

Reforming Agricultural Development Banks



Division 41
Section Financial Systems Development

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1. **Agricultural development banks: the forgotten half of rural finance?**

The issue of agricultural development banking discussed in this paper has a history to it. For a hundred years or more, until the middle of the 20th century, a small number agricultural banks existed outside of Europe. During that period, 15.5% of the banks in the *AgriBank-Stat* inventory, were established.¹ Some seem to have led an inconspicuous life, like the predecessors of the Agricultural Cooperative Bank in Syria and the Agricultural Credit Corporation in Jordan, established in 1888². Others, like the predecessor of Bank Rakyat Indonesia dating back to 1885, were at the center of lively debates over such issues as centralized vs. decentralized rural banking; the role of the government as a decision-maker vs the people themselves, perhaps organized in cooperatives; and banking in kind vs. banking in money.³ However, whatever lessons might have been drawn from that experience appear to be lost in history.

For three decades, roughly from the 1950s to the 1970s, agricultural development banks (AgDBs) were considered a panacea. During that period, 50% of the agricultural banks in the *AgriBank-Stat* inventory were established. 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

¹ Most of the figures reported here are based on 58 agricultural banks on which sufficient data exist in the *AgriBank-Stat* inventory, out of a total of 75 institutions listed. The *AgriBank-Stat* inventory has been created by the Food and Agriculture Organization FAO and the German Technical Cooperation GTZ and is hosted on FAO's homepage (<http://www.fao.org/ag/ags/agsm/Banks/index.htm>)

² The Ottoman Agricultural Bank, from which the two banks originated, had its head office in Damascus and three branches in what is today Jordan (see chapter 6.1). (Seibel 2002)

³ Many of the issues today discussed in rural, micro and agricultural finance already existed at the beginning of the 20th century in Indonesia, under Dutch colonialism. For a recent summary of the rich literature see Steinwand 2001.

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, informal traders 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; Ghatge 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 can be vast, in some countries in the millions and even tens of millions; and there is no immediate alternative available, most certainly not in the form of credit NGOs. 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 if the branches were closed, and a great gain if they could be turned into profitable enterprises. In addition, profitable AgDBs might have access to capital markets because of their size in equity and liabilities in order to mobilize long-term funds by bond issues. Small financial institutions do not have this opportunity and therefore lack this funding source being crucial for agricultural long-term lending.

The fourth reason is the unsolved problem of financial services in rural areas. After closing AgDBs in several countries specially in Latinamerica the gap has been never closed by new financial institutions, such as the promising microfinance institutions. Microcredit turned out to be an appropriate credit technology in urban areas to finance small scale trading activities but only in very few cases it could provide sufficient or appropriate products in rural areas or for agricultural production. Thus, the notion that AgDBs hinder or undermine the development of new credit providers in rural areas has been never evidenced at least in Latinamerica.

The fifth 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!

Since around 2000, there is now a new interest in the reform issue: cautious and gradual, but continual. Several multilateral, bilateral and international organizations have been involved: FAO, IFAD, the World Bank, GTZ, a CGAP Working Group on Agricultural Development Bank Reform, and, with support from IFAD and GTZ, the regional agricultural credit associations AFRACA, APRACA and NENARACA.

The structure of this paper is as follows. In the introductory chapter, we have given an overview over the background and the crucial issues. This is followed by a confidence building section (with the evidence presented only in chapter 5). After briefly listing the flaws and ills of the old world of agricultural credit, we outline the new consensus on rural finance, which overlaps with that on microfinance, and list the major lessons taught by international experience in a condensed format. Finally, we deal with the issue whether agricultural finance is really as risky and unprofitable as it is usually depicted, particularly by those who stay away from it.

In chapter 3, we present some puzzling insights into agricultural finance from both a supply-side and a demand-side perspective, pre-empting some of the evidence given in chapter 6. There is the usually reported lack of funds in banks and lack of finance among

the potential investors (such as farmers, microentrepreneurs, commodity processors and traders) in some cases; but also the abundance of funds and shortage of investment opportunities in others.

In chapter 4, we set the scene for the subsequent presentation of data, coming back to the basic issue of the introduction: ignoring, closing or reforming agricultural banks. In Chapter 5 we present the statistical facts as given in the *AgriBank-Stat* inventory of agricultural banks, amply illustrated by presentations of pre-reform, reforming and reformed agricultural banks in Chapter 6.

In the final chapter, we present the new recent initiatives at agricultural bank reform, the role played by the agricultural bank associations, and a planning framework for policy and decision makers.

2. The old and the new world of development finance

2.1. The old world of agricultural credit

During the 1950s and 60s and well into the 70s, when donor money flowed abundantly into development banks, there was agreement in the donor community on how to deal with low levels of agricultural productivity:

- ◆ Given the level of poverty in the underdeveloped world, international experts advised governments to subsidize interest rates.
- ◆ Given the level of illiteracy, international experts also advised government administrations to guide production through directed credit, with a strong emphasis on self-reliance in staple crops, supplemented by an emphasis on cash crops for export.

Thus, governments owned AgDBs, subsidized interest rates and prompted production decisions. In many cases, crops were planted because of the availability of inputs including credit, not because soils were suitable and production was profitable. As a result commercial thinking was lacking, both in agricultural production and agricultural finance. Credit was scarce and was grabbed by small numbers of bigger farmers; outreach to the poor remained far behind expectations. Frequently, credit was provided to the wrong people (eg, with political connections) at the wrong time (eg, after the planting season) for the wrong purposes (eg, administratively defined uses). Neither bank staff nor the farmers took agricultural credit seriously, which had evolved into a political affair. Repayment rates turned out to be abysmally low – except when tied directly to outgrower schemes and marketing boards - and became an eternal drain on government and donor resources. In the process, banks, farmers and agricultural credit were discredited. 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 1970s and 1980s, a consensus gradually evolved on **the negative effects of financial repression:**

- ◆ Rural areas have been severely underbanked; an effective rural financial infrastructure is largely absent in many countries.
- ◆ 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.
- ◆ In many countries, 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 service 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 (particularly non-mutualist local financial institutions, such as equity-based rural banks). This has prevented informal institutions from upgrading to registered local financial institutions. Thus, they remain small and isolated.
- ◆ Rural and other microfinance institutions are not supervised, there are no prudential standards, and no enforcement mechanisms. This has had serious negative 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.

2.2. The emerging consensus on the new world of rural and microfinance

In an increasing number of countries, there have been notable changes to varying degrees from the old world of directed credit to a new world of sustainable institution building. In this new world, governments make determined efforts to create conducive policy environments with new legal forms for local financial institutions, deregulated interest rates, and prudential regulation and supervision of financial institutions.

Responding to the demands of their customers, institutions undergo reform and provide an array of savings and credit products for a wide range of income-generating activities, thereby generating the loanable funds and the profits needed for expansion. Many agricultural and rural banks, cooperatives and other MFIs have learned to manage their risks. The transition from the old to the new world of development finance, as described in the following matrix, is a challenging framework to any institution and donor agency aiming at sustainable development.

Table 1: From the old world of directed credit to the new world of financial systems development and institution-building

	The old world of directed credit	The new world of institution-building
Policy environment	Banks as input providers	Banks as profit oriented actors within a market driven financial system
Legal framework	Public owned or public financed financial institutions without supervision; governments keep distressed institutions alive	Supervised private commercial institutions, member based co-operatives, NGOs and public banks
Development approach	Supply-driven	Demand-driven
Institutional focus	Monopoly institutions	Various competing financial institutions
Clients perceived as:	Beneficiaries	Customers
Selection of clients	Targeting by donors and governments	Self-selection
Outreach	Banking as public service	Banking with clients
Loan products	Specified targeted loan schemes for single purposes	Cash-flow based credit
Other products	Lack of savings facilities	Universal banking
Non-formal FIs	Millions of informal MFIs ignored	Opportunities for mainstreaming
Semiformal FIs/NGO	No standards, no deposit mobilization	Microfinance boom in urban and periurban areas; transformation to deposit-taking formal FIs allowed
Financial co-operatives	Unsupervised, ruined by governments	Self-reliance
AgDBs	Highly subsidized; deposit mobilization not allowed	Reforms towards autonomy and viability
Rural banks (RBs)	Lack of opportunities for private RBs	Legal framework for private RBs
Commercial banks	Forced to provide funds	Some voluntary down-scaling of products to poorer client segments

The transition to a new world of finance, as promising as it looks, has only just started. Neither does it cover all developing countries; not does it cover all institutions and spheres of the economy in those countries where it has commenced. In most countries, the situation is highly complex and full of contradictions, for example:

- ◆ failing and prospering institutions may exist side by side;
- ◆ governments pass laws on market-driven institutions, yet continue subsidizing the interest rates of others;
- ◆ agricultural development banks and commercial banks – facing high minimum reserve requirements and high T-bill rates and plagued by weak lending technologies - may produce huge amounts of excess liquidity, yet the government borrows money from international donors and increases its external debts.

In sum, despite promising beginnings, rural areas and agricultural finance have been least touched by these changes. Once it was savings⁴, now it is agricultural credit that is *the forgotten half of rural finance*. There lies an enormous underutilized potential!

