Reforming agricultural development banks (AgDBs)

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1. Historical perspectives: trial and error in AgDB development and reform

For a hundred years or more, until the middle of the 20th century, a small number agricultural banks existed outside of Europe. For three decades, roughly from the1950s to the 1970s, agricultural development banks (AgDBs) were considered a panacea. At first, they were to finance progress in high-yielding agriculture and generate thereby excess revenues to be invested in the emerging industrial sector. Next, poverty alleviation through smallholder credit was added to their mandate. Donors were eager to support them with soft loans for credit lines, repayable over 40 years, and with technical assistance. Donor experts assisted in preparing and implementing the key components of the development banking concept: government ownership, the enactment of special AgDB laws and exemption from central bank supervision, budgetary allocations and external credit lines as sources of funds, subsidized interest rates, targeted credit, and, in a later phase, a poverty focus frequently combined with group lending. However, most AgDBs turned out to be a flop. Instead of producing income to be profitably reinvested, they disbursed funds that were not repaid, generated losses that were a drain on public resources, and, last but not least, missed their target group and their purpose. In their downfall, they frequently pulled with them large numbers of cooperatives which they had used as credit channels. One of the chief reasons for their failure was cogently summarized in a book title: *Undermining Rural Development with Cheap Credit* (Adams et al., 1984).

For the next two decades, the 1980s and 1990s, many donors withdrew their support to AgDBs, among them, to name but two, the World Bank and KfW. Surprisingly, this did not keep governments from establishing new agricultural banks; 34% of the banks in the FAO's data bank were established during that period. Contrary to the expectations of the modernization theorists of the 1960s, the economic miracle of Germany, partially based the transfer of capital through development banks, was not repeated in any developing country. Some regional development banks and multilateral institutions continued using them as channels for their credit lines, but with the unfortunate result that this made many AgDBs and recipient countries poorer, not richer. At the end, a considerable number of AgDBs were technically bankrupt; many were closed, particularly in Africa; some were privatised, as in Latin America; yet, for political reasons, many were kept going through perpetual budgetary allocations, particularly in the Near East, but also elsewhere.

AgDBs disappeared from the agenda of international conventions and workshops, as attention shifted from *agricultural credit* to *rural finance*, proposing (i) savings as a service and source of funds and (ii) portfolio diversification by including rural microentrepreneurs and other customers as additional new market segments. Institutionally, AgDBs were declared unsuitable to cope with the new rural finance agenda and were subsequently ignored. Instead, two new topics came up: financial systems development and microfinance (The World Bank 1989; Seibel 1996), the latter oscillating for a while between donor-driven credit NGOs and market-driven microbanks. Even informal financial institutions appeared more promising than AgDBs (Adams & Fitchett 1994; Ghate 1992; Kropp et al. 1989; Seibel & Marx 1987). As a result – paraphrasing an article on rural savings by Robert Vogel (1984) –, agricultural banks became *the forgotten half of rural finance*.

So, the concluding question is: What should happen to the remaining agricultural banks: **Ignore them, close them or reform them?** Ignoring the issue may be the worst strategy,

throwing good money after bad, though this is a strategy many a government administration has chosen confronted by political pressure in favor of the banks.

But why not close the remaining AgDBs if they are so underperforming? There are several reasons why we should take a fresh look at agricultural banks. The first is a moral one: If donor experts were responsible for the flaws in the design of the banks, as was frequently the case, they should now, enlightened by 40 years of development banking experience, not discard them without due diligence.

The second is inspired by theory: If a credit bias is the problem, why not solve that problem by mobilizing savings deposits as the main source of funds and at the same time a much-demanded service to the rural population? If cheap credit is the problem, why not introduce market rates of interest? If governance is the problem, why not find alternatives to government ownership and solutions to political interference? If financial repression is the problem, why not engage in a policy dialogue and adjust the legal and policy framework? These issues may not be entirely unrelated: As cheap credit together with a credit bias create dependency on public resources and invite interference by government and politicians, savings mobilization as the main source of funds and the deregulation of interest rates on deposits and loans might eliminate the material basis for government interference.

The third is a pragmatic one: Even if the quality of their service is low, their outreach is vast, in some countries in the millions and even tens of millions; and there is no immediate alternative available. Also, large amounts of money have been invested in the infrastructure of development banks, some of them with thousands of branches and sub-branches and tens of thousands of staff members. It would be a great loss is the branches were closed, and a great gain if they could be turned into profitable enterprises.

The fourth and most convincing reason is a historical one: Not all AgDBs have failed. In a number of countries, unviable agricultural banks with insignificant outreach and poor service are a thing of the past. In others, there is a keen awareness, at least in the agricultural banks and in some quarters of the administration, that things must change. But most importantly, under conditions of a conducive policy environment, there have been spectacular reforms in a number of countries. Let us examine them first before giving up on agricultural banks!

All the banks presented below were insolvent and unsustainable during some extended phase of their history. Reform has turned them around into sustainable, profitable banks with increasing outreach and a wide range of products. All but one of them started out as government-owned banks. All but two of them are still government-owned.

2. AgBanks in Asia

2.1 Bank for Agriculture and Agricultural Cooperatives (BAAC), Thailand: gradual reforms against obstacles of financial repression[1]

Reform history: BAAC was established in 1966 as a government owned agricultural development bank. The original mandate was to provide agricultural credit to farm households. During almost four decades, BAAC has gone through a process of transformation from a specialized agricultural lending institution to a diversified rural bank. There were four major phases of reform:

[1] For a detailed presentation see: Maurer, Klaus, with Shyam Khadka & Hans Dieter Seibel: Agricultural Development Bank Reform: The Case of The Bank for Agriculture and Agricultural Cooperatives (BAAC), Thailand. Working Paper 2000-3, www.uni-koeln.de/ew-fak/aef .

