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Reaching hundreds of millions of the rural poor with sustainable savings and credit services: The role of rural & agricultural banks and their reform in Asia

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Rural and agricultural banks, among them state-owned agricultural development banks (AgDBs) and cooperative banks, have a wide outreach in Asian countries. Their potential as retailers and wholesalers (through cooperatives, rural banks, NGOs) for providing sustainable savings deposit and credit services to the rural poor is enormous. Some examples:

(a) The quantative and qualitative outreach BRI Microbanking Division, with 25.1 million microsavings accounts and 2.6 million current microcredit accounts (at a profit!), surpasses that of some 10,000 formal and semiformal MFIs in Indonesia.
(b) BAAC provides near-total coverage in terms of rural saver and agricultural borrower outreach in Thailand.
(c) The outreach of NABARD in India through rural banks, financial cooperatives and self-help groups (SHGs) exceeds a hundred million. With regard to outreach to the very poor, NABARD has achieved spectacular success through its program *Linking Banks and SHGs,* expecting an outreach of a hundred million rural poor by 2008.
(d) In Nepal, IFAD and AsDB helped ADB/Nepal to build up a rural financial infrastructure of small farmer groups. With assistance from GTZ, 101 subproject offices have been transformed into autonomous savings and credit cooperatives (SFCLs), with an astonishing ratio of financial self-sufficiency of 117%. The success of the SFCLs in the fertile plains and the marginal hill areas is living proof of the compatability of outreach to the poorest and institutional sustainability even in a most difficult environment.

Yet, the large majority of AgDBs in Asia and elsewhere are grossly underperforming and are a major drain on public resources. Therefore, they have been ignored by most donors in recent years. However, experience in Asia shows that there is an enormous potential for reform. There is little chance that the small MFIs donors have been focussing on will even remotely come close to the Summit's quantitative aims of outreach. Rural and agricultural banks must be included in our joint campaign to combat poverty, and every effort should be made to convince governments to **transform rural and agricultural banks into viable and sustainable financial intermediaries with wide outreach to the rural poor.**

IFAD's new initiative with CGAP, the World Bank, FAO, GTZ, regional development banks and the RACAs (Afraca, Apraca, Nenaraca) has focused on the potential as well as reform needs of AgDBs and increasingly attracted international attention. By including rural and agricultural banks in the Summit's agenda, it is expected that synergies will be mobilized with the objective of substantially increasing access of the poor and very poor to sustainable financial services throughout Asia and the Pacific. The ***Microcredit Summit Campaign*** may play an important role in generating the necessary political will.

The role of rural & agricultural banks and their reform in Asia [1]

1. The Emerging Consensus on Rural and Microfinance

For decades, financial repression has undermined the evolution of a diversified financial sector with cost-effective services available to all segments of the population. The rural and urban poor in the developing world have been the most affected. During the `70s and `80s, a consensus gradually evolved on **the negative effects of financial repression:**

- Rural areas have been severely underbanked**;** an effective rural financial infastructure is largely absent in many countries, particularly in marginal areas.
- Preferential credit programs have tended to curtail - rather than expand - outreach to small farmers and low-income people. These programs have undermined the health of agricultural development banks, cooperatives, and other institutions serving as credit channels.
- Interest rate regulation has prevented institutions from covering their costs, and had a severe, negative impact on access to financial services among the poor.
- Agricultural credit has all but dried up.
- A credit bias of government-owned development banks has led to a lack of savings deposit facilities, which are a first priority among many of the poor.
- Commercial banks collect savings in rural centers and siphon them off into urban areas.
- Informal financial institutions, which are formed by the local people through self-help, have been given little attention.
- In many countries, there is a lack of suitable legal forms for local financial institutions.
- This has prevented informal institutions from upgrading to registered local financial institutions. Thus, they remain small and isolated.
- In many countries, there a lack of non-mutualist local financial institutions, such as equity-based rural banks.
- Rural and other microfinance institutions are not supervised, there are no prudential standards, and no enforcement mechanisms. This has had serious consequences, particularly for:
  - ◊ agricultural development banks, many of which are technically bankrupt;
  - ◊ cooperatives and credit unions, which were used as credit channels, resulting in widespread inefficiency, corruption and the breakdown of whole networks;
  - ◊ credit NGOs, which have been donor-driven, are barred from mobilizing deposits from the public and have shown a limited potential, except when transformed into a bank;
  - ◊ overall rural financial intermediation has been impeded.

However, in all these fields, there have been notable **new positive developments**. Experience in a variety of countries has shown that with the right policies and strategies, stakeholder participation and donor coordination, the effectiveness of the rural financial system can be greatly improved. What would have considered as miracles only ten years ago, is now spreading in many regions of the world: market-friendly policy reform, AgDB restructuring, reform of the sector of financial cooperatives, commercialization and mainstreaming of credit NGOs, and linkages between formal and informal financial institutions. These are no longer mere exceptions, but pace-setting examples. However, depending on the political economy, wide differences still prevail between countries and regions.

[1] For a concise presentation of the theme see: H. D. Seibel, *Agricultural Development Banks: Close Them or Reform Them?* Finance & Development, published by the International Monetary Fund, June 2000: 45-48.