2.3. Lessons taught by international experience: What matters in development finance?

Due to the overall failure of donor-driven directed credit, the emphasis in development policy has shifted to (rural) financial systems development and the building of self-reliant, sustainable institutions. Regardless of ownership, type of institution, rural or urban sphere of operation and target group, financial institutions in developing countries, with the exception of apex banks, ultimately have to accomplish the following:

- ◆ mobilize their own resources mainly through deposits
- ◆ have their loans repaid
- ◆ cover their costs from their operational income
- ◆ earn enough profits to offset the effects of inflation
- ◆ finance their expansion from their profits and commercial funds mobilized.

Box 1: Fundamentals of sustainable rural finance

Sustainable financial institutions mobilize deposits or other commercial resources, provide financial services according to demand, cover their costs from their operational income, have their loans repaid, make a profit, and finance their expansion from deposits and retained earnings. Resource mobilization comprises equity, savings deposits, retained earnings and commercial borrowings, augmented by external resources such as soft loans and grants. Of these resources, three are fundamental to self-reliance and dynamic growth: savings deposits and equity including retained earnings. Financial services comprise credit for various purposes and savings deposit facilities; they may further include money transfer, check clearing and insurance. Insurance may serve the triple function of borrower protection, loan protection and resource mobilization. Sustainable institutions need an appropriate legal status which authorizes them to carry out all these functions; and they need to be properly regulated and effectively supervised. Financial systems development comprises processes of establishing a conducive regulatory environment (including a legal framework, prudential norms and effective supervision), an adequate infrastructure of viable small and large financial institutions, adequate demand-oriented financial products and good operational practices.

In addition to these fundamentals, a wealth of lessons have been taught by international experience, but not always learned by donors and governments. The lessons are complex and are presented below in a condensed form.

What matters to the poor:

- ◆ *First of all, client experience matters.* Clients have experienced in projects that credit can make them poorer or richer

⁴ Robert Vogel, *Savings Mobilization: The Forgotten Half of Rural Finance*. Pp. 248-265 in: D.W.Adams, D.H. Graham & J.D. Von Pischke, *Undermining Rural Development with Cheap Credit*. Westview Press, Boulder 1984.

- ◆ *The poor themselves matter ... and so do the non-poor.* Their autonomy in self-selection, instead of targeting, should be respected, also on separate vs. mixed institutions of women and men
- ◆ *Access to savings facilities, credit, insurances and money transfer services matters* – far more than interest rates.
- ◆ *Rural enterprise viability matters* and is mutually reinforcing the viability of rural financial institutions.
- ◆ *Household portfolio diversification matters*; however small scale farms have to get specialized in order to grow.

What matters in terms of origin, history and culture:

- ◆ *Informal finance matters*, particularly in the form of self-help groups (SHGs). Upgrading and mainstreaming through networking and linking them to banks are two ways in which donors can support expansion of outreach and financial deepening.
- ◆ *History matters.* MFIs in Europe, since 1720, have started from informal beginnings and evolved, through appropriate regulation and supervision, to co-operative banks and savings banks. Financial system development takes time.
- ◆ *Crisis matters.* Financial innovations typically emerge in response to crisis. Inflation can erode a savings culture.
- ◆ *Development matters:* Microfinance is no panacea; it requires a climate of broader development to be fully effective
- ◆ *Culture matters.* Development from above, through the established authorities, is more effective in hierarchical or closed societies; development from below, through participatory processes, is more effective in segmentary or open societies.

What matters at the level of financial systems:

- ◆ *Financial systems matter.* Donors can contribute to that evolution, but only in a long-range perspective and in a donor-coordinated and goal-oriented manner.
- ◆ *Financial sector policy matters*, particularly interest rate deregulation.
- ◆ *The legal framework matters.* Appropriate legal forms allow people to establish their own financial institutions in private, cooperative or community ownership.
- ◆ *Savings matter*, as a service to the poor and as a source of loanable funds.
- ◆ *Financial intermediation matters:* savings-first for low-yielding activities; and credit-first for high-yielding activities - depending on the rate of return.
- ◆ *Interest rates on loans matter*, covering all costs of financial institutions
- ◆ *Institutions matter* (projects or credit funds don't), providing continuity and efficiency.
- ◆ *Competition matters*, entailing institutional diversity and pressures to perform.
- ◆ *Prudential regulation and supervision matter*, to enlarge banking services, to protect savers and to enforce standards in supervised institutions.
- ◆ *Knowledge matters.* Effective knowledge management is urgently needed.

2.4. Agricultural finance: how to manage its risks

Is agricultural finance really risky and unprofitable?

A good number of agricultural and rural banks, cooperatives and other MFIs have learned to manage their risks by:

- ◆ diversifying their portfolio,
- ◆ analysing the investment and repayment capacity of the entire household,
- ◆ providing a range of appropriate financial services,
- ◆ starting small and granting repeat loans of increasing size,
- ◆ providing incentives to both staff and borrowers to enforce timely repayment,
- ◆ combining group and individual technologies and offering opportunities to group members for graduation to larger loans as need be, and
- ◆ expanding into remote areas through linkages with self-help groups.

There is no doubt that agricultural finance faces high levels of risk: climatic, economic, technical and political. These risks may be covariant, affecting many borrowers in a given area. For reasons of risk management, farmers may prefer traditional agricultural varieties and practices which are less profitable but also less hazardous. These may be supplemented by modern cash crops which promise higher profits but are also riskier. Furthermore, the budgets of farmers and microentrepreneurs are integrated into their household economies, and expenditures for agricultural and non-agricultural, consumption and social purposes may be closely linked. In a number of cases, the belief of bank CEOs and donors in unsurmountable problems of rural and commodity finance has turned into a *self-fulfilling prophecy*, either by categorically excluding this type of finance, or, when giving it a try, failing because loan officers are not experienced and not convinced.

If one moves up the scale from micro to meso finance, the situation changes. There is a trade-off between diversification and specialisation. Access to global markets requires producers to specialise, adopting high-yielding varieties and benefiting from economies of scale. They may have to adopt risk pooling mechanisms (eg, insurance, price stabilisation funds, futures) instead of diversifying into a range of small scale activities. Non-financial institutions and governments may have an important role to play in this kind of risk management to facilitate investments in the commodity sub-sectors and to stimulate the flow of finance from the private sector.

Experience around the developing world shows that virtually any type of financial institution, including commercial banks staying away from agriculture, can fail in the face of bad policy or bad management. On the other hand, experience also shows that any type of rural financial institution, once reformed and well-managed, can provide finance in a profitable and sustainable way for a variety of activities including those along the commodity chain – some with a stronger emphasis on commodity production, others on processing and trade. Among these are:

- ◆ AgDBs like BNDA in Mali and CNCA in Burkina Faso (both with monopsonistic relations to organised commodity sectors), BNA in Tunisia, BK in Iran, BRI in Indonesia, BAAC in Thailand
- ◆ Rural and community banks, eg, in Nigeria, Ghana, Tanzania, the Philippines and Indonesia
- ◆ Commercial mesobanks like Centenary RDB in Uganda, CMF in Uganda, EBS in Kenya, Banco Caja Social in Colombia, Bank Dagang Bali in Indonesia, Micro Enterprise Bank (MEB) in Bosnia
- ◆ Financial cooperatives like SACCOs in Kenya and Tanzania, credit unions in Madagascar, People's Credit Funds in Vietnam, savings and credit cooperatives in the Philippines
- ◆ NGOs like CHF/JACP in Jordan, UMU in Uganda, EKI in Bosnia, ASA in Bangladesh
- ◆ Credit-NGOs establishing banks like K-Rep in Kenya, CARD and others in the Philippines, Bina Swadaya, Purba Danarta and others in Indonesia, and, soon, in Uganda
- ◆ Member-owned village funds like sanadiq in Syria and SHGs linked to banks in India and Indonesia.

Finance as a commercial proposition

For these institutions and their customers, rural and agricultural finance has turned into a commercial proposition. Their experience has demonstrated that the social and economic objectives of rural and agricultural development are best achieved not by charity, but by financial relations between institutions and their customers based on commercial principles. Such institutions may profitably include commodity finance: not as their sole objective, but as part of a commercially balanced portfolio. The frontier of finance lies in a progressively extended balance between purely commercial and developmental objectives. It is hoped that, as financial institutions contribute to the growth and profitability of farm, off-farm and non-farm enterprises of various sizes, their overall lending volume to that sub-sector increases in size and profitability; and what may appear as social banking at the onset turns into commercial banking.