- 1966-74, laying the foundation for individual lending to farmers through joint liability groups;
- 1975-87, expanding its lending operations through access to commercial bank and donor funds and consolidating its operations by substantially reducing loan channelling through cooperatives;
- 1988-96, striving for viability and self-reliance, under conditions of controlled interest rates, through savings mobilization, improved loan recovery and increased staff productivity;
- since 1997, adjusting to prudential regulation by the central bank and diversifying into non-agricultural lending.

The result of gradual reform has been the largest relative outreach by any Agricultural Development Bank: 92% of farm households in Thailand, combined with institutional viability.

Elements of reform: BAAC's perennial reform has been guided by two, sometimes conflicting, objectives: outreach to all farm households as its political mandate; and financial viability in the bank's own interest. Important elements in the reform process have been:

- Government respect for the bank's considerable, though not complete, operational autonomy.
- A corporate culture emphasizing cost-effectiveness, productivity and efficiency.
- Decentralization and expansion of branch network operating as profit centers.
- Individual lending through joint liability groups, as a financial technology attuned to Thai culture.
- Substantial improvements in portfolio quality, which created depositor confidence.
- A radical shift in the financial resource base to rural savings mobilization. (Maurer & Seibel 2000)

Outreach: In 2001, BAAC had 1476 branches and other outlets in all of the country's 76 provinces and a staff of 12,960, 6,308 them loan officers. In 1988, banking operations were downscaled from the provincial to the district level.

BAAC has 5.2 million registered direct and indirect borrowers, which is 92% of all farm households in Thailand. Of these, 2.74m are active borrowers, all in rural areas (ie, 8.5% of the rural population, 46% of total farm households). Together they hold 4.41m loan accounts, with an average outstanding loan balance of $1,321, which is 62.5% of per capita income.

BAAC has 9.57m savings accounts (ie, 29% of rural population, 34% market share), with an average deposit balance of $270 or 12.8% of per capital income.

Products: There are five savings products, two of them to small savers. One of these, introduced in 1995 with a minimum opening deposit of $1.15, has a lottery component and has attracted 2.1 million depositors with an average balance of $87. From 1967 to 2001, deposits from the public have increased from 11% to 76% of liabilities, the deposit-to-loan ratio from 14% to 98%.

BAAC offers two loan products: retail credit to individual farmers through joint liability groups, accounting for 94% of the portfolio; and wholesale credit to agricultural cooperatives and farmer associations (6% of the portfolio). Until 1993, BAAC was restricted to agricultural production loans. Since then, it is permitted to extend loans for farm-related activities such as agro-processing and marketing up to a maximum of 20% of its portfolio. In addition, BAAC offers three insurance products, transfer and payment services. The bank is making strong efforts to have this restriction lifted and lend to all segments of the rural population for all purposes.

Performance: Total assets as of 2001 were $7.8bn, net loans outstanding $5.6bn, savings deposits $6.0bn, equity 0.57bn. BAAC is struggling with an arrears ratio of 12.6% and a ratio of arrears older than one year of 9.4% (including borrowers under debt suspension). Productivity was 434 active borrowers per loan officer. A cap on interest rates – perhaps the bank's most serious problem - has restricted the bank's profitability and the growth of equity, which in some years has fallen below the inflation rate. The capital adequacy ratio is 7.3%. ROA was 0.2% in 2001, ROE 2.2%.

An unfinished agenda: BAAC has demonstrated how gradual reform can be carried out in periods of financial repression, with directed credit, interest rate ceilings and mandated agricultural lending quotas. Under these restrictions, BAAC expanded its outreach, forced cost-efficiency upon its staff, and prepared the ground for deposit mobilization. The reform agenda is still unfinished:

- With the emergence of private depositors as major stakeholders, ownership of BAAC stock might be diversified, with adequate representation of the new shareholders on the Board of BAAC.
- Lending rates need to be fully liberalized and re-aligned to reflect the true costs (ie, increased from 12% to 15-16% p.a.).
- BAAC needs a new, performance-related management information system (MIS) which also enables field-level managers to track the performance of both savings and loans of a particular client.
- Performance-related staff incentives need to be implemented

A recent paper by BAAC concludes:

> "… the deep-rooted truth for BAAC's financial situation has to be seen in the political restriction on its lending rates. A more realistic pricing for BAAC's loan operations is an important restructuring issue for the future." (Haberberger et al., 2003)

2.2 Agricultural Bank of Mongolia (Ag Bank), now Khan Bank: reform by trial and error

From state to private banking…: AgBank was created in 1991 as a privately owned joint stock bank , carved out of the former one-tier State Bank of Mongolia. All banking business outside the capital was transferred to AgBank. Yet, the bank was unable to shed the legacy of local government influence inherited from state banking: deciding on recruitment, lending to government projects, providing free payment services to government agencies and, finally, defaulting on loans.

… and twice into bankruptcy: In 1995, the bank was declared insolvent, but not closed, as Asian Development Bank (ADB) injected US $ 4.2 million: capital that the government of Mongolia will have to repay. Without a sound and tightly enforced reform agenda, the bank went insolvent again in early 1999 and was first placed under conservatorship, than under receivership. In the ensuing debate, the international donor community suggested closing; but the government, under political pressure from the provinces, opted for something like *reforming-in-reverse*: substituting full government ownership for private shareholding.