Box 1: Recent developments and continued shortcomings in rural and microfinance		
Topic	*Recent developments in some countries*	*Continued shortcomings in the majority of countries*
1. Policy environment	Macroeconomic stability; deregulation of interest rates; greater ease in setting up banks, branches, and local MFIs with lower capital requirements	Inadequate policy & legal environment; Slow implementation of deregulation; Inadequate property rights and judicial procedures
2. Agricultural development banks (AgDBs)	Incipient reforms towards autonomy, operational viability and financial self-sufficiency, with or without privatization	Lack of viability and self-reliance Dependent on budgetary allocations Political interference Inability to meet demand for credit, deposit facilities and insurance
3. Microfinance institutions	New legal forms for commercially operating MFIs; increasing numbers of viable and self-sustaining MFIs	Lack of appropriate legal forms Standardized minimum capital requirements unadapted to local rural conditions
4. Agricultural finance	Self-financing from profits and savings plus commercial microcredit replace preferential sources	Self-financing and commercial credit from MFIs insufficient in meeting the demand for financial services
5. Upgrading of nonformal financial institutions	New legal framework provides opportunities for upgrading to formal levels and financial market integration	The potential of upgrading millions of informal financial institutions has remained almost untapped
6. NGOs	Innovative approaches to poverty lending in repressive environments; some successful conversions to formal intermediaries	NGOs barred from deposit mobilization; Supply of easy money undermines the drive for self-reliance among credit NGOs
7. MFI regulation and supervision	Controversial discussion of the need for effective regulation and supervision of MFIs	First-tier authorities unable to supervise MFIs AgDBs not properly regulated and supervised Lack of MFI self-regulation

These new developments have created the foundation for a **new consensus** on rural and microfinance, particularly during the 90s[2]:

- The poor can save, invest, and repay their loans.
- In order to develop their agricultural activities and microenterprises, prepare for emergencies and provide for the future, they need access to a range of microfinance services, with priority given to savings deposit facilities, credit and insurance.
- This requires a diversified financial infrastructure of competing institutions, and diverse strategies adjusted to a given economic and sociocultural context.
- Outreach can only be maximized by sustainable financial institutions, which cover all their costs, mobilize their own resources, protect their funds against erosion from inflation and non-repayment, and make a profit to finance their expansion.
- With sound practices, any type of financial institution can become sustainable and combine outreach and viability; but in most regions, institutions built on self-help and private ownership have better prospects.
- Through technical and financial assistance, donors can greatly contribute to the development of an efficient rural and microfinance sector, but must be effectively guided by the goals of viability and self-reliance set by rural and microfinance institutions.
- The main function of the State is to provide a conducive policy and regulatory framework, including deregulated interest rates, appropriate legal forms for small financial institutions, and effective delegated supervision.

[2] H.D. Seibel, *Financial Systems Development and Microfinance: Viable Institutions, Appropriate Strategies and Sustainable Financial Services for the Microeconomy*. TZ-Verlag, Rossdorf, & GTZ, Eschborn, 1996 (ISBN 3-88085-515-3)

2. **Agricultural Development Banks: Ignore them, Close them, or Reform them?**

Historically, AgDBs were set up by their respective governments to promote rural development and alleviate poverty, though in actual fact, in a number of countries, they have tended to undermine rural finance and development. Donors provided funding and technical assistance. Embedded into a political economy of administrative planning, AgDBs have channeled scarce government and donor resources into financial as well as income-generating activities with the lowest rates of return – just the opposite of what financial intermediation, and development, should be about.

For extended periods of time, neither their performance nor their impact were properly monitored. When donors finally did evaluate their support to AgDBs, many cut down or even stopped their assistance. In recent years, there has been a tendency to ignore AgDBs in programs of rural and microfinance systems development.

On the negative side, AgDBs are weak or distressed in the large majority of countries. They fail to mobilize voluntary savings and domestic capital market resources. Mandated quota allocations from commercial banks set the wrong signals. Repayment rates are low; and transaction costs are high. Moreover, there has been a lack of supervision by regulatory agencies and donors. As a result, most AgDBs are unsustainable, and their outreach and growth restricted. In most cases, their contribution to poverty reduction has been minimal. Many are technically bankrupt; and in Africa and Latin America a number of them have actually been closed.

On the positive side, AgDBs have continued to be major providers of rural and microfinance services in most countries through their branch network. Information on their **outreach** is spotty; but there is no doubt that in many countries, they major providers of rural financial services, sometimes the only one. Data compiled by the FAO for 1997 give a total of 53 million savers in 18 banks and 21 million borrowers in 26 banks. Most prominent is the case of Indonesia where BRI's Microbanking Division, with 25 million savers and 2.6 million borrowers, exceeds the outreach of some 10,000 formal rural banks and semiformal MFIs (Table 1). Data are not disaggregated by client category and loan or deposit size. In the case of BRI, most savers are microdepositors, while loan sizes vary from US$5 to US$5,000 and include a vast number of microborrowers.

Where AgDBs have been closed, their market share has usually not been taken over by other institutions. There are now some examples of successful AgDB reform, particularly in Asia. These indicate that reform may well be feasible and that their financial performance and outreach can be greatly increased. These few AgDBs have become instrumental in fighting rural poverty.