Risk management strategies

The issue is thus not whether rural and agricultural finance face particular problems, but that these problems are surmountable and have in fact been solved by a number of institutions. These institutions have developed a range of risk management strategies for the financing of agricultural and other rural investments. An abbreviated list of risk management strategies, which should be of particular interest to rural and agricultural finance institutions, is given below.⁵

⁵ See also Frank Höllinger (2003) and AFR series vol. 3 & 4

Managing credit risks:

Moral hazard of clients:	Rigid loan examination, monitoring and enforcement; graduating from small group loans to larger individual loans based on track record; pilot-testing of new products
Investment failures:	Spreading the risk through household diversification
Co-variance of risks:	Portfolio diversification
Weather-related risks:	Expansion of outreach to wider area and different crops; index-based agricultural credit insurance
Market-related risks:	Contract farming; commodity price risk insurance
Inadequate customer self-financing capacity:	Providing opportunities for savings accumulation
Inadequate client skills:	Linking financial services with training and technical services (BDS or extension services)
Inadequate client information:	Establishing total track record including savings behaviour; microcredit technology if possible;
Credit overdue:	Customer incentives for timely repayment; instant recovery action; cooperation with local authorities to enforce repayment
Lack of collateral:	Warehouse receipts; non-formal collateral; joint liability; peer pressure

Managing transaction costs:

Remote clients:	Linking with SHGs; outgrower schemes; mobile banking
High operational costs:	Wholesaling; economies of scope through savings, credit and insurance; computerisation; credit scoring; effective cost management
Institutional efficiency:	Rationalizing products and procedures

Managing asset-liability risks:

Inadequate equity:	Equity participation by customers; new international social investors
Inadequate funds:	Mobilizing deposits by transformation into supervised and licensed financial institution; refinancing on national capital markets
Interest rate risks:	Matching fixed vs. variable interest rates of assets and liabilities
Political interference in interest rate setting:	Enhancing networks and associations of financial institutions for lobbying; collaboration with donor agencies
Liquidity risks:	Liquidity exchange; foreign currency loans
Lack of term finance:	Increasing equity and quasi-equity; promoting term savings; new products such as bonds and debentures

3. Supply- and demand-side issues:

lack vs. abundance of resources and investment opportunities

3.1. Lack of finance in most cases...

There are stark contrasts in the problem situation concerning the availability of agricultural finance between different areas and institutions. There are two basic problems here: one is the lack, the other one the abundance of financial resources, both resulting, paradoxically, in a lack of resources for agricultural investments. In many areas, there is a *lack of loanable funds*, or an absence of financial institutions willing or able to lend for agriculture. Most AgDBs and credit NGOs are not authorized to collect savings from the general public; others have an inadequate branch and agency network, like the ACB in Syria; or they refuse to accept savings because they are afraid of losing them, like ACC in Jordan. As FAO & GTZ (1998) stated, just at a time of expanding market conditions for agriculture, “the number of donor-supported agricultural credit programmes is in decline and there is little evidence, in many countries, that governments or commercial financial intermediaries are compensating for the reduction in supply of loanable funds to agricultural production, processing, and marketing.” Agricultural input finance has been declining since the early 1990s as a result of liberalisation and the dismantling of commodity boards. This has led to a reduction in agricultural production and yields, deterioration in quality, reduced investments, a decline in income of small producers, and an aggravation of poverty. In many cases, rural financial institutions give preference to financing those commodities which allow for deduction at source within a single-channel marketing system; among them are BNDA in Mali, CNCA in Burkina Faso, FECECAM in Bénin and the SACCOs in Kenya. Once the single-buyer privilege (*monopsony*) is abolished, seasonal finance dries up. There is anecdotal evidence of a tendency for farmers to finance (low-yielding) agricultural investments from savings and use expensive credit for high-yielding non-farm investments, including agricultural processing.

3.2. ... vs. abundance of finance in some cases

In contrast, in a number of other cases, there is *an abundance of loanable funds* due to successful savings mobilization. In many rural institutions offering financial products without a credit bias, the ratio between borrowers and savers is between 1:6 and 1:10; and deposits exceed loans outstanding. This excess liquidity, though generated in rural areas, is thus not available for agricultural finance and other purposes; instead, it is siphoned off to urban areas. Two striking case studies are presented in chapter 6.3: the Bank Rakyat Indonesia Microbanking Division and Centenary Rural Development Bank in Uganda. Another example are the Chinese Postal Banks mobilizing around 10% of all Chinese deposits but are not allowed to provide loans.

Abundance of opportunities for agricultural investments in some cases...

Similar to the stark contrasts between different areas and institutions concerning the availability of finance, there are contrasting abilities of rural people to find profitable investments. In many areas, there is *an abundance of investment opportunities and entrepreneurship* relative to the available finance. Of course, this is akin to saying: *there is*

a lack of finance for the existing demand, be it ample or limited. Thus, most institutions entering, or willing to expand, rural and agricultural finance will find a considerable amount of unsatisfied actual and potential demand, particularly for micro and small investments, many along the commodity chain. The challenge is to enhance products and procedures to expand outreach beyond top-level clients. *Spreading the existing experience* is thus the most promising strategy for rapidly expanding outreach to large numbers of the poor and other segments of the rural economy.

...vs. dearth of investment opportunities: a new challenge

Given the growth of savings, profits and other loanable funds in increasing numbers of rural microfinance institutions including some agricultural banks, there is a new tendency now for existing loanable funds to chase a limited number of rural entrepreneurs and investment opportunities. Thus, in a number of areas, there is *a lack of investment opportunities and entrepreneurship* relative to the available finance. Situations differ widely and pertain to all levels of investment size: from micro to small and medium. In some high opportunity areas, eg, in West and East Africa and in Indonesia, MFIs and rural banks, respectively, now start reporting “too much competition”, which would of course be diminished if new investment opportunities could be opened up. In other areas, as in the Philippines, rural banks and other MFIs engaged in poverty lending on a commercial basis do very well with microloans for microinvestments, using the group lending technology. However, graduating clients to larger individual loans at lower interest rates has proven difficult. Rural banks have a strong interest deepening their outreach by helping clients across the poverty threshold with bigger loans, but are facing a lack of demand. Reasons may be variegated: profitable investment opportunities are not directly available; the rural poor are unable to take advantage of existing opportunities; or they are unwilling to face the substantially higher risks of bigger and longer-term loans; processing technologies are either lacking, or technological consulting services, agricultural extension services and business development services fail to reach down to the local level; financial products are not tuned to the cash flow of investors; markets are currently depressed, and investors disinclined to take on new risks. (Seibel 2004)

There is thus an increasing need for developing new technologies, investment opportunities, market linkages, and local entrepreneurship. Over the past decade, rural and microfinance have focused on the supply-side, particularly the enhancement of sustainable financial services. There is some discussion about Finance-Plus, ie, financial plus non-financial services. But most financial institutions have been hesitant, despite tempting donor offers, to take on non-financial responsibilities, which may range from agricultural and technological advice to health and educational services. They would rather prefer to link up with other agencies supplying such services.

4. **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 burn scarce public funds best described by the so-called “subsidy dependence index”. Donors provided funding and technical assistance (see Giehler, 1999, pp 11-15). 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 majority of countries. They fail to mobilize voluntary savings and domestic capital market resources. 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, many AgDBs are unsustainable, and their outreach and growth are 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. Their outreach varies widely; but in many countries, they are major providers of rural financial services, sometimes they are the only one. Data compiled in the *AgriBank-Stat* inventory, however incomplete, give a total of 87 million savings accounts in 35 banks and 24 million borrowers in 50 banks, excluding the two giants, China and India. If we include the outreach of rural financial institutions in India⁶ (3/2000) with 412 million deposit accounts and 72 million loan accounts, total saver outreach is 499 million and total borrower outreach 96 million. The importance of government-owned agricultural banks is not necessarily diminished by the development of a differentiated rural financial infrastructure; a telling example is the BRI Microbanking Division in Indonesia, with 29 million saving accounts and 3 million borrowers, which exceeds the outreach of some 54,000 formal and semiformal financial institutions and outlets.⁷

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. They indicate that reform may well be feasible and that their financial performance and outreach can be greatly increased. There are thus **three responses** that have emerged in response to the failings of AgDBs: ignoring, closing and reforming AgDBs.

⁶ 142,000 rural outlets: 50,000 banking outlets and 92,000 primary cooperatives.

⁷ The BRI units (excluding the branch corporate business of BRI) and account for 62% of all savings accounts and 74% of all deposits; 8% of loan accounts and 39% of loans outstanding.

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 through credit subsidies, reschedulings, debt forgiveness, interest rate exemptions and recapitalization – 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 *worst practices* in rural finance.

Closing AgDBs is a strategy particularly widespread in Latin America and 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 very 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, but increasingly also in Asia. 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 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.

5. Agricultural banks in the *AgriBank-Stat* inventory

5.1. Description of data bank

This chapter is based on an evaluation of *AgriBank-Stat*, an inventory initiated jointly by the Food and Agriculture Organisation of the United Nations (FAO) and Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH. 75 banks are included, among them agricultural development banks, commercial banks, cooperative banks and apex banks⁸. All institutions have at least 10% of their portfolio allocated in the agricultural sector. Agricultural Development Banks are defined as mainly (above 50% of the shares) government owned institutions. Commercial banks are defined as banks falling under the banking law and not under a special act, such as the development banks act or the agricultural reform act. Apex banks are second tier or wholesale financial institutions. For the purpose of this report, a SPSS-file containing around 20 variables has been compiled, listed in Table 2, which can be made available to users upon request.

Table 2: Variables

Variables	N	Missing values	
		Number	Percent
Country	75	0	0
Continent	75	0	0
Date of establishment	71	4	5.3
Date of balance sheet	71	4	5.3
Type of institution	71	4	5.3
Type of legislation	64	11	14.7
% governmental ownership	66	9	12.0
Number of branches	65	10	13.3
Number of staff	58	17	22.7
First source of funds	65	10	13.3
Second source of funds	43	32	42.7
Third source of funds	20	55	73.3
Number of loan accounts	50	25	33.3
Number of savings deposit accounts	51	24	32.0
S/L ratio (deposit accounts/loan accounts)	75	30	40.0
Total assets (in US\$ m)	64	11	14.7
Total outstanding net loan balance (US\$ m)	51	24	32.0
Total outstanding gross loan balance (US\$ m)	15	60	80.0
% of loan portfolio allocated to agric. sector	61	14	18.7
Number of association memberships	74	1	1.3

There are two major deficiencies in the data set. One is the large number of missing values, e.g., in about one-third of the cases there is no information on the number of

⁸ The data bank is hosted at <http://www.fao.org/ag/ags/agism/Banks/index.htm>.

savings accounts and the number of loan accounts. The problem of missing values is particularly prevailing among banks from Latin America, where nine out of 19 banks have provided little more than their name and address. All 75 banks in the inventory are included in Table 2, Table 5 and Annex 1; however, only 66 banks have provided enough information to be included in the other tables. We also excluded one non-bank microfinance institution (MFI), which provided insufficient data, and nine apex banks, which do not fit into the framework of our analysis. This leaves a total of 57 commercial and development banks. The second deficiency lies in the dated nature of the information from some of the banks and the spread over a wide period of time. In twelve cases, the reporting date lies before 2000.