Back into government ownership: In the wider framework of a World Bank Financial Sector Adjustment Credit programme, the Government of Mongolia, the Bank of Mongolia, the World Bank and USAID agreed in 2000 to implement a restructuring plan that included a recapitalization and a management turnaround. Under this plan, Development Alternatives, Inc. was contracted to manage the bank. The government brought equity back to zero by recapitalizing the bank to the tune of $8m (converting certain deposits into capital and issuing

restructuring bonds); agreed to pay for financial services rendered by the bank; accepted a management team of two American (among them the CEO) and four Mongolian managers financed by a USAID grant; and appointed a board of directors with the explicit objective of controlling government interference, consisting of two members from government, two linked to USAID and an independent chairman. This prepared the way for re-privatization.[2]

Sustainability with outreach – reform accomplished: Khan Bank now offers various financial services, including 14 loan products, three types of deposit products and Visa cards. With 410 branches, the bank has the most extensive banking network of Mongolia. As of June 2006, Khan Bank had an outstanding portfolio of 142.3 M USD for 207,284 borrowers and deposits of 190.4 M USD for 767,956 depositors. Its owners are HS Investment Co. Ltd. - a subsidiary of the Japanese holding HS Securities Co. Ltd - (53.2%), Tavan Bogd Trade Co. Ltd. (35.5%), the International Finance Corporation (9.1%) and Development Alternatives, Inc. (2.2%).

Product development: Key to the Bank s turnaround and current success has been the successful development and implementation of new products throughout the country. The new product approach was to quickly pilot products and then rapidly expand the delivery countrywide, rather than focusing on quick saturation at each branch. This strategy effectively leveraged Khan Bank's unmatched market access via the existing branch network to rapidly reach the economies of scale necessary for profitability. The current menu of credit and deposit products is carefully tailored to be responsive to the unique demands of the market, is diversified by geographic area, and has evolved with changing market needs. Although Khan Bank s main product focus has always been on rural Mongolia, its successes there have laid the foundation for substantial growth and new services for all Mongolians. From the core micro and small business product, the line has expanded to 14 as of mid-2004, including medium enterprise, pensioner, payroll deduction and agricultural loans. The Bank is currently piloting mortgage loans. By recognizing the informal lending sector as a real competitor, and providing a service that encourages borrowers to successfully move into the formal financial system, Khan Bank has created a new kind of bank borrower. Individuals who do not qualify for the Bank's small business loans often use a consumer loan to get started in a new venture. Thus, the right products create burgeoning demand, leading to repeat, larger loans, and demand for other products and services, resulting in economies of scope, cost recovery, sustainability, and finally profitability across the product line. As a result, families and businesses are able to borrow more money at better terms and lower costs, while outreach to the rural poor continues to be deep. (Gutin & Young, 2005)

Rating: In 2006 Khan Bank has been assigned a global rating of A- by PlanetRating, with a positive trend. This rating reflects the bank's leading position in the Mongolian banking sector. In an increasingly competitive environment, Khan Bank is one of the most profitable banks of Mongolia and has been growing continuously thanks to its excellent reputation and its rural market dominance. It has developed a diversified range of financial services and reports an excellent portfolio quality. The management team, led by skilled and committed expatriate top managers, is being strengthened with experienced local managers. The main challenges of Khan Bank in the medium term are turning all its branches and sub-branches to the online MIS in the most cost-effective way and bringing additional capital to accompany the growth of the institution. (PlanetRating, 2006)

[2] There were dissenting views, presented by GTZ: "Privatization is no panacea. Especially given the Mongolian context, with an insufficient supply of financial services in rural areas, it might be appropriate to maintain public ownership of AgBank. No other financial institution comes close to AgBank's quantitative outreach and public ownership will guarantee this continuing. Addressing the governance issue seems more important than condemning state ownership per se. The bank's prospects are bright – even under public ownership – if government does not interfere in operations…" (Grashof 2002)

2.3 Bank Rakyat Indonesia (BRI), Microbanking Division: the big bang reformer[3]

Reform by deregulation: Until 1983, interest rates in Indonesia were regulated, the financial sector was dominated by state banks, century-old BRI was the main provider of agricultural credit through a network of sub-district units (*unit desa*), heavily subsidized. When oil prices dropped and GDP fell, the government offered the bank two options: *close it or reform it*. In 1983, interest rates were fully deregulated, and BRI was placed under new management, which decided to commercialise the 3,600 rural outlets (*unit desa*, established at sub-district level) of hitherto subsidized credit into self-sustaining profit centres.

Product development: With technical assistance from the Harvard Institute for International Development, the bank calculated microsavings and microcredit transaction costs and carefully crafted two new commercial products. One was a scheme of voluntary savings withdrawable at any time with a lottery component, SIMPEDES, which proved to be immensely attractive and at the same time served as an instrument of resource mobilization at village level. The other one was a non-targeted credit scheme, KUPEDES, open to all and for any purpose, the only credit product offered by the units. Its features included simple procedures, short maturities, regular monthly instalments mainly from non-agricultural income, flexible collateral requirements and collateral-free microloans, incentives for timely repayment, repeat loans contingent upon successful repayment of previous loans, and market rates of interest amounting to 2% flat per month (equal to an effective rate of 44% p.a., minus 11% for timely repayment = 33% p.a.) to cover all costs and risks.