There are thus **three responses** that have emerged in response to the failings of AgDBs:

- Ignoring AgDBs
- Closing AgDBs
- Reforming AgDBs

Ignoring AgDBs and excluding them from the development agenda is at present the most common donor strategy. A variant of this is the practice of some donors to continue providing credit lines to unviable AgDBs and ignoring that this contributes to the perpetuation of an untenable situation. In some regions, governments pour vast amounts of funds into their state-owned development banks and into credit subsidies, ignoring the deleterious effect this has on institutional sustainability, outreach to the rural population including the poor, and the growth of the rural economy. This has fostered a culture of bad practices in rural finance, including interest rate subsidization, disbursement targets, and nonrepayment of loans.

Table 1: Saver and borrower outreach of selected rural and agricultural banks (1997)

Bank	**No. of savers**	**No. of borrowers**	**Total loan outstanding** (USD million)
Agricultural Bank of Iran	4 200 000	600 000	2 500.0
Agricultural Bank of Sudan		25 000	25.0
Agricultural Cooperative Bank, Syria		400 000	1 600.0
Agricultural Credit Corporation, Jordan		7 000	120.0
Agricultural Development Bank, Nepal	400 000	400 000	185.0
Agricultural Development Bank of Pakistan	700 000	750 000	1 300.0
Agricultural Finance Corporation, Zimbabwe		30 000	95.0
Banco de Desarrollo Agropecuario, Panama		13 000	90.0
Banco Nacional de Desarrollo Agricola, Honduras		50 000	11.0
Bank of Agriculture and Agricultural Coops, Thailand	5 500 000	4 850 000	4 000.0
Bank BUKOPIN, Indonesia		7 000	800.0
Bank of Ceylon	4 000 000	600 000	1 100.0
Bank Pertanian, Malaysia	1 300 000	100 000	350.0
Bank Rakyat Indonesia	20 000 000	2 500 000	8 800.0
Banque Nationale de Développement Agricole, Mali	30 000	20 000	85.0
Caisse Nationale de Crédit Agricole, Morocco	150 000	450 000	1 100.0
Cooperative Central Bank Ltd., Cyprus	2 800		510.0
Development Bank of Ethiopia		3 000	200.0
Development Bank of Philippines	150 000	40 000	1 800.0
Federal Bank of Cooperatives, Pakistan		30 000	100.0
Land Bank, South Africa		25 000	1 200.0
Land Bank of the Philippines	800 000		2 700.0
National Bank of Commerce Ltd., Tanzania	450 000	3 000	120.0
Nat. Soc. Coop. d'Epargne et de Crédit Rural, Cameroun	4 000	400	0.5
People's Bank, Sri Lanka	5 800 000	3 000 000	1 000.0
Principal Bank for Dev. and Agricultural Credit, Egypt	2 200 000	3 500 000	3 100.0
Union Bank of Nigeria PLC	2 000 000	150 000	250.0
Vietnam Bank for Agriculture & Rural Development	5 000 000	3 500 000	2 000.0
TOTAL no. of savers (18 banks)	**52 686 800**		
TOTAL no. of borrowers (26 banks)		**21 053 400**	
TOTAL loan outstanding (28 banks)			**35 141.5**

Source:
AgriBank-Stat - http://www.fao.org/waicent/faoinfo/agricult/ags/AGSM/banks/invent.htm

Closing AgDBs is a strategy particularly widespread in Latin America and West Africa. In many countries this has resulted in a situation where agricultural credit has all but dried up; local financial institutions, frequently barred by obstructive legislation, have been slow in moving into the void; and large segments of the rural population are left without any, or with totally inadequate, financial services.

Reforming AgDBs in continued state ownership is a favored strategy applied in several Asian countries. Privatization as a strategy is more in favor in Latin America. A variant of this is a combination of state ownership with autonomous commercial management, eg, through a management contract with a private firm.

In the interest of government finances and good use of scarce donor funds, our first proposal is: **close them or reform them**, but don't continue to ignore them. If there is no scope for reform, for whatever reason, than AgDBs should be closed and make room for other developments in rural finance.

However, with the reform technologies available and the need for a diversity of competing institutions with financial services to smallholders, microentrepreneurs and the rural poor, we strongly advocate AgDB reform. **AgDBs should be transformed** into self-reliant, sustainable financial intermediaries:

- mobilizing domestic resources while providing positive real returns to their depositors;
- having their loans repaid and their costs covered from their operational income;
- producing sufficient retained earnings to offset the erosion of their resources from inflation and to finance their expansion; and
- continually increasing their saver and borrower outreach and the quality of their services to all segments of the rural population including the poor.

Depending on the political economy of a country, **ownership** may be private, cooperative, public or mixed. AgDB reform deserves **high priority in the fight against poverty.** AgDBs and donors should therefore cooperate in generating the required political will. In the absence of the political will, donors should stop undermining rural finance by using AgDBs as credit channels.