5.2. Basic data of banks

Origin: In terms of origin, the banks are spread over two centuries. The oldest institution, the State Bank of India, dates back to 1806 while the latest was established in 1999. 15.5% were established before 1950. There is a peak during the 1960s, when almost one-quarter of 71 banks were established, presumably in response to hopes for rapid economic development during the post-independence period. It is notable that the enthusiasm for establishing agricultural banks does not seem to have suffered much after that peak period; during each of the last three decades, between 11 and 14 new banks were established (Table 3).

Table 3: Date of establishment

Year	Number	Percent	Cumulative Percent
1800 - 1899	4	5.6	5.6
1900 - 1949	7	7.8	15.5
1950 - 1959	6	8.5	23.9
1960 - 1969	17	23.9	47.9
1970 - 1979	11	15.5	63.4
1980 - 1989	12	16.9	80.3
1990 - 1999	14	19.7	100.0
Total	71	100.0	

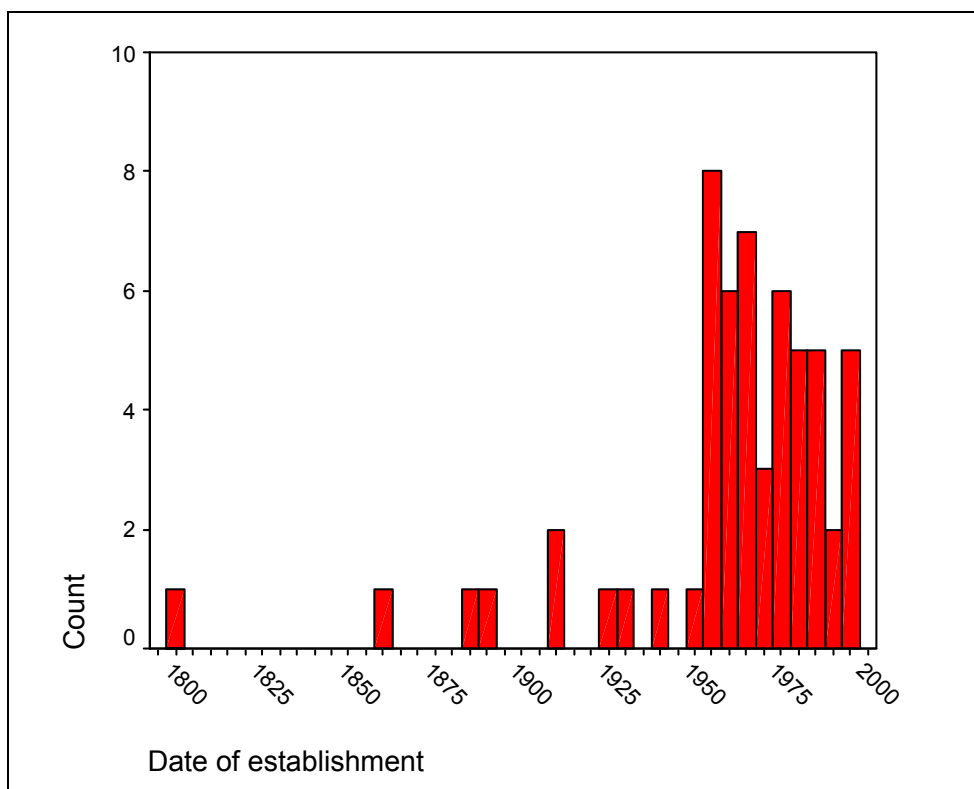


Figure 1: Date of establishment

Region: A majority of institutions (41%) are from Asia-Pacific, followed by Africa (32%) and Latin America (24%) – two continents that have suffered much from the closing of agricultural banks. As banks from Latin America were less prolific in providing data, they account for only 9% of the banks in the remaining sample of banks with sufficient data, while Asia-Pacific banks account for 49% and African banks for 40%. (Table 4).

Table 4: Number of institutions by continent

Continent	Number		Percent	
	All cases	Filtered	All cases	Filtered
Africa	24	23	32.0	40.4
Asia & Pacific	31	28	41.3	49.1
Latin America	18	5	24.0	8.8
others	2	1	2.7	1.8
Total	75	57	100.0	100.1*

* Error due to rounding

Table 5 provides an overall survey of the banks listed by continent, country, and abbreviation of bank, in alphabetic order. All variables in the data set are included in the order in which they listed in Table 2. The full names of the banks are given in Annex 1.

Table 5: Basic data of agricultural banks in FAO *AgriBank Stat* (amounts in million US\$)⁹

COUNTRY, BANK	ORIGIN	REF. DATE	TYPE	LEGIS	% GOV. OWN	BRANCH	STAFF	SOURCES OF FUNDS	LOAN ACCOUNTS	SAVINGS ACCOUNTS	S/L RATIO	TOTAL ASSET	R. LOANS OUTST.G	D. LOANS OUTST.G	% AGR. LOANS	MEMBER
Africa																
Algeria, BAAR		1992 2000	DB	BL	100	310	7,200	D, CB				6,000	2,300.0		25.82	
Botswana, NCB		1963 2001	DB	SL	100	3	115	C, G	1,600	0	0.000	80	70.0		20	
Burkina Faso, BNC		1990 2001	DB	BL	80	19		D, S	10,000	70,000	7.000	74	52.0		75.47	
Egypt, PRONC		1991 1998	DB	BL	100	1,500	25,000	D, E	3,500,000	2,200,000	0.629	2,800	2,200.0		80.88	
Ethiopia, DEBE		1970 2002	DB	BL	100	30	820	D, C	11,000			170	115.0		35.47	
Ghana, ADB/G		1955 2000	DB	BL	100	45	1,100	D, G	44,000	23,000	0.523	190	85.0		65.47	
Kenya, APC		1963 2000	DB			40	1,000	S, ..	22,000	0	0.000	57	36.0		100.00	
Kenya, CBE		1965 1997	CB		0	30	1,000	D, ..	3,600			310	170.0		.. AP, IC	
Kenya, K-Rep		1999 2001	CB	BL	0	35	200	D, ..	16,000	28,000	1.750	15	12.5		.. NR	
Libya, AML		1957 1995	DB	SL	100	45	550	D, R				340		200.0	100.00	
Mali, BMDA		1961 1997	DB	BL		20	150	D, R	20,000	30,000	1.500	85		65.0	95.47	
Mali, EJ		1988 2000	CB					D, ..	25,000	68,000	2.720				.. NR	
Morocco, CRCA		1961 2001	DB	BL	100	220	3,000	S, D	270,000	190,000	0.704	1,950	1,100.0		65.88	
Nigeria, AN		1991 2000	DB	SL	100		170	D, G	5,600				10.5		60.88	
Nigeria, NACB		1973 2000	DB	SL	100	70	2,000	G, S	40,000	0	0.000	42		40.5	100.00	
Senegal, CRCA		1984 2001	DB	BL		15	170	D, CB	6,000	205,000	34.167	100	40.0		90.47	
South Africa, LB		1912 2001	DB	SL	100	30	1,000	R, R	71,000	0	0.000	1,700	1,600.0		100	
Sudan, ABS		1957 2001	DB	SL	100	95	2,100	CB, D	125,000	5,000	0.040	58	28.0		90.82	
Sudan, PCB		1998 2001	CB	BL	0	30	550	D, S				90		43.0	60.82	
Sudan, ICMB		1982 2001	CB	BL	51	30	600	D	1,100	30,000	27.273	36	24.0		10.82	
Tunisia, INA		1959 2000	CB	BL	65	160	3,200	D	250,000	700,000	2.800	2,000	1,550.0		41.47, 82	
Uganda, CENDEB		1983 2000	CB	BL	0	22	590	D	17,000	240,000	14.118	38	11.0		16.82	
Uganda, UMT		1984 2000	MT	SL	0	20	130	D, R	32,000	45,000	1.406	3	2.0		15.47	
Zimbabwe, ABZ		1999 2000	CB	BL	100	15	400	D, B	8,500	10,000	1.176	57	14.0		28.0	.. AP
Asia-Pacific																
Bhutan, BOPC		1989 2001	DB		100	25	125	R, S	12,000			17	13.5		35.47	