Reform continued – reorganization of BRI: The financial crisis of 1997/98 would have wiped out BRI had it not been for its microfinance operations. During the crisis year, 1998, when state banks went technically bankrupt, the units yielded consolidated profits of $94m and produced excess liquidity of $1.43bn. In response, BRI was reorganized in 1998 into three divisions: a Corporate Banking Division for loans above Rp 3 billion ($300,000 at the Oct. 1988 exchange rate), a Retail Banking Division with 323 branches which offer savings deposit services, provide loans on commercial terms from Rp 25 million to Rp 3 billion ($2,500-$300,000) and handle the remaining subsidized targeted credit programs; and a Microbanking Division, with 4,185 outlets (2,566 village units, 1,220 peri-urban units, and 379 village posts), with loans from $5 to $2,500 and unrestricted savings services.

Outreach: As of December 2006, the BRI units served 3.5m borrowers with loans outstanding amounting to US$3.0bn, or $880 per borrower. The number of savings accounts had grown to 30.9m (down from 32.3m in 2005 due to consolidation), amounting to $4.8bn; or $158 per account). In 2000, there were about 6,000 formal and 48,000 semiformal microfinance outlets in Indonesia, serving some 45 million depositors and 32 million borrowers; the BRI units accounted for 74% of microsavings balances and 39% of microloans outstanding (ADB 2003).

Performance history: SIMPEDES, voluntary savings withdrawable at any time, with a lottery component, proved to be most attractive savings product, outperforming all others by a wide margin. By December 1989, BRI had broken even in terms of resource mobilization: fully mobilizing its loanable funds through village-level savings, and generating excess

[3] For a detailed presentation see: Seibel, H. D., 2005: The Microbanking Division of Bank Rakyat Indonesia: A Flagship of Rural Microfinance in Asia. Pp. 7-20 in: Malcolm Harper & Sukhwinder Arora, eds., Small Customers, Big Market: Commercial Banks in Micro-Finance. ITDG Publications, Bourton-on-Dunsmore, & TERI Press, New Delhi. *Website:* Working Paper 2005-2, www.uni-koeln.de/ew-fak/aef .

resources thereafter. BRI's self-reliance in terms of fund mobilization, together with its profitability, has created the material base for its autonomy and freedom from political interference which has so severely afflicted other state banks.

The BRI units reached their break-even point eighteen months after the inception of their reform, generating Rp 9.8bn ($8.7m) in profits. For the period 2/1984-6/2003, the long-term loss ratio (total overdue ≥1 day, including amounts written off, divided by total which has fallen due during that period) was 1.62%; for the period 1-12/2002, the 12-month loss ratio was 1.55%. Since 1994, return on assets (ROA) has been consistently around 5%-6%. ROA stood at 6.4% in 12/2002 and 5.4% in 6/2003. Profits at unit level amounted to $177m in 1996, $94m in 1998, $167m in 1999, $119m in 2000, $129m in 2001, $186m in 2002 and $89m during the first half of 2003[4]. After 23 years, there is still no sign of the often-quoted iron law in microfinance of an increase in defaults and a fall in profits over time.

The BRI units have a highly efficient MIS, which provide instant information on a daily basis. The data are forwarded to the head office where they are compiled and published on a monthly basis. The table below summarizes some of these data and may serve as a model to other banks.

Agricultural finance: Under the subsidized BIMAS program handled by the units until 1983, an average of $101m was lent over a 14-year period, part of which flowed into non-agricultural activities. Under BRI's nonsubsidized KUPEDES scheme, about 20% of loans are directly invested in agriculture, that was $384m (out of total disbursements of $1.92bn) in 1996; and $338 of loans outstanding (out of a total of $1.60bn) as of 6/2003.

The challenge of success: how to recycle savings at village level: The units' success in savings mobilization has created a new problem: recycling the savings within the village economy vs. siphoning them off. Since 1989, the units have produced excess liquidity, for the past fifteen years consistently above US$1bn in all but one of the years. During the crisis years 1998 and 1999, excess liquidity was $1.43bn and $1.56bn, respectively – at a time when donors rushed to Indonesia to provide fresh credit lines, thereby further raising the country's mountain of external debts. In 2006 excess liquidity amounted to $1.84bn, which the units are required to place with the BRI branch system. With its individual lending technology and no special outreach mechanism to villages beyond the subdistrict towns and their vicinity, BRI has not been able to recycle the savings mobilized locally, despite an unmet demand for credit (presumably by about 50 % of the rural population).

Reforming the bank as a whole–from bankruptcy to profitability: BRI is generally renowned as the bank which revolutionized rural microfinance, correctly so. The microbanking division is indeed highly profitable, and its outreach is vast; but this is only one of several divisions, accounting for 34% of total assets, 31% of loans outstanding and 41% of deposits in 2001. In 1998, the bank's interest income turned negative; in 1999, accumulated losses amounted to US$3.98bn, and BRI, like many other banks after the Asian Financial Crisis, was technically bankrupt. While the central bank enforced prudential regulation through bank mergers and closures, BRI was spared because of its Microbanking Division. In 2000 the government as owner of BRI decided to reform the bank: injecting the equivalent of US$3bn in fresh capital, installing a new management, discarding corporate lending and focusing on MSME. Subsequently, BRI turned a profit. In 2003 BRI went public, with over 40% of its capital sold.

Who saved BRI? In 2000 the government recapitalized BRI as a loss-making bank, to the tune of $3m. Historically, the units have cross-subsidized the bank in two ways: through the continual transfer of profits from the units to the bank; and through the siphoning off of

[4] Consolidated profits before tax reported by the bank as a whole were Rp1,545bn, or $187m, during the first half of 2003; ie, about half that amount was earned by the units.

savings mobilized at village level to the branches and the head office. From 1990 to 2003, cumulative profits of the units amounted to $1.6bn, and cumulative excess liquidity to $15.7bn ($20.4bn until Dec. 2006). Thus, it was the village units which ultimately saved the bank in 1998, provided the ground for its reform in 2000, and enabled its entry into the stock market in 2003.

