: 1). preserving the exiting entrepreneurial base of Kerala at the grass roots, from further deterioration; and 2) enhancing the tempo of start-up, with focus on sustainability. Taking into account these two aspects, a 'Skills Bridge Strategy' is advocated.

Regulation and the patronage of the State government has done more harm than good for enterprise development in the State. Given Kerala's advantages relating to Panchayati Raj, and its large network of women SHG groups, there need to be an economic counterpart to this currently unutilised capabilities on the organisational front. Therefore, the focus need to be on local economic development, for which, we advocate a Local Economic Development Fund. A National Fund, to be administrated by NABARD, should provide the lead.

The focus given to local economic development provides an ideal environment for planning and grooming social enterprises. With an appropriate legislation, strategies need to developed for this sector.

The research leads us to the need for structuring new and more appropriate financial products. Value chain approach and production cycle approach have been proposed as two models. This requires scientific mapping of subsectors, and development of strategies around them.

Cost of credit has been found to be a major burden of rural service enterprises, and therefore, there is a need for reducing the cost of credit. We propose the concept of a Services Finance Park that can offer a customer- friendly window. While the limited availability of institutional credit from the banks has led to several institutional innovations in the recent past, their success depend upon aligning with the Entrepreneurs Associations and ensuring the timeliness of credit. While the field research shows that, the agenda of financial inclusion has not percolated to the context of rural service enterprises, there is great need for exploring alternatives.

We also advocate serious efforts towards building up the knowledge base of the rural services sector. Strengthening the research units of the Banks and setting up a dedicated Service Enterprise Observatory, can go a long way to enhance the knowledge base.

The entrepreneurship development interventions have lost their importance and quality over time. There is need for having innovative start-up and growth programmes.

This study, against the background of the debated on 'Kerala model of development' has great relevance. The so-called 'Kerala Model' sustains on the adversities of the so-called 'Dutch disease', where the accelerated flow of foreign remittances practically contribute to eroding the entrepreneurship base of the State. The generic focus on 'the so-called 'investment promotion' has failed to attract corporate sector investments. While there is a market in waiting for quality services of global standards, the task of public policy need be to nurture and upscale entrepreneurship in the micro-meso private sector. DFIs and the government have to play a major role in this regard.

Enthusiasm and motivating the entrepreneurial class is of paramount importance. It is as well a professional and political exercise, where, new concepts like 'responsible business' and 'ethical products' become important and worthy of examination. Conservative models of financing need to undergo transformation. Formalisation of some degree has to take place in the industry. Financial institutions need to take the lead in innovation. The example of Dutch and German banks deserve closer examination in this context.

Our field research provides some important findings that are crucial for policy exercises. The meticulous analysis of entrepreneurial attributes indicates a tendency towards entrepreneurial stigma and a 'rentier entrepreneurship' syndrome. Breaking out of this ratchet is difficult in a context where the State has been reeling under a phenomenon of the so-called 'Dutch disease', where achievement motivation is the victim. Market opportunities on the supply side are increasingly provided by imports, rather than by local production.

Against the above background, limited promotional measures such as cheaper credit, technology and infrastructure cannot, by themselves, enhance achievement motivation. The social value system created by the return migrants has to be translated into a ground for Socially Responsible Investments (SRI), that lead to supply of ethical products in the market. Kerala has already demonstrated some elements of ethical consumerism. Considering its history of social movements, as also the enhanced role of media in shaping the development agenda, Kerala can trigger an ethical consumerist movement. This can create the ground for a new agenda of local economic development, which in turn, will help to motivate the rural entrepreneurs.

Changes on the above lines need to happen with the support of an effective knowledge system and with the role of knowledge institutions that can influence policy.

From the point of view of immediate action strategies, this study recommends the following:

1. Identification on the selected subsectors for concentrated action and development of appropriate strategies. This includes 6 subsectors, that is, printing, local tourism, urban agriculture and related services, recycling industry, ethnic foods and hotels & services. While speedy development of these subsectors can provide substantial employment opportunities and can lead to a significant flow of institutional credit. There is also the imperative for legal and institutional reforms. The second recommendation relates to strategies of enhancing the scale and the extend of the market for the existing tiny units. Based on the concept of 'grass root services hub', developed by the ISED (ISED-2016), a local economic development strategy with the active role of local governments, is proposed.

This study leads us to conclude that the rural services sector in Kerala has substantial latent potential, which can best be harnessed with the help of the new economy and its crucial parameters.