⁹ Source: <http://www.fao.org/ag/ags/agsm/Banks/index.htm>

COUNTRY, BANK	ORIGIN DATE	REP. TYPE	LAGS	\$ GOV. OWN	BRANCH	STAFF	SOURCES OF FUNDS	LOAN ACCOUNTS	SAVINGS ACCOUNTS	S/L RATIO	TOTAL ASSET	N. LOANS OUTST'G	G. LOANS OUTST'G	\$ AGR. LOANS	MEMBER
China, ABC	1979	1997	CB	BL	100	50,000	500,000	D, D	..	..	190,000	125,000.0	..	..	.. AP
China, ADB/C	1994	2001	DB	SL	100	2,300	55,000	CB	..	..	93,000	..	90,000.0	..	100 AP
Fiji, FDB	1967	2001	DB	SL	100	9	240	B, K	0	0.000	141	128.0	..	..	14 AI
India, MABARD	1982	2002	AB	SL	100	320	5,300	CB, B	..	..	9,200	..	8,400.0	..	90 AP, BW
India, OBC	1943	2001	CB	BL	100	940	14,000	D	..	..	6,000	2,500.0	..	..	15 AP
India, SBI	1806	2002	CB	BL	12	9,100	215,000	D	..	..	93,000	35,000.0	..	..	15 AP
Indonesia, BRI-Units	1968	2001	DB	BL	100	3,800	22,000	D	27,000,000	10.385	6,400	2,300.0	..	..	16 AP, BW
Indonesia, BUKOPIN	1970	1997	CB	BL	40	80	1,700	D	7,000	..	1,600	900.0	..	..	.. AP
Iran, AB/I	1933	2000	DB	BL	100	1,700	12,000	G, C	6,600,000	6.600	10,000	..	8,100.0	..	95 AP, NE
Jordan, ACC	1959	2000	DB	SL	100	23	420	K, S	0	0.000	180	152.0	..	..	100 NE
Kyrgyzstan, KAPC	1997	2002	DB	BL	100	11	185	G	0	0.000	25	20.0	..	..	70 AP
Malaysia, BP	1969	2000	DB	SL	100	150	2,400	D, G	1,600,000	29.091	1,100	550.0	..	..	100 AP, AI
Myanmar, MADB	1953	2000	DB	SL	100	204	3,900	CB, D	2,000,000	1.000	..	..	..	..	35 AP
Nepal, ADB/N	1967	2001	DB	SL	93	660	4,000	D	400,000	1.000	350	..	265.0	..	75 AP
Oman, OCB	1997	2001	DB	SL	100	10	130	C, G	0	0.000	190	..	89.0	..	30 NE
Pakistan, ADB/P	1961	2000	DB	BL	100	346	7,782	CB	700,000	0.875	1,500	470.0	..	..	88 AP, AD
Pakistan, PBC	1976	1998	AB	BL	100	230	2,300	CB	0	0.000	110	100.0	..	..	100 NE
Philippines, LBP	1963	2001	CB	SL	100	350	8,500	D	2,000,000	..	5,000	2,300.0	..	..	45 AP
Philippines, FDB	1961	2001	CB	BL	0	40	700	D, B	40,000	7.018	398	238.0	..	..	11 AI
Philippines, FMB	1916	2001	CB	BL	..	320	..	D	2,000,000	..	3,700	1,600.0	..	..	.. AP
Polocco Islands, DBSI	1978	1999	DB	SL	100	8	75	S, D	4,100	2.562	10	11.7	..	..	16 AP, AI
South Korea, NACF	1961	2001	AB	CL	0	5,000	..	D, C	..	..	115,000	42,000.0	..	..	30 AP, IC
Sri Lanka, PS/SR	1961	2001	DB	SL	100	515	11,500	D	3,000,000	1.933	1,800	950.0	..	..	10 AP
Syria, ACB	1888	1999	DB	BL	100	110	4,700	D, B	1,100	0.004	3,000	2,000.0	..	..	100 NE
Thailand, BAAC	1966	1998	DB	SL	100	600	13,000	D, B	9,200,000	1.840	650	5.5	..	..	100 AP, BM
Tonga, TDB	1977	2001	DB	SL	100	6	125	G, K	1,800	0.360	19	17.5	..	..	45 AI
Turkey, AB/T	1863	2002	DB	SL	100	1,350	23,000	D, E	20,000,000	29.000	22,000	..	..	..	60 AD
Uzbekistan, Pakhta Bank	1995	2000	CB	BL	0	230	6,742	D, G	16,000	2.000	110	..	100.0	..	10 AP
Vietnam, VBAED	1990	1998	CB	BL	100	2,500	22,134	D, B	3,500,000	1.429	2,700	2,000.0	..	..	75 AP
Yemen, CMCB	1982	2000	DB	BL	86	35	1,000	E, S	900	..	48	22.0	..	..	80 NE, AD

COUNTRY, BANK	ORIGIN DATE	REV. DATE	TYPE	LEGIS	% GOV. OWN	BRANCH	STAFF	SOCIETIES OF FUNDS	LOAN ACCOUNTS	SAVINGS ACCOUNTS	S/L PARTIO	TOTAL ASSET	N. LOANS CUST'G	G. LOANS CUST'G	% AGR. LOANS	MEMBER
Latin America																
Hollivia, MAVIBO	1995	2001	AB	BL	80	..	..	B, S	14	0	0,000	270	228.0	..	..	35 AL
Colombia, BAC	1999	2002	CB	BL	100	700	..	..	..	..	..	1,900	..	500.0	..	70 AL
Dominican Republic, BAHICOCA	..	2002	..	..	..	..	..	..	..	..	..	..	..	..	..	..
Ecuador, BEOE	1976	2001	DB	BL	100	4	..	B, G	250	0	0,000	240	167.0	..	..	15 AL
Ecuador, BNT	..	2002	..	..	..	..	..	..	..	..	..	..	..	..	..	.. AL
Ecuador, CBN	..	2001	AB	..	100	9	..	B, S	..	..	..	575	70.0	..	..	20 AL
El Salvador, BPA	1973	2002	DB	..	100	..	..	..	..	..	..	160	..	81.0	..	.. AL
El Salvador, BMT	1994	2002	DB	SL	100	..	..	CB, B	..	..	..	500	..	290.0	..	.. AL
Chatemala, BDR	..	..	..	..	..	..	..	..	..	..	..	..	..	..	..	.. AL
Honduras, BANADESA	1980	2000	DB	SL	100	35	700	D, K	20,000	50,000	2,500	22	8.0	..	..	91 AL
Mexico, FIRBA	1954	2000	AB	SL	100	160	1,700	CB, B	..	0	..	11	..	..	..	70 AL
Panama, BDA	1973	1998	DB	SL	100	35	700	..	14,000	0	0,000	175	97.0	..	..	100 AL
Paraguay, BNP	1961	..	..	..	100	50	..	..	..	..	..	..	..	..	..	.. AL
Paraguay, CAR	1943	..	DB	SL	..	70	..	G, B	..	..	..	..	..	..	..	90 AL
Paraguay, PGP	1969	2000	DB	..	100	5	..	..	0	..	..	..	46.0	..	..	100 AL
Peru, COFIDE	1992	2001	AB	BL	99	..	120	..	50	0	0,000	..	..	..	..	.. AL
Uruguay, BCU	1896	2001	CB	BL	100	120	4,600	D	465,000	..	..	5,000	..	3,500.0	..	30 AL
Venezuela, FONDARA	1974	..	AB	SL	100	..	..	..	28,000	0	0,000	..	..	..	..	100 AL
Others																
Cyprus, CCS	1937	2000	AB	CL	0	4	190	D	4,400	6,000	1,364	1,150	545.0	..	..	15 BR, IC
Moldova, MAIB	1991	2001	CB	BL	0	45	1,300	D	..	..	..	113	55.0	..	..	12

Legend	
TYPE	SOURCES OF FUNDS
DB	B
CB	C
MFI	CB
AB	D
	E
	G
	S
LEGISLATION	MEMBER
BL	NE
SL	AF
CL	AP
	AD
	AL
	BW
	AI
	MN
	IC
	NEWARACA
	AFRACA
	APRACA
	ADFINI
	ALIDE
	BWTP
	ADFIAP
	Microfinance Network
	ICA

5.3. Type and ownership

Type of institution: Within the filtered data set, 68% of 57 institutions are reported as development banks, 32% as commercial banks.

Table 6: Type of institution

Type of institution	Number	Percent
Development bank	39	68.4
Commercial bank	18	31.6
Total	57	100.0

Government ownership: Bank status overlaps, but is not identical, with government ownership. Among 52 banks with sufficient information, 43 banks (83%) are mainly, and of these 38 fully, government-owned; seven banks are fully private. 89% of development banks and 37.5% of the commercial banks are fully government-owned; 44% of the commercial banks are private. There is a strong statistical correlation between type of institution and government ownership ($r = -0.68; \alpha = 0.000$).

Table 7: Governmental ownership by type of institution

Government ownership	Type of institution				Total
	Development bank		Commercial bank		
	Number	%	Number	%	
Below 50%	0	0	9	56.25	9
Above 50%	36	100.0	7	43.75	43
Total	36	100.0	16	100.0	52

Type of legislation: 31 (60%) out of 52 institutions report registration under banking law, 21 institutions (40%) under special law. All but one commercial bank operate under banking law while development banks operate either under banking law (44%) or special law (56%).

Table 8: Type of institution by type of legislation

Type of legislation	Type of institution				Total
	Development bank		Commercial bank		
	Number	%	Number	%	
Banking law	15	41.7	16	100.0	31
Special law	21	58.3	0	0	21
Total	36	100.0	16	100.0	52

5.4. Size

The banks vary widely by size, as indicated by the minimum and maximum values in Table 9. Three indicators of size are reported here: number of branches, number of staff and total assets. Given the weight of one extreme case, namely the Agricultural Bank of China, the median (*with the same number of cases above and below*) is the most useful statistical measure.