Lessons learned: Several lessons can be drawn from the experience of the BRI Microbanking Division:

- Financial sector policies work and are conducive to financial innovations.
- With attractive savings and credit products, appropriate staff incentives, and an effective system of internal regulation and supervision, rural microfinance can be highly profitable.
- The poor and near-poor can save; and rural financial institutions can mobilize their savings cost-effectively.
- If financial services are offered without a credit bias, the demand for savings deposit services effectively exceeds the demand for credit by a wide margin.
- Incentives for timely repayment work.
- Outreach of a financial institution to vast numbers of low-income people is compatible with viability, self-reliance and financial self-sufficiency.
- Average transaction costs can be lowered, and both the profitability of a financial institution and the volume of loanable funds can be increased, by catering for both the poor and the non-poor with their demands for widely differing deposit and loan sizes.
- Reform is a never-ending challenge.

Sharing experience: Within a six-year period,1984-89, the BRI unit system became a model case in Asia of the transformation of an unsustainable program of an ailing AgDB into a network of viable and self-sufficient financial intermediaries with ever-increasing outreach and financial resources, competing successfully with a wide array of other local financial institutions. There is no doubt in BRI what the answer should be to the question, *Agricultural Development Banks: Close Them or Reform Them?* [5] It is this experience which BRI is prepared to share with others through an institutionalised exposure visit and training program.[6]

[5] This is an astonishing development, in which the microfinance units played a decisive role. With total equity at US$ -3.65bn, the bank was technically bankrupt in 1999. In 2000, a new management took over, and the government injected some US$ 3bn. The corporate market was all but abandoned, and the bank now focuses fully on the micro, retail and SME markets. This resulted in a turn-around of the bank, which was internationally rated as BBB in 2001 (a better risk than the country at C). This new policy has been so successful that Moody's assigned a B3 rating to BRI (9/2003); and the bank is now traded at the stock market.

[6] International Visitor Program SBU Micro Banking, BRI, Jakarta. Fax 62-21-2511644, 2513013; ivp@bri.co.id, , ivpbri@cbn.net.id.

Table: Performance of BRI village units, 1984–2006

Year	*Savings deposits*		*Loans outstanding*							
	*No. of accounts ****	*Amount in mn US$*	*No. of accounts*	*Amount in mn US$.*	*Savings to loan ratio*	*Excess liquidity mn US$*	*12-month loss ratio*	*Arrears ratio**	*Return on assets*	*US$ exchange rate***
1984	2,655	39.3	640,746	103.4	38%	-64.2	1,0%	5.4%	n.a.	1,074
1985	36,563	75.5	1,034,532	203.6	37%	-128.1	1,8%	2.1%	n.a.	1,125
1986	418,945	107.1	1,231,723	203.7	53%	-96.6	2,7%	4.5%	n.a.	1,641
1987	4,183,983	174.2	1,314,780	260.4	67%	-86.1	3,0%	5.8%	n.a.	1,650
1988	4,998,038	284.8	1,386,035	313.3	91%	-28.5	4,6%	7.4%	n.a.	1,731
1989	6,261,988	484.6	1,643,980	427.7	113%	56.9	2,3%	5.4%	n.a.	1,979
1990	7,262,509	891.5	1,893,138	726.9	123%	164.7	2,0%	4.1%	3.0%	1,901
1991	8,587,872	1,275.4	1,837,549	730.8	174%	544.6	4,9%	8.6%	2.7%	1,992
1992	9,953,294	1,648.4	1,831,732	799.5	206%	849.0	3,4%	9.1%	2.6%	2,062
1993	11,431,078	2,049.9	1,895,965	927.7	221%	1,122.2	2,2%	6.5%	3.3%	2,110
1994	13,066,854	2,381.4	2,053,919	1,118.8	213%	1,262.5	0,7%	4.5%	5.1%	2,197
1995	14,482,763	2,633.8	2,263,767	1,397.2	188%	1,236.6	1,1%	3.5%	6.5%	2,284
1996	16,147,260	3,002.4	2,488,135	1,725.7	174%	1,276.7	1,6%	3.7%	5.7%	2,362
1997	18,143,316	1,622.0	2,615,679	860.0	189%	761.9	2,2%	4.7%	4.7%	5,448
1998	21,698,594	2,043.5	2,457,652	594.5	344%	1,449.1	1,9%	5.7%	4.9%	7,901
1999	24,235,889	2,420.1	2,473,923	844.9	286%	1,575.2	1.7%	3.1%	6.1%	7,050
2000	25,823,228	1,986.0	2,715,609	813.2	244%	1,172.7	1.1%	2.5%	5.7%	9,625
2001	27,045,184	2,105.2	2,790,192	945.2	223%	1,160.0	0.5%	2.2%	5.8%	10,446
2002	28,262,073	2,627.3	3,056,103	1,343.9	195%	1,283.4	1.7%	1.6%	6.4%	8,937
2003	29,869,197	3,527.3	3,100,358	1,678.2	210%	1,849.1	1.9%	2.5%	5.7%	8,451
2004	31,271,553	3,533.8	3,210,678	2,062.6	171%	1,471.6	1.3%	1.9%	6.8%	9305
2005	32,252,741	3,745.4	3,313,532	2,319.6	161%	1,425.8	1.3%	1.4%	7.0%	9823
2006	30,907,566	4,875.6	3,455,528	3,039.4	160%	1,836.2	1.2%	1.3%	8.5%	8977

Source of original data: BRI, Laporan Statistik BRI Unit
* Total payments overdue one day or more in % of total loans outstanding, excluding loans written off.
** End-of-year exchange rates. Sources: 1984 – 1992: Bank Indonesia, Badan Pusat Statistik Indonesia; 1993 – 2006: http://www.oanda.com/convert/classic.
1997/98: Asian financial crisis
*** The decline in the number of savings accounts in 2006 is due to the closing of inactive accounts.