3. Agricultural Development Bank Reform: Three Cases[3]

Three examples of the reform of the rural microfinance operations of AgDBs are given below, all from Asia. They differ widely in their approach, indicating that there is *no single best way* of reforming AgDBs:

- The Microbanking Division of Bank Rakyat Indonesia (BRI) as a case of *big-bang reform* following the deregulation of interest rates in June 1983, when BRI was given the option of closing its network of rural units or standing on its own feet. BRI provides credit to millions of rural people and savings services to tens of millions - at a profit! Its challenge: Can BRI lower its interest rate on loans and further increase its outreach?
- Bank for Agriculture and Agricultural Cooperatives (BAAC) in Thailand, as a case of *gradual reform*. At low interest rates, BAAC covers its costs and reaches all rural households with adequate savings and credit services: Its current challenge: Can it maintain its viability and withstand political pressures?
- Agricultural Development Bank of Nepal (ADBN), which is transforming the operations of its Small Farmer Development Project into autonomous member-owned local financial institutions. Its challenge: Can it expand financial services and cooperative ownership by the poor throughout the country.

[3] Basic reading: C. Gonzalez-Vega & D.H. Graham, *State-Owned Agricultural Development Banks: Lessons and Opportunities for Microfinance.* Economics and Sociology Occasional Paper No. 2245, Rural Finance Program, Dept. of Agricultural Economics, The Ohio State University, Columbus, OH 43210-1099, June 1995; J. Yaron & S. Charitenenko, *Making the Transition from State Agricultural Credit Institution to Rural Financial Intermediary: Role of the State and Reform Options.* Washington DC, The World Bank, 1999. J. Yaron & S. Charitenenko, *Improving the Outreach and Sustainability of State-Owned Rural Finance Institutions: Issues and Policy Implications.* Pp. 413-428 in: M. Zeller & M. Sharma, eds., Innovations in Microfinance for the Rural Poor: Exchange of Knowledge and Implications for Policy. Proceedings of the International Workshop in Accra (1998) – DSE/IFPRI/IFAD/Bank of Ghana. Feldafing, DSE, 1999

Bank Rakyat Indonesia (BRI Microbanking Division)[4]:
Within a policy framework of financial deregulation, the granting of management autonomy and carefully-crafted financial products have turned BRI into the largest and most successful provider of financial services to the poor and non-poor in the developing world. This has set new standards for AgDBs – they can be reformed! – and the microfinance industry: sustainability and massive outreach to the poor are compatible!

Box 2: **BRI, Indonesia: The agricultural development bank which revolutionized rural finance**
The case of BRI, IFAD's partner in P4K, is evidence that, in a deregulated policy environment, the microcredit operations of an ailing government-owned agricultural development bank can be transformed into a highly profitable, self-reliant microfinance intermediary. Since 1984, BRI has evolved into a major microfinance provider. Massive staff retraining in the new microbanking culture, with its new financial services and incentive schemes, was of crucial importance. Its 3,700 local units serve some 25.1 million savings accounts and 2.6 million borrowers (July 2000). With non-targeted loans of from \$5 to \$5000 at rural market rates of interest and unrestricted deposit services, it reaches out to vast number of the poor and the non-poor. Making good use of a start-up liquidity injection, it has fully replaced external funds with local savings since 1989. Profits of the now autonomous Microbanking Division of BRI were \$150 million in 1999. The ultimate test came with the Asian financial crisis. When the Indonesian banking system collapsed, BRI's Microbanking Division remained profitable. At the peak of the crisis, from June to August 1998, the local units attracted 1.29 million new savers during the three-month period. At the same time, demand for credit stagnated because of a lack of confidence in the future. Since then, the division's 12-month loss ratio has been continually dropping to 1.35 percent (July 2000), substantially below its already low long-term loss ratio (1984-99) of 2.1 percent. Savings balances in the units now exceed loans outstanding by \$ 1.45 billion (a recurrent problem during the 100-year history of BRI and rural financial institutions elsewhere), requiring new strategies to recycle them within the rural economy – perhaps BRI's greatest challenge.
Numerous lessons can be drawn from BRI's experience: (1) Financial sector policies work and create an environment conducive to financial innovations. (2) The political will to reform can be created; and political interference can be kept at bay. (3) With attractive savings and credit products, appropriate staff incentives, and an effective system of internal regulation and supervision, rural microfinance can be profitable. (4) The poor can save, and rural institutions can mobilize their savings cost-effectively. (5) Without credit-biased incentives, the demand for savings deposit services exceeds the demand for credit by a wide margin. (6) Incentives for timely repayment work. (7) Transaction costs can be lowered, and outreach to the poor increased by catering for both the poor and the non-poor alike, with their demands for widely differing deposit and loan sizes. (8) Outreach to vast numbers of low-income people is compatible with financial self-sufficiency. (9) Agricultural development banks can be transformed into profitable and sustainable providers of microsavings and microcredit services.

[4] H. D. Seibel, *How an Agricultural Development Bank Revolutionized Rural Finance: The Case of Bank Rakyat Indonesia.* IFAD Rural Finance Working Paper No. B5, Doc. #48881

Bank for Agriculture and Agricultural Co-operatives (BAAC), Thailand:
BAAC has gone through four major phases of reform: 1966-74, laying the foundation for individual lending with joint liability; 1975-87, expanding its lending operations through access to commercial bank and donor funds while greatly 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. Gradual reform has resulted in the largest outreach achieved by any AgDB, to 88% of farm households, combined with viability.