Table 9: Indicators of size

	Mean	Median	Minimum	Maximum
Number of branches	1,422	45	3	50,000
Number of staff	19,003	1,200	75	500,000
Total assets (in US\$ m)	8,771	310	10	190,000

Number of branches: More than half of the banks have less than 50 branches; the smallest has three branches. The Agricultural Bank of China, the biggest bank in terms of branches, has 50,000 branches, which is over 40,000 more than the State Bank of India, which is next in size. The median size is 45 branches.

Table 10: Number of branches

Number of branches	Number	Percent	Cumulative Percent
1 - 10	7	12.7	12.7
11 - 25	9	16.4	29.1
26 - 50	13	23.6	52.7
51 - 100	3	5.4	58.2
101 - 500	11	20.0	78.2
501 - 1,000	4	7.3	85.5
1,001 - 5,000	6	10.9	96.4
More than 5,000 [*]	1	3.6	100.0
Total	55	100.0	
Mean:	1,422		
Median:	45		

* Maximum = 50,000

Number of staff members: 40% of the banks have less than 1000 staff members; the median size is 1,200. The smallest bank has a staff of 75; the biggest bank, the Agricultural Bank of China, has 500,000 staff members, or 10 per branch. The State Bank of India, which is next in size, has 215,000 staff members, or 113 per branch.

Table 11: Number of staff

Number of staff	Number	Percent	Cumulative Percent
75 - 199	9	17.3	17.3
200 - 499	4	7.7	25.0
500 - 999	8	15.4	40.4
1,000 - 4,999	16	30.8	71.2
5,000 - 9,999	4	7.7	78.8
Above 9,999 ^a	11	21.2	100.0
Total	52	100.0	
Mean:	19,003		
Median:	1,200		

a maximum = 500,000

Total assets: Total assets vary from a minimum of US\$10 million to a maximum of \$190,000 million. The median size in terms of total assets is \$310 million. The three biggest banks in terms of total assets account for 81% of all assets recorded in this data bank. They are all from Asia; two are in China (together \$273 billion in total assets); the other one is India (\$93 billion).

Table 12: Total assets (in US\$ million)

Assets in US\$ m	Number	Valid Percent	Cumulative Percent
50	10	18.9	18.9
100	8	15.1	34.0
500	13	24.5	58.5
2,500	8	15.1	73.6
10,000	10	18.9	92.5
above ^a	4	7.5	100.0
Total	53	100.0	
Mean:	8,771		
Median:	310		

a maximum = 190,000

Explaining variance: Using factor analysis, size is the most important factor to explain variance within this data set, explaining 44% of the variance. The rotated¹⁰ component matrix (Table 13) resulting from all variables in the data set indicates that the following variables load highly on a first factor, which we call size of institution: number of branches, number of staff, number of saving accounts, number of loan accounts, total assets and total outstanding net loan balance.

¹⁰ Only the rotated matrix is displayed since the non-rotated solutions may depend randomly on start conditions of the iteration.

There are two other factors, but of lesser importance. Factor 2, which we call development orientation, explains another 20% of variance. It comprises type of institution and percentage of loan portfolio allocated to agriculture (see figures in italics¹¹). Factor 3, type of legislation, explains an additional 15%.

Table 13: Rotated Component Matrix

Factor	Component		
	1	2	3
Type of institution	-.025	-.763	.285
Type of legislation	-.159	.321	-.807
% governmental ownership categorized	.219	.693	-.387
Number of branches	.941	-.072	.157
Number of staff	.912	.072	.210
Number of saving accounts	.894	-.103	-.113
Number of loan accounts	.810	.065	-.062
Total assets (in US\$ m)	.840	.097	.402
Total outstanding net loan balance (US\$ m)	.679	.178	.581
% of loan port. allocated to agric. sector	-.117	.840	.231

Extraction Method: Principal Component Analysis.

Rotation Method: Varimax with Kaiser Normalization.

5.5. Credit

Number of loan accounts: Only 44 banks have indicated the number of loan accounts. They range from a minimum of 250 to a maximum of 5,000,000; the median is 21,000 (Table 14).

Table 14: Loan accounts

Number of loan accounts	Number	Percent	Cumulative Percent
1 - 10,000	15	34.1	34.1
10,001 - 50,000	12	27.3	61.4
50,001 - 100,000	3	6.8	68.2
100,001 - 500,000	5	11.4	79.5
500,001 - 1,000,000	3	6.8	86.4
1,000,001 - 5,000,000	6	13.6	100.0
Total	44	100.0	
Mean:	546,564		
Median:	21,000		

¹¹ The minus at *Type of institution's* loading on factor 2 is due to coding, with *development bank* coded 1 and *commercial bank* coded 2. According to the data, development banks are more likely than commercial banks to allocate their portfolio to agriculture.

Due to a highly skewed distribution (Figure 2), the mean, with 547,000 accounts, differs widely from the median of 21,000.

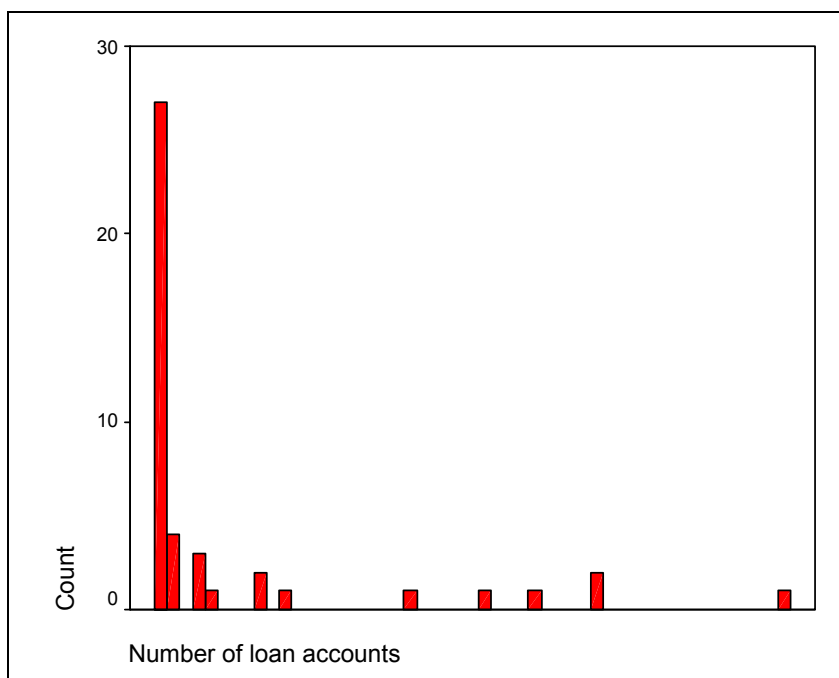


Figure 2: Loan accounts

Net loans outstanding: The distribution of *net loans outstanding*, reported by 45 banks, is similarly skewed, ranging from a minimum of \$2 million to a maximum of \$125 billion (Table 15). The median is \$115 million, the mean \$4,133 million.

Table 15: Total loans outstanding net (US\$ m)

Loans outstanding (net)	Number	Valid Percent	Cumulative Percent
- 50	17	37.8	37.8
- 100	5	11.1	48.9
- 1,000	10	22.2	71.1
- 10,000	11	24.4	95.6
- 100,000	1	2.2	97.8
above	1	2.2	100.0
Total	45	100.0	
Mean:	4,132.7		
Median:	115.0		

As the extremes of the scale cannot be easily captured in a graph, three observations each at the low, middle and high end of the scale are presented in (Table 16).

Table 16: Selected net loans outstanding at the low, middle and high end of the distribution (US\$ m)

Category of net loans	Size of net loans outstanding
Smallest three	3.5
	5.5
	8.0
Middle three	97.0
	115.0
	128.0
Largest three	2,500.0
	35,000.0
	125,000.0

Number of loan accounts and net amounts of loans outstanding correlate highly with number of branches, as measured by Spearman's rho¹². Coefficients are highest for number of branches with number of loan accounts (0.81) and net amount of loans outstanding (0.67) and somewhat lower for number of loan accounts with net amount outstanding. That means, number of branches and number of loan accounts increase simultaneously in our distribution; at the same time, average loan size falls somewhat; therefore there is a small correlation between branches and loans outstanding and an even small correlation between number of loan accounts and amount outstanding.

Table 17: Bivariate correlations (Spearman's rho) between Number of branches, Number of loan accounts and Total loans outstanding (net)

Spearman' rho	Number of loan accounts	Total outstanding net loan balance (US\$ m)
Number of branches	.813**	.669**
Number of loan accounts		.434**

** Correlation is significant at the 0.01 level (2-tailed).

Agricultural lending: Fifty banks indicated the *Percentage of loan portfolio allocated to agriculture*. The lowest percentage given was 10%, the highest 100%. 26% of the banks lend up to 20% of their portfolio to agriculture, 34% more than 80%. There are 11 banks among the 50 that lend exclusively to agriculture. All 17 banks with a more than 80% agricultural portfolio are development banks.

¹² This is more appropriate than Pearson's r, which is more sensitive to extremes.

Table 18: Percentage of loan portion allocated to agricultural sector

% allocated	Number	Percent	Cumulative Percent
Up to 20	13	26.0	26.0
21-40	6	12.0	38.0
60	6	12.0	50.0
80	8	16.0	66.0
99	6	12.0	78.0
100	11	22.0	100.0
Total	50	100.0	
Mean:	58		
Median:	63		

5.6. Savings deposits

44 banks provided information on savings accounts; 31 banks out of the total number of 75 gave no information. 11 of the remaining 44 banks, or 25%, stated they offer no savings deposit services; all of these 11 banks are development banks. The number of savings accounts ranges from zero to 27,000,000. The mean number of savings accounts of the 44 banks is 1,969,952, the median 35,000.