3. AgBanks outside of Asia

3.1 Centenary Rural Development Bank (CRDB), Uganda: an African flagship of reform[7]

Reform history: Centenary RDB was established by the Catholic Church of Uganda in 1983 as a trust fund, with the mandate of providing savings and credit services to economically disadvantaged people, particularly the rural poor. While it did well in savings mobilization, it performed poorly in lending. In 1990, the political will to reform the fund evolved in the board, with the objective of transforming the fund into a viable and sustainable institution with increasing outreach to the poor. With assistance from the German Savings Banks Foundation and a German consulting firm, IPC, the fund was reformed within a five-year period, starting with its transformation into a full-service commercial bank in 1993. The key elements of the reform package were an individual microlending strategy, a staff incentive scheme, and enforcement of timely repayment assisted by a computerized system of daily

[7] For a detailed presentation see: H. D. Seibel, Centenary Rural Development Bank, Uganda: A Flagship of Rural Bank Reform in Africa. Working Paper 2003-3, www.uni-koeln.de/ew-fak/aef .

loan tracking. This has made the bank the African flagship of rural banking, combining sustainability with outreach to the rural poor and demonstrating the feasibility of agricultural lending. With its new approach, Centenary RDB was also able to turn a number of branches taken over from the defunct government-owned Co-operative Bank into profitable operations.

Individual microlending is guided by five principles: (i) lending only to businesses which have operated for at least six months and possess a deposit account; (ii) lending to individuals only, but analyzing the activities, cashflow and repayment capacity of the whole household; (iii) starting small ($58) and short-term (3-6 months) and graduating after three satisfactory repeat loans to so-called automatic loans at substantially lower interest rates; (iv) flexibility concerning collateral, combining fixed assets and personal guarantees, land without a title, livestock, household items and business equipment; and (v) computerized loan monitoring as a basis for follow-up, staff performance analysis and incentives, and provisioning.

Incentives at branch, staff and customer level include (i) converting branches into profit centers; (ii) incentive payments up to 45% of one's salary, based on individual staff performance rating for loan officers and branch managers on position-specific scales, tied more to repayment (75% of the score) than disbursement; (iii) rewarding good customers, graded on a 1-5 scale, with repeat loans of increasing size and maturity and, after the third loan, a reduction in the effective interest rate from 48% to 30%, dropping defaulters at the same time. Until 2001, the emphasis of the incentive scheme was on portfolio quality (ie, the elimination of defaults) rather than productivity: a reflection of past bad experience of the whole banking sector in Uganda. This created a quality-vs.-productivity dilemma, which was only resolved in 2002 with a more balanced incentive scheme.

Daily loan tracking, combined with zero-tolerance of arrears, is the single most important element in its financial technology. It is applied at four levels: the customer, the loan officer, the branch, and the bank. It has the following operational elements: (i) daily tracking by each of at least five loan officers per branch, one acting as a head loan officer; at the end of each day, every loan officer knows which customers have missed a payment; (ii) MIS on-line, entering information on missed payments the day a payment falls due into a data base; (iii) zero-tolerance action, reminding the delinquent the very next day orally, then in writing within a week while documenting the results of the investigation; after one month, the total amount falls due; and legal action is initiated.; (iv) branch control through the branch manager, who receives the MIS data and checks the performance of each loan officer; (v) head office control, reporting every morning to the General Manager of the Credit Division at head office, who in turn reports to the Chief Executive; (vi) Instant communication through a direct telephone line of the Credit Division to the branches; (vii) substantial individual staff incentives, provided loans in arrears for one day or more do not exceed 5%; (viii) customer incentives through access to bigger repeat loans and lower interest rates, and penalization of defaulters by being dropped from the list of eligible borrowers; those who are late in repaying fall back on the rating scale.

Supervision: The branches are audited thrice a year by internal auditors, twice by branch operations supervisors, twice by credit supervisors from head office and once by external auditors and central bank examiners.

The results of the reform process are impressive, providing strong evidence that rural bank reform is feasible in Africa (*Dec. 2002 data*):

- The bank mobilizes its own resources ($ 48.7m) from 316,650 depositors (up 13% over 2001);
- It lends to 31,500 borrowers (up 43%) with a volume of $ 23.05m loans outstanding (up 84%), 99% of them small and micro borrowers;
- It has its loans repaid, with portfolio-in-arrears ratios of 2.1-3.1% during 2000-02;

- It pilot-lends to 4,900 smallholders and 323 commercial farmers , with lower-than-average arrears;
- Total assets were $61.3m in 2002 (up 35%).
- It is highly profitable, with returns of 4% on assets and 27**%** on equity
- Since 1999, it fully finances its expansion from profits and deposits.

Total assets grew from Ush 63.5bn ($37m) in Dec. 2000 to Ush 86.2bn ($50m) in 2001 and Ush 116.5bn ($61.3m) in 2002; total equity grew 2000-01 from Ush 7.8 bn ($4.5m) to Ush 12.2bn ($6.4m) – increases of 35% and 56%, respectively, after a doubling of these figures between 1998 and 2000, and to 16.6bn ($ 8.7m) in 2002 (doubling from 2000 to 2002).