Box 3: BAAC, Thailand: The gradual reformer

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:
(1) Government respect for the bank's considerable operational autonomy.
(2) A corporate culture emphasizing cost-effectiveness, productivity and efficiency.
(3) Decentralization and expansion of branch network operating as profit centers.
(4) Individual lending through joint liability groups, as a financial technology attuned to Thai culture.
(5) Substantial improvements in portfolio quality, which created depositor confidence.
(6) A radical shift in the financial resource base to rural savings mobilization.
For full self-reliance, the bank would have to increase its lending rate from 12% to 15-16%. This is difficult in the political climate ofearly 2001, where the bank is threatened by a debt moratorium.

BAAC has demonstrated how gradual reform can be carried through 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:
(1) 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.
(2) Lending rates need to be fully liberalized and re-aligned to reflect the true costs.
(3) 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.
(4) Performance-related staff incentives, presently under pilot-testing, need to be implemented

OUTREACH March 2000

Lending outreach	
Number of borrower clients	45.0 million
% of farm households in Thailand	88%
Loans outstanding	US$ 5.7 billion
Average loan size (farmer clients)	US$ 2,042
Savings outreach	
Number of deposits by individuals	8.3 million
Deposit volume (incl. Institutions)	US$ 4.5 billion
Average deposit size	US$ 246
Market share in rural deposits	15%

SUSTAINABILITY March 2000

Capital adequacy	Capital/net loans	9.1%
Portfolio quality	Past dues/loans outstanding	16.5
Operational self-sufficiency	Income/operational cost	228%
Financial self-suficiency	Income/operational cost and cost of funds	98%
Self-sufficiency in funds	Loan to deposit ratio	81
Efficiency	Administrative cost/average loans outstanding	3.1%
Productivity	Number of active borrowers/credit officer	473

Source: Klaus Maurer, *AgDB Reform: The Case of BAAC.* IFAD Doc. #46498.

Agricultural Development Bank of Nepal (ADBN)*[5]*:
In Nepal, IFAD up to 1992 and the Asian Development Bank thereafter assisted ADBN to establish an infrastructure of small farmer groups, which in turn formed intergroups and management committees under sub-project offices. Supported by GTZ, ADBN has transformed these into autonomous local financial institutions. An unsustainable project is being successfully transformed into vibrant financial cooperatives: a highly successful model for the very poor in marginal hill areas!

Box 4:
ADBN, Nepal:
Transforming an unsustainable credit program into viable local financial intermediaries

Since 1975 the Agricultural Development Bank of Nepal has built up its Small Farmer Development Project (SFDP), a subsidized credit program targeted at the poor. With assistance from IFAD as the first major donor until 1992 and the Asian Development Bank thereafter, farmers were organized in some 25,000 small groups. With repayment rates, since 1980, of 39-54% and a savings ratio consistently below 1 %, plus high transaction costs, SFDP was found unsustainable, and growth of outreach to poor farmers remained restricted. However, the credit line to ADBN had enabled poor farmers including women to build up a group structure. In the more liberal policy environment of the 1990s, ADBN, assisted by GTZ and inspired by a charismatic Nepali leader, responded positively to the farmers' initiatives and embarked on a new strategy. The groups under each subproject office are being transformed into autonomous *Small Farmer Cooperatives Ltd. (SFCL),* which mobilize savings and cover their own costs. The results to date have been spectacular. By 2000, 101 SFCLs had been transformed, with 56,000 members (33% women), low overhead costs and a financial self-sufficiency ratio of an astonishing 118% (1999/2000) – up from 38.8% in 1997/98.[6] Women's SFCLs are generally stronger than men's. Most remarkable is that SFCLs in marginal hill areas (117.3%) are equally self-sufficient as in the plains (117.7%). The remaining 280 subproject offices are to be transformed within the next five years. Most remarkable: Some SFCLs are now receiving their limited banking licence, which allows them to further increase their services and outreach. At the same time, restructuring ADBN into a viable bank is under consideration.

Through user ownership and vigorous savings mobilization, unsustainable credit programs can be transformed into networks of viable local financial intermediaries. A recent GTZ study concluded:

(1) SFCLs have the potential to fully cover their costs through internally generated income. Full financial self-sufficiency can be expected earliest after two years of transformation. On average, financial self-sufficiency is achieved in most cases three to five years after transformation.

(2) SFCLs are operating on modest transaction costs due to the cooperative-style of management. Even in marginal hill areas, SFCLs achieve full financial self-sufficiency.

(3) SFCLs are increasingly replacing external through internal financial resources, indicating that sustainable microfinance institutions tend to be savings-based than credit-driven.

(4) SFCLs have to strengthen their capital base to adequately cover their risks.

[5] H. D. Seibel & G. Ketterer, *Small Farmer Development Project Nepal: an Evaluation.* GTZ, Eschborn, 1996; H. D. Seibel & M. Mortuza, *Rural Financial Systems Development in Nepal.* GTZ, Eschborn, 1995; U. Wehnert & R. Shakya, Are Small Farmer Co-operatives Ltd. (SFCLs) Viable Microfinance Organisations? Working Paper No. 1, RUFIN, ADBN & GTZ, Kathmandu, Jan. 2001.