Table 19: Number of saving accounts

Number of savings accounts	Number	Valid Percent	Cumulative Percent
0	11	25.0	25.0
1 - 10,000	6	13.6	38.6
10,001 - 50,000	7	15.9	54.5
50,001 - 100,000	2	4.5	59.1
100,001 - 500,000	5	11.4	70.5
500,001 - 1,000,000	2	4.5	75.0
1,000,001 - 5,000,000	6	13.6	88.6
5,000,001 - 10 m	3	6.8	95.5
above 10 m	2	4.5	100.0
Total	44	100.0	
Mean:	1,969,952		
Median:	35,000		

How the number of savings accounts varies conjointly with the number of branches and loan accounts is shown in the following 3-D surface plot.

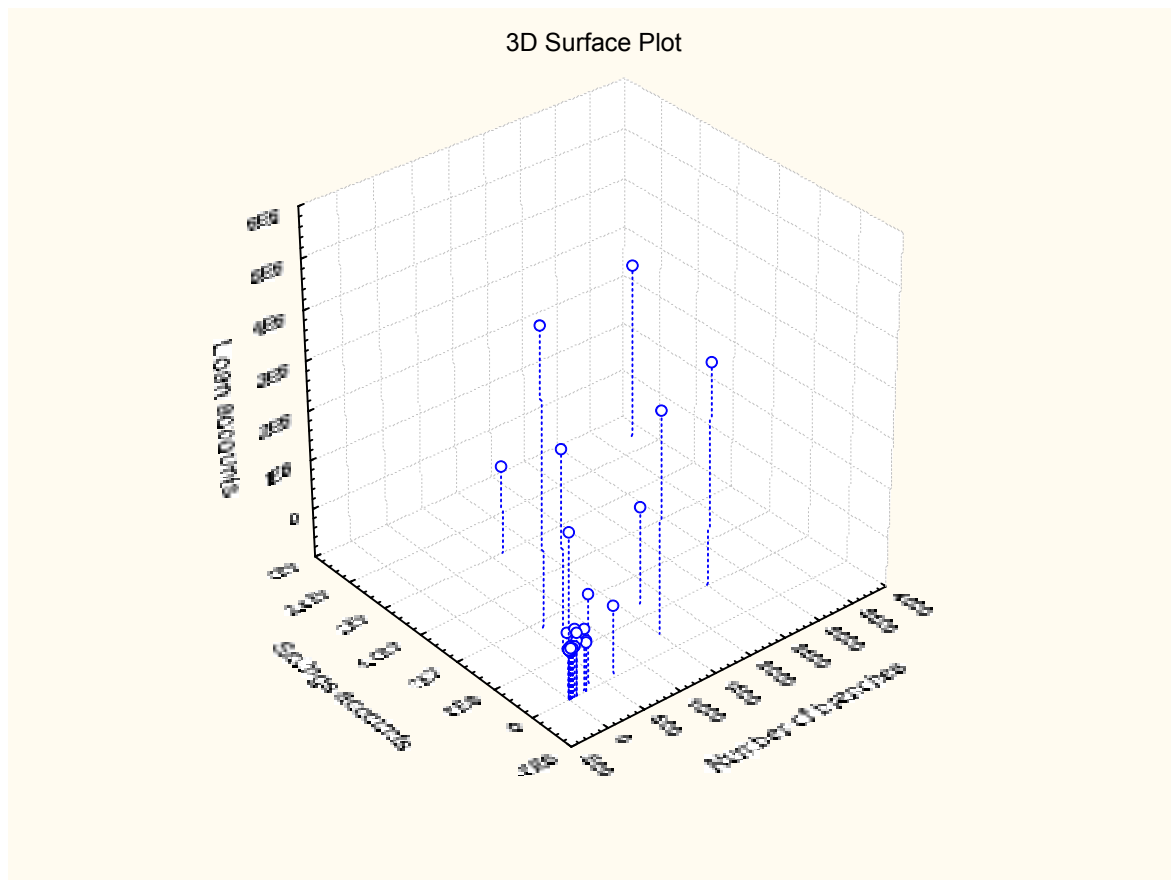


Figure 3: A model for outreach? Savings accounts and Number of branches against Loan accounts (extremes excluded)

5.7. Membership in international associations

Three banks did not join any of the international associations. The majority of 54 banks with valid data holds a single membership. The in the mid 70s established regional agricultural credit associations APRACA, NENARACA and AFRACA, in that order, are the most commonly joined associations. This underlines the importance of these associations for the political dialogue on AgDB reform.

Table 20: Membership in international associations

Association	Number
Asia Pacific Rural and Agricultural Credit Association (APRACA)	19
Near East North Africa Regional Agricultural Credit Association (NENARACA)	14
African Rural and Agricultural Credit Association (AFRACA)	10
Association of Development Financial Institutions in Asia-Pacific (ADFIAP)	6
Asociación Latinoamericana de Instituciones Financieras para el Desarrollo (ALIDE)	5
Association of National Development Finance Institutions in Member Countries of the Islamic Development Bank (ADFIMI)	3
Microfinance Network	3
Banking With The Poor Network	2
International Co-operative Alliance (ICA)	3
No membership	3

6. Case studies of agricultural banks

6.1. Banks preparing for reform

A regional perspective: Two banks in neighboring countries are presented below, both dating back to the Ottoman Bank of Myra, with its head office established in Damascus in 1888. *Myra* means the share of the state as landowner in cereal revenues. The original function was that of a tax-in-kind collection agency rather than a financial intermediary. Both have come a long way to where they are now, ready for reform to a commercially operating rural bank with national outreach. Both banks have participated in the dialogue on agricultural bank reform organized by NENARACA among its member institutions and supported by IFAD. A continual policy dialogue among the member institutions of NENARACA and among the policy makers of the respective countries in North Africa and the Near East might play a crucial role in creating a general climate of agricultural bank reform in the region.

6.1.1. Agricultural Cooperative Bank (ACB), Syria: separating banking from trading

Incipient liberalization of the policy environment: ACB operates within a macro-economically stable, but tightly controlled system. Interest rates and agricultural prices are regulated; the exchange rate is fixed; banks are nationalized. The enactment of a private banking law in 26/9/2001, backed by a new monetary and banking law in March 2002, and the opening of the first private bank on 7 January 2004 are signs of the gradual opening of the economy. To expand growth and well-being to the rural areas where half the population lives, Syria needs an effective rural financial system with a full range of financial services to all segments of the rural population. The access of small producers, women and the poor to adequate deposit services and credit is restricted.

Outreach: With 266,000 borrowers (20% of rural households, 7% of rural adults) and a portfolio of US\$ 461m of loans outstanding in 1999, ACB, has an important role to play in the growth of rural finance. Its main outreach instrument are 6,820 cooperatives, which the bank uses as a channel for microcredit to 215,000 small farmers. 81% of all clients are reached through cooperatives. In terms of amount, direct lending to farmers accounts for 60%. Among the bank's assets are a network of 106 branches all over Syria; a staff of 2,367, 91% of them in the branches; its focus on private farmers and cooperatives (rather than state-owned enterprises); its provision of both credit and deposit services; and its access to judicial process in case of defaulting.

Products: Deposit products comprise current accounts at 4.0% interest p.a.; passbook savings at 8.0%; 6-month term deposits at 7.6% and 12-month term deposits at 8.0%. Total deposits in ACB amount to SP 8.6bn (US\$ 187m) and account for 41% of loans outstanding. The bulk of deposits – 86% - is in current accounts: practically the only type of deposits of the public sector and the cooperatives. The public sector is a small borrower (0.6% of loans outstanding), but a big depositor (73% of all current account deposits and 63% of all deposits). Cooperatives account for 21% of current account deposits and 18%

of total deposits. Private farmers mainly save in passbook savings accounts (withdrawable at any branch): 64% of their deposits are in passbook savings, 8% in term deposits and 28% in current accounts. The deposits of private farmers account for 19.5 % of all deposits.

There are three major types of loans: Seasonal and short-term loans for periods less than 360 days; medium-term loans for period up to 5 years; and long-term loans for 6-10 years. There are seven loan products, with interest rates varying from 4% to 7.5% p.a. Most loans, including all small loans, are at 4%; the highest interest rate is charged on larger-size private loans. Total portfolio in 1999 was SP 21.2 bn (US\$ 461m). In addition, ACB handles a portfolio of SP 668m on behalf of the Ministry of Agriculture and other agencies. Other services are the bank's major business, namely commerce in agricultural inputs, equipment and seeds. Warehouse stocks at the end of 1999 amounted to SP 1.0bn. Fertilizer trading is the single most-important item (69% of warehouse stocks), followed by chemicals and bags.

Performance: The bank faces a mission impossible in its striving for good performance: transaction costs are high due to overstaffing at branch level; and it is compelled to pay the same interest rates on deposits as all other government banks while charging the lowest rates for its services.