Outreach: Total saver outreach was 237,000 accounts as of end-2000, 280,000 as of 2001 and 316,650 as of 2002. 93% are passbook savers. Total borrower outreach was 18,411 accounts as of Dec. 2000, 24,120 in 2001 and 31,493 in 2002. The borrower-to-saver ratio was 1:12.9 in 2000 and 2001 and improved to 1:10.0 in 2002.

Products: By far the biggest demand, particularly by the poor, is for savings deposits to which the bank has vigorously responded. The bank offers (i) passbook savings as its most popular product generating two-thirds of total deposits (minimum deposits $5, up to 23 free withdrawals p.m., 2% interest p.a.); (ii) fixed deposits of 3 and 6 months (up to 5% interest p.a.); and (iii) current accounts with checking services. Total deposits increased by 27%, 34% and 22%, respectively, since 1999 and amounted to $48.8m in 2002.

There are seven credit products: (i) business loans up to one year, the Bank's most popular credit product (effective annual interest rate: 48%, lowered to 30% after three satisfactory loans;[8] (ii) investment loans up to two years; (iii) agricultural loans to smallholders with less than 2 ha of land; (iv) agricultural loans to commercial farmers; and, since 2002: (v) home improvement loans of $52-5,200, averaging $1,600; (vi) salary loans of $52-13,000, averaging $2,000; and (vii) small-and-medium-enterprise (SME) loans of a minimum size of $7,900.

Loans outstanding increased since 2000 annually by 14%, 31% and 84%, respectively, over the preceding year, reaching $23.05m in 2002. Thus, the deposits collected by Centenary are only partially intermediated and transformed into loans – at a lending ratio of 35% in 2001 and 47% in 2002: still low[9] but higher than that of most other commercial banks in Uganda. The introduction of an SME loan product in 2002 has enabled the bank in a generally difficult year to keep up its profitability. Far from creating a sustainability-vs.-outreach dilemma, it has enabled the bank to continue growing, at an unprecedented rate of 44% of borrower outreach, with 99% of these borrowers in the micro bracket and no mission drift.

Box 1: Starting small, growing big with hard work, savings and credit

Financing start-ups from farming profits, their expansion through credit: Nandina is 35, married, and has four children. In 1983, she started with a small rice farm. To protect her savings from inflation, she put up a building for a mill in 1992, continued saving and installed a mill in 1996 – all self-financed from the proceeds of her farm. Since 1999, she received four loans from Centenary. She acquireda second mill, expanded her produce trading operations, and bought two minibuses. During 2½-years, the value of her business grew from $3,500 to $8,000. She has two employees in her business and several contract laborers on her farm.

A business empire built on hard work, savings and credit: C. Watuwa is around 50, married and has six children. Born in a village, she moved to Mbale where business

[8] This compares favorably to commercial bank prime rates of 25-26% in 2000.
[9] Reasons are a banking crisis and excessively high TB rates in the latter 90s.

opportunities are better. In 1971, she opened a small restaurant with her husband. From the income, she saved money in a bank and opened a hardware store of her own in 1975. In 1986 she got a loan from the now defunct Cooperative Bank for a lock-up store and, in 1991, a loan from the Uganda Women's Finance Trust for produce trading. When Centenary opened a branch in Mbale in 1998, she became one of its first depositors. "Centenary is a greener pasture, it gives you no headaches", she says. Within two years, she received three loans: around $1,000, $2,000 and $5,300. As all her payments were on time, she then graduated to an automatic loan of $8,670 at a substantially reduced interest rate. She invested the loans in a second lock-up store, a mattress store, and an extension to the restaurant. The total net worth of her business is now $133,000. Her secret of success is hard work and credit: "I worked when I was pregnant up to my 9th month. I can work. All I need to expand is bigger loans."

Agricultural lending: In mid-1998, Centenary pilot-tested agricultural lending. Within three years (June 2001), the number of agricultural loans outstanding in the Bank reached 3,000: 13% of all active borrowers and 14.5% of the portfolio. The main pilot branch in Mbale reached its break-even point within 8 months and an operational sustainability rate of 157 % by mid-2001; its arrears ratio was a mere 1.51 %, with an even lower figure for its agricultural portfolio (1.20%). Its portfolio remained virtually unaffected by the bumper crop and the resulting precipitous drop in agricultural prices of early 2002. Major success factors lie in prudent staff selection and specialization on agricultural lending; holistic loan appraisal; and instant enforcement of repayment.

Future challenges: The results of the reform of Centenary RDB are proof that rural bank reform is feasible in Africa. Given its successful financial technology and the virtually unlimited size of the rural market, untapped in many areas, further expansion of outreach to rural and agricultural areas remains the Bank's biggest task. In that respect, the Bank has taken a new initiative, adding mesofinance for small and medium entrepreneurs to microfinance for microentrepreneurs. Far from creating a sustainability vs. outreach-to-the poor dilemma, this new venture allows the bank to mobilize more savings, which are of particular importance to low-income people, and to transform them into productive assets. Convenient deposit services for small savings are normally not available in the proximity of low-income people, in rural areas, but are of utmost importance to self-financed business growth and borrowing capacity.

In this vein, major challenges and opportunities for Centenary include the following: expanding into remoter areas through sub-branches and linkage banking; expanding opportunities for graduation to mesofinance; lending wholesale to NGOs, MFIs and associations of farmers and microentrepreneurs – provided donors do not undermine finance with cheap credit; offering tied savings-cum-credit products and cross-selling of financial products; providing exposure training to MFIs and banks in the region.