[6] From the ADBN/GTZ sample study: The 33 SFCLs' average financial self-sufficiency ratio for the year 1996/97 was 38.8%; it doubled in 1997/98 to 79.2% and increased to 117.6% in 1999/2000. Except for the newly transferred SFCLs with one year of operation, all SFCLs managed to achieve the 100% level. The Financial Self Sufficiency Ratio (PEARLS) was calculated as: total income - (subsidies + other income) / (total operational expenses + total provision + total financial cost + imputed cost of capital - other expenses).

4. Reforming Agricultural Development Banks

How best to initiate reform is an issue to be discussed in a participatory manner, in two fora: the donor community and associations of AgDBs. In order to agree on a conceptual framework, division of labour and steps to be followed, some initiatives have been taken, as indicated below:

- A joint IFAD/FAO/World Bank initiative on the restructuring of AgDBs[7]
- The establishment of a CGAP Working Group on AgDB Reform (Abidjan, June 1999), comprising members from AfDB (Abidjan); AsDB (Manila); GTZ and KfW (Germany),; OECF (Japan); SDC and SODC (Switzerland); UNCDF/UNDP (New York); World Bank (Washington)
- Discussions during AsDB's Regional Workshop on Microfinance Development Strategy (Manila, September 1999)
- A presentation to the Donors' Working Group on Financial Sector Development (Rome, September 1999)
- Discussions during the Third Annual Seminar on New Development Finance (Frankfurt, September 1999)
- A presentation to the7th CGAP Meeting (Endinburgh, June 2000)
- A presentation to the Micro and Rural Finance Workshop (Abuja, September 2000)
- Preliminary agreements with the regional agricultural credit associations (RACAs, which are partner organizations of FAO and IFAD): Afraca (Nairobi), Apraca (Bangkok) and Nenaraca (Amman) on workshops to initiate reform among member AgDBs; and presentations at their respective regional and subregional workshops in Tunis, Abuja, Nairobi and Bangkok during 2000

New studies of AgDBs are being undertaken by:

- AfDB on development finance institutions in Africa;
- AsDB on the role of central banks in microfinance in 12 countries in Asia;
- FAO on CNCA in Morocoo;
- IFAD on BAAC in Thailand[8];

During 2000, regional and sub-regional workshops on AgDB reform are being held AFRACA for Africa (Abuja 4.-7.4.; Dakar 10.-12.5.; Arusha 5.-9.6.; Douala 4.-6.7.; Maseru 8.-10.8.; Nairobi 28.-29.11); by APRACA for Asia (Beijing 18.-19.10.; Bangkok 20.-23.11.); and by NENARACA for North Africa and the Near East (Tunis 30.5.-1.6.) - with the following agenda:

- Initiate a participatory process among AgDBs, RACAs and donor agencies
- Review AgDB reform experiences and needs
- Work out appropriate strategies of AgDB reform
- Examine the demand for consultancy services to AgDB member institutions
- Work out a coordinated approach to AgDB reform in a participatory way
- Identify AgDBs for pilot reform initiatives, starting with pre-feasibility studies

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[7] In an exchange of letters of 14 June 2000 and 19 July 2000, respectively, the presidents of IFAD and the World Bank agreed that "… it would be timely for the World Bank and IFAD to collaborate more closely to help interested member states to develop the potential of these poorly performing institutions" (IFAD); and that "we fully agree on the need to substantially enhance agricultural and rural development through either closure or revitalization of agricultural development banks"(World Bank). FAO has longstanding technical collaboration agreements with both the World Bank and IFAD and the proposed collaborative work with AgDB reform falls within these arrangements. Discussions with the regional development banks are under way.

[8] Agricultural Development Bank Reform: The Case of the Bank for Agriculture and Agricultural Cooperatives (BAAC), Thailand. IFAD Rural Finance Working Paper No. B6, Doc #46498

- Assist member AgDBs in accessing donor support for reform
- Support networking and exchange of experience on AgDB reform among member countries
- Disseminate the results through workshops and publications

These discussions are to prepare the ground for a number of projects in RACA member countries and for donor agreements on their support. It is expected that the generation of political will to reform AgDBs will require a multidonor approach, including prolonged and concerted negotiations by the IMF, the World Bank, IFAD, FAO, the regional development banks and other multilateral and bilateral donors with the concerned governments.