3.2 Banque Nationale Agricole (BNA), Tunisia: a North-African flagship of reform

Reform history: Tunisia is a middle-income country with political and macroeconomic stability (inflation below 3%) and GDP growth rates at or above 5%. The financial sector is largely liberalized, with a tendency for development banks to be converted into deposit banks. BNA has gone through 40 years of transformation and reform, in four distinct phases:

- It started out in 1959 as an agricultural finance institution providing credit to priority sectors, ran into heavy losses, and turned out to be unsustainable.
- In 1969 it entered into a second phase as a national universal bank with a diversified portfolio to all sector.

- The third phase began in 1980 with its listing on the stock exchange and an emphasis on commercial lending from mainly domestic resources.
- This evolutionary process was interrupted in the early 80s by a wave of donor-financed development banking interventions, an experiment which soon collapsed.
- 1989 then marked the beginning of the last and still ongoing phase: the consolidation of BNA as a universal bank characterized by operational autonomy, self-reliance through deposit mobilization and commercial domestic borrowings, portfolio diversification, and profitability.

Ownership and governance: BNA is a partially privatized bank listed at the Tunisian stock exchange. Government agencies hold the majority of shares; 34% are held privately. Like all public banks, it is under the authority of the Ministry of Finance and supervised by the Central Bank. Its Board of Directors comprises four government agencies, three parastatals and a bank. It is chaired by the president and director-general of BNA. Despite a predominance of government representatives, BNA is a bank with full operational autonomy.

Outreach: As one of 14 deposit banks, BNA is a universal bank of national outreach through 16 regional offices and 145 branches, the largest branch network of any bank in Tunisia. Total staff in 2000 was 3,138: 1,457 in the head office and 1,681 in the branches and regional offices.

BNA has 700,000 clients, who are all depositors, 58% in urban and 42% in rural areas. 250,000 of them are also borrowers.

Products: Deposits from clients as of Dec. 2000 amounted to $1.23bn, total deposits to $1.42bn. Of 963,611 deposit accounts by approximately 700,000 clients in 2000, about half were checking and current accounts and one-third passbook savings accounts. There were 70,000 tied savings and loan accounts, which are one of BNA's most innovative and attractive products. Interest rates are 4% on passbooks savings and 5-6% on term deposits, all with positive real returns (at an inflation rate of 2.7%). The average cost of funds mobilized from clients is 3%.

BNA has abandoned subsidized credit as ineffective and inefficient. There is a cap on interest rates as defined by the usury law; but with interest rates on loans of 6,5-10% (equivalent to real rates of 3.8-7.3%), it remains well below that ceiling. BNA provides a full range of banking services, including deposit-taking, lending, money transfer, foreign transactions, and stock market intermediation. Its services include ATMs. BNA also invests directly in commercial papers and companies. BNA's portfolio of loans outstanding to clients (excluding inter-bank loans) was TD 2,245.4m ($1.65bn)[10] in 2000; this is 77.5% of total assets. BNA's main lending instrument is the current account, totaling 180,000. BNA has a special tied savings and loan instrument, totaling 70,000 accounts. Clients save for a stipulated period of time until they become eligible for a loan. Most attractive is the educational savings and loans product with almost 44,000 accounts; second in the favor of clients are consumer savings and loan accounts, numbering almost 25,000.

41% of its net portfolio are in agriculture, 59% in non-agricultural activities. Agricultural loans are capped by law at 11.67% . Of the loans to the agricultural sector, 64.2% are in production and 35.8% in commerce. There are two major types of agricultural loans: seasonal loans up to one year, particularly for grain and vegetable farming, fruit trees and fisheries; and investment loans for the financing of machinery, livestock, land and infrastructure. The later comprise medium-term loans for 2-7 years with a one-year grace period and long-term loans for 8-15 years with grace periods of up to 5 years. With 41% of its portfolio in agriculture, BNA has retained its agricultural mission. Its agricultural portfolio has declined in relative, but substantially increased in absolute terms.

[10] Exchange rate on 31/12/2000: $1 = DT 1.3683; DT1 = $0.733.

There is an obligatory crop insurance scheme, for which BNA pays a premium of 2% on all loans, which is charged to clients.

Performance: BNA's paid-in capital is DT 100m; total equity including year's retained earnings was DT 350m as of 2000. This corresponds to 16% of loans outstanding and 12% of total assets. Total assets amounted to $2.12bn, total loans outstanding to $1.65bn, total deposits to $1.42; the deposit-to-loan ratio was 86%.

At average cost of funds of 3.0% and average interest rates on loans of 6.5% (adjusted for defaulting), the bank's margin is 3.5%. While collection rates still need to be improved, BNA has made a net profit of DT 23.4m ($17.15m) in 2000: evidently an efficiently operating bank given its narrow margin. Return on total (year-end) assets was 0.8%, return on equity 7.2%. BNA has demonstrated that, in a reformed bank, sustainability and outreach can go together, even under conditions of imposed interest rate ceilings.

Sharing experience: Among the agricultural banks in North Africa and the Near East which are members in NENARACA, BNA belongs to a category of its own: a reformed bank which looks up to banks among highly developed European countries as benchmark institutions, rather than to AgDBs in the region. Within that region's community of banks, its most noble function would be to act as an adviser to decision makers and a provider of exposure training to institutions entering into the reform process. It may serve as a model case of a universal bank which has retained its rural-agricultural mandate and which has combined sustainability with outreach.