Box 5: Afraca's AgDB Reform Initiative
(i) The governments have to take a decision to reform their ailing AgDBs…(ii) Adequate reform strategies should be worked out… (iv) The new banks should be operationally autonomous… (x) The new bank should endeavour to attain financial sustainability through charging market interest rates, savings mobilization, retained earnings… *(Communique of the Afraca workshop in Abuja, April 2000)*

Box 6: Nenaraca's AgDB Reform Initiative
(i) Nenaraca should write to member banks, asking which banks may be interested in undertaking a pre-feasibility study of restructuring and reform. (ii) The banks may approach donors for assistance in carrying out the pre-feasibility studies. (iii) Nenaraca will actively participate, or initiate, donor coordination in all phases of support to AgDB reform. (*Recommendations of the Nenaraca workshop in Tunis, June 2000)*

Box 7: APRACA's AgDB Reform Initiative
To maximize their outreach, AgDBs… must cover all their costs, mobilize their own resources, protect their funds and assets against erosion from inflation and non-repayment of loans, and make a profit to finance their expansion…. The recent financial crisis in Asia has highlighted the need for closer scrutiny and regulation of financial organizations, including AgDBs and MFIs…. The challenge is to find a way for all parties involved to work together for the continuous delivery of sustainable financial services by helping improve their viability and outreach to the poor. (*APRACA-NACF Regional Conference in Bangkok, November 2000*)

5. A Planning Framework for Rural and Agricultural Bank reform

The following ***objective of AgDB reform*** is suggested:

> Agricultural development banks are transformed into viable and sustainable providers of financial services to all segments of the rural population, including the poor.

To reach this objective, the following **key results** (see ***Annex 1***) are to be achieved:

- ✓ activating the political will to reform or to close down
- ✓ adequate reform strategies
- ✓ an effective planning process
- ✓ operational autonomy and freedom from political interference
- ✓ an appropriate legal and regulatory framework with prudential norms
- ✓ financial restructuring (preceded by consolidation of the bad debts of state-owned and other enterprises)
- ✓ organizational restructuring & staff retraining
- ✓ an effective delivery system, with branches as profit centres
- ✓ demand-driven financial products
- ✓ operational and financial sustainability
- ✓ effective internal control and external supervision

To facilitate a **participatory planning process** among AgDBs a framework (with accompanying worksheets) has been prepared.[9] (***Annex 1***).

AgDB reform exceeds the capacity of single donors and will require **partnerships** between several financial and technical assistance agencies. Close cooperation of donors with agencies such as the RACAs, CGAP and others is expected to contribute to the generation of the political will to reform. IFAD's special focus would be on the reform of the AgDBs' microsavings, microcredit and other microfinance services to smallholders, micro-entrepreneurs and the poor, including their self-help groups, informal financial institutions, business associations and supporting NGOs. The Microcredit Summit Campaign may play an important role in generating the political will to transform rural and agricultural banks into viable and sustainable financial intermediaries with an outreach to hundreds of millions of the rural poor.

[9] S. I. Ijioma, Sub-Regional Activities for 2000*: Agricultural Development Banks – Ignore, Reform or Liquidate.* Afraca News no. 31, April 2000: 8-9. M. R. Mustafa, *Restructuring Agricultural Banks in the NENA Region.* Paper presented at the Nenaraca Workshop in Tunis, 30/5-1/6, 2000.

Annex 1:

Rural and Agricultural Development Bank Reform
A participatory planning framework

Objective: **Rural and agricultural development banks (AgBDs) are transformed into sustainable providers of financial services to the rural population**	
Key results and outputs:	
1.The political will to reform the AgDB is activated: 1.1The political decision is taken by government to reform its AgDB 1.2A participatory planning process involving all stakeholders is agreed upon **1.3**The AgDB management and the stakeholders agree on the mandate and market of the AgDB	
2.Adequate reform strategies are worked out: 2.1Alternative reform strategies are examined including: 2.2government-owned AgDB under autonomous management 2.3government-owned AgDB under commercial bank management 2.4full or partial privatization 2.5transformation of microbanking operations into user-owned local financial institutions 2.6closure or fusion 2.7Appropriate reform strategies are selected 2.8Adequate process technologies are developed 2.9Implementation phases of the reform process are determined and periodically revised 2.10Logistic support of multilateral institutions is secured 2.11Reform strategies of international financial institutions are coordinated	
3.The planning process is implemented: 3.1A feasibility study is carried out 3.2An operational plan for the implementation of the reform process is prepared 3.3External technical and financial support of the reform process is mobilized and coordinated *3.4*The process of restructuring and reform is monitored	
4.Operational autonomy is effective: 4.1The AgDB is granted operational autonomy 4.2A commercially experienced, politically independent general manager is appointed 4.3The Central Bank or Bank Superintendency enforces the attainment of operational autonomy	
5.An appropriate legal and regulatory framework is provided: 5.1A dialogue is initiated on the policy, legal and regulatory framework conducive to AgDB reform 5.2The ADB law is revised 5.3Politically motivated loan forgiveness is excluded by law 5.4Prudential norms are defined and enforced	

6.The AgDB's finances are restructured: 6.1The portfolio is cleaned 6.2The bank is recapitalized	
7.The bank structure is reorganized: 7.1Microfinance services are organized in an autonomous corporate division 7.2Savings deposits are recycled among the microfinance units 7.3Branches are decentralized into profit centers 7.4The branch network is expanded 7.5Outreach is expanded to the poor and their self-help groups	*1.*
8.Effective delivery schemes are operational: 8.1Viable wholesale schemes are operational 8.2Linkages with self-help groups, informal financial institutions and NGOs are initiated if feasible 8.3Viable retail schemes are operational	
9.Effective financial services are offered according to demand: 9.1Savings are mobilized through appropriate savings products and collection services 9.2Interest rates on savings are adequate, with positive real returns 9.3Credit products with appropriate terms and collection services are provided 9.4Insurance and other financial products are provided	
10.Financial sustainability is attained: 10.1Viability is attained through adequate interest rate spreads and adequate repayment performance 10.2Self-reliance is attained through savings mobilization and retained earnings 10.3Financial self-sustainability is attained through adequate returns on capital	
11.Human resources are developed: 11.1Staff selection procedures are established for the hiring of appropriate staff 11.2Training and retraining schemes are established to inculcate the reformed operational practices 11.3Staff training and retraining is implemented on a continuous basis 11.4Staff incentive schemes are operational 11.5A performance-based staff testing and promotion system is established	
12.Internal and external supervision are effective: 12.1International accounting standards are operational 12.2Prudential norms are observed 12.3A MIS with effective on-time monitoring of loans and prompt action taken is operational 12.4Internal supervision is operational 12.5External supervision is operational 12.6Effective supervision services to wholesale clients are provided by the AgDB	

Annex 2: #153681

Asia and Pacific Region
Microcredit Summit Meeting of Councils

New Delhi, India
1-5 February 2001

Associate Session:

Reaching hundreds of millions of the rural poor with sustainable savings and credit services: The role of rural & agricultural banks in Asia

Saturday, 3 February 2001, 1:15-2:15 p.m.

Agenda:

(1) International Fund for Agricultural Development (IFAD), Rome:
Mobilize your own resources, cover your costs and reach out to hundreds of millions of the rural poor: The role of rural & agricultural banks in microfinance and rural poverty alleviation in Asia

(2) *National Bank for Agriculture and Rural Development (NABARD), India:* Linking self-help groups, NGOs and rural banks: Will NABARD in India reach a hundred million of the very poor?

(3) Bank for Agriculture and Agricultural Cooperatives (BAAC), Thailand:
The bank that covers its costs and reaches all smallholders with adequate savings and credit services: How did BAAC in Thailand do it at low interest rates?

(4) Bank Rakyat Indonesia (BRI), Indonesia:
BRI in Indonesia provides credit to millions of rural people and savings services to tens of millions - at a profit! Can BRI lower its interest rate on loans and further increase its outreach?

(5) Agricultural Development Bank of Nepal (ADBN), Nepal:
Sustainable financial services to the very poor in marginal areas: how ADBN transformed its Small Farmers Development Project into self-reliant local financial intermediaries owned and managed by the poor

(6) Donors:
Sustainable banking for the rural poor in Asia: the role of donors, APRACA and the Microcredit Summit

Associate session:
Sunday, 4 February 2001, 1:15-2:15 p.m.

Reaching hundreds of millions of the rural poor with sustainable savings and credit services: The role of rural & agricultural banks and their reform in Asia

By
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Rural and agricultural banks, among them state-owned agricultural development banks (AgDBs) and cooperative banks, have a wide outreach in Asian countries. Their potential as retailers and wholesalers (through cooperatives, rural banks, NGOs) for providing sustainable savings deposit and credit services to the rural poor is enormous. Some examples:

(a) The quantative and qualitative outreach BRI Microbanking Division, with 25.1 million microsavings accounts and 2.6 million current microcredit accounts (at a profit!), surpasses that of some 10,000 formal and semiformal MFIs in Indonesia.
(b) BAAC provides near-total coverage in terms of rural saver and agricultural borrower outreach in Thailand.
(c) The outreach of NABARD in India through rural banks, financial cooperatives and self-help groups (SHGs) exceeds a hundred million. With regard to outreach to the very poor, NABARD has achieved spectacular success through its program *Linking Banks and SHGs,* expecting an outreach of a hundred million rural poor by 2008.
(d) In Nepal, IFAD and AsDB helped ADB/Nepal to build up a rural financial infrastructure of small farmer groups. With assistance from GTZ, 101 subproject offices have been transformed into autonomous savings and credit cooperatives (SFCLs), with an astonishing ratio of financial self-sufficiency of 117%. The success of the SFCLs in the fertile plains and the marginal hill areas is living proof of the compatability of outreach to the poorest and institutional sustainability even in a most difficult environment.

Yet, the large majority of AgDBs in Asia and elsewhere are grossly underperforming and are a major drain on public resources. Therefore, they have been ignored by most donors in recent years. However, experience in Asia shows that there is an enormous potential for reform. There is little chance that the small MFIs donors have been focussing on will even remotely come close to the Summit's quantitative aims of outreach. Rural and agricultural banks must be included in our joint campaign to combat poverty, and every effort should be made to convince governments to **transform rural and agricultural banks into viable and sustainable financial intermediaries with wide outreach to the rural poor.**

IFAD's new initiative with CGAP, the World Bank, FAO, GTZ, regional development banks and the RACAs (Afraca, Apraca, Nenaraca) has focused on the potential as well as reform needs of AgDBs and increasingly attracted international attention. By including rural and agricultural banks in the Summit's agenda, it is expected that synergies will be mobilized with the objective of substantially increasing access of the poor and very poor to sustainable financial services throughout Asia and the Pacific. The ***Microcredit Summit Campaign*** may play an important role in generating the necessary political will.