During the 70s and 80s, arrears as a percentage of the amount due declined from a high of 40% in 1970 to an all-time low of 2.4% in 1990, reflecting increasing insistence on repayment. This trend was reversed during the first part of the 1990s. Arrears increased from 2.4% to 6% between 1990 and 1994, lingered around 10% during 1995-96 and jumped to an all-time high of 44% in 1999. While the high in arrears ratios was attributed to drought, the reasons for the overall trend from 1970-90 and 1990-1999 have remained unexplained. There is no a write-off policy. Loans are either rescheduled; or carried on the balanced sheet as *loans under settlement*, namely 32% of loans outstanding. In 1974 and 1999/2000, the government rescheduled all loans across the board. The cost of rescheduling were being borne by the government (not the Central Bank!). Rescheduling was combined with total exemption from interest payments and penalties. Interest already paid was deducted from the principal, to be settled against the Bank's profits and provisions. Banking or charity – that is the question.

Box 2: Fifteen trips to the bank for a loan

In July 2001, Samirah applied to ACB for a loan of SP 50,000, repayable over 5 years. Only women are eligible to apply; but according to social etiquette, it is up to the husband to travel to the bank branch for loan negotiations. It took Samirah's husband Barjas 15 visits to the bank branch, plus one visit by the wife to sign the papers. Travel expenses amounted to 16 x 200 = SP 3,200. Each visit took 9 hours. At a rural wage of SP 200, opportunity costs amounted to another 16 x 200 = SP 3,200. Interest payments during the first year are only SP 2,750; but total borrower transaction costs were SP 6,400 – payable up-front. Samirah and her husband Barjas expected disbursement a week after our visit; but if the loan officer of ACB happens to be sick that day, yet another trip might be due.

Credit is subsidized, and the interest rate structure inverted, ie, interest rates on savings deposits tend to exceed lending rates. This has been a disincentive for the bank to mobilize savings. Only 14% of deposits mobilized by ACB are passbook savings and term deposits, leaving a large savings potential untapped and depriving the rural population of an essential service; the balance are current accounts deposits, mainly by state enterprises. The inverted interest rate structure makes banking unprofitable and is a disincentive to lend savings mobilized. This is also the reason why transaction costs are shifted from the bank to the borrower, who incurs heavy non-interest expenses. In response to unprofitable banking, the bank has turned into a trading company.85% of its gross income is derived from input trading and only 15% from banking. Its banking operations are loss-making at a reported margin of 9%; the Bank derives its profits from its trading operations at a margin of 3%.ACB's banking operations are thus cross-subsidized by its commercial operations.

Challenges: Among the Bank's weaknesses are its lack of autonomy resulting in governance problems and a lack of performance orientation in banking; the mixing up of profitable commercial operations with loss-making banking operations; an inverted interest structure which undermines both deposit-taking and lending; a lack of portfolio diversification and of attractive loan products for various market segments and loan purposes; absence of prudential norms under central bank supervision; limited outreach; a weakening credit moral due to recent loan rescheduling and interest exemptions *across the board*; and a lack of management information on portfolio quality.

Reform agenda: Given its importance in rural finance and its potential outreach to vast numbers of small farmers and the rural poor, ACB should now be transformed into a financially sound and growing rural bank, which mobilizes its own resources, covers its costs, has its loans repaid, and finances its expansion from its profits; while its successful commercial wing should be separated as a subsidiary. Transforming ACB into a healthy bank requires:

- ◆ Full bank autonomy under central bank supervision and prudential norms
- ◆ streamlining its organization structure, branch staffing, operational manuals and procedures
- ◆ rationalization of interest rates, replacing directed rates by market rates of interest on loans and deposits
- ◆ vigorous deposit mobilization as a source of funds and as a service to farmers and rural microentrepreneurs to strengthen their self-financing capacity
- ◆ demand-oriented financial products leading to a diversified portfolio
- ◆ timely repayment encouraged by incentives and the offer of repeat loans
- ◆ transforming branches into profit centers and offering performance incentives to staff
- ◆ increasing outreach substantially, especially to small farmers and male or female microentrepreneurs
- ◆ maintaining a high level of portfolio quality, with separate balance sheets for banking and commercial operations
- ◆ accounting and provisioning according to international standards

- ◆ staff (re-) training in commercial rural banking operations.

The crucial and as yet not fully resolved issue is the political will to transform ACB into a viable and sustainable rural bank. This requires a continual policy and reform dialogue between the bank and the policymakers of Syria.

6.1.2. Agricultural Credit Corporation (ACC), Jordan: challenged by the market economy

Banking in a liberal policy environment: Jordan has a growing economy with macro-economic stability and a differentiated banking sector, which is highly liquid. To expand growth and well-being to the rural areas, Jordan also needs a differentiated rural financial system with a full range of financial services to all segments of the rural population, among them small producers, women and the poor in particular. Their access to credit and savings deposit facilities is restricted. Commercial banks and credit NGOs have moved into rural and microfinance, both with high performance standards.

Outreach: ACC has 21 branches, which cover most of the country. Jordan is an urban country; only 20% of its population, or 153,000 households, live in rural areas; 50% of them own land. By end-2002, ACC had a total borrower outreach of 68,550 loans outstanding., which is close to market saturation rate with classical agricultural loans based on land as collateral. Saver outreach is nil. Over the last two years, around 4,200-4,700 new loans were disbursed to clients: significantly less than the long-term average annual disbursement of 6,800 loans. ACC has difficulty attracting new creditworthy clients. Most ACC loans are granted to smallholders. In 2001, 88% of the number and 74% of the value of loans went to clients owning up to 3 hectares, and 89% of the number and 57% of the value of loans were below JD 5,000 (approx. \$7,000¹³). ACC loans outstanding are 2.0% of the entire credit portfolio of the financial system.

Products: Contrary to its original mandate, ACC does not accept deposits, which would be endangered by defaulting. ACC is thus a lending-only institution, with loans outstanding absorbing 93.5% of total liabilities. There are three major loan categories: interest-bearing loans to rural clients, which account for 96% of all loans outstanding (2000); loans on Islamic principles; and housing loans to ACC employees. Loan products are mainly differentiated by duration, comprising seasonal loans up to 11 months, short-term loans for 1-2 years, medium-term loans for 2-10 years and long-term loans for 10-15 years. The bulk of loans (JD 80m) is in the medium-term category. Seasonal loans have recently dropped from JD 20 million in 1999 to JD 3-4 million at the end of 2001 and 2002, while the total number of loans dropped from 8-10,000 in 1999 and 2000 to 4,166 in 2001 and 4,519 in 2002. These figures include loans rescheduled once or several times. Major problems of financial products, which explain part of the decline as well as low client retention rates, include lack of savings products, lack of consumer and non-agricultural loans, excessive loan sizes and loan periods (in order to reduce transaction costs), and frequent rescheduling across the board.

¹³ Exchange rate: JD1 = US\$1.42; US\$1 = JD0.71.

Box 3: Two clients of ACC

Financing a successful horticultural entrepreneur: Tamam, a single woman, is a nurse in the Ministry of Health, where she works in shifts. In Z., she plants vegetables in several large plastic-covered greenhouses, which she transports to the market in her own truck and sells to wholesale traders. She employs three workers. In 1995 she received a first mid-term loan of JD4,000 from the ACC Income Diversification Project to build the greenhouses. JD800 remain outstanding. In 1997 she took a seasonal loan of JD2,000 to plant vegetables. She has paid the interest; but as the loan fell under two government-directed reschedulings in 1998 and 2001, she has not repaid the principal. In May 2001, she took an Islamic loan of JD8,543 with a maturity of 8 years to buy a tractor and install an irrigation system. Monthly deductions from her salary of JD 180 are JD45 for the 1995 loan and JD116 for the 2001 loan. She lives on the income from her vegetable sales. She estimates the value of her investment at JD20,000.

The man who keeps planting olive trees, which all dry up: Omar is 55 years old. He has seven children. In 1991 he received a first loan of JD4,500 with a maturity of 12-15 years for planting 300 olive trees and building a two-room house. The land is located on a dry plain, and the olive trees died. In June 1992, he received an 8-year loan of JD6,000 from an ACC goat smallholder project, which is now fully repaid. In the same year, he planted another 250 olive trees – from his own funds, he says. These also dried up. In 1999, at a time of drought, he replanted another 150 olive trees, again from his own resources. In May 2000 he received a third loan from ACC: JD1,500 to add two rooms to his house. Omar says that all the dairy he produces is consumed by his family; and that there is no other source of income other than his pension of JD 150, from which JD 90 are deducted every month. But why does he keep planting olive trees which all die? “Without an olive tree project, I have to return the loan at once,” he explained.

Performance: ACC was established as a monopoly provider of low-cost agricultural credit at subsidized interest rates. Its health and outreach have been severely curtailed by a political culture of defaulting obscured by frequent interest exemptions and total portfolio restructuring. Repayment rates are low, varying from 66.7% in 1990 to 75.4% in 1999; during that period, overdues amounted to 45% of total assets, 51% of total loans and 137% of total equity.¹⁴ In 1999 all loans were rescheduled by decree, a frequent practice in Jordan, for a period of at least 4 years, affecting 40,762 borrowers, JD 60m in outstandings, and rescheduling periods of 3-10 years. Loan repayments thus started afresh in 2000. In 2002, the repayment rate was 70.5%. Interest rate exemptions were granted in 1985, 1986, 1991, 1994, 1999, 2000 and 2001, affecting a cumulative number of 266,864 borrowers and an amount of JD 32.1m borne by the government. The *New Agricultural Policy Strategy 2003-2010* assessed the impact of these decisions as severely negative for the sustainability of ACC.

Reform agenda: ACC has a limited market; and it serves that market poorly. Under conditions of increasing competition on rural financial markets in Jordan, the government therefore faces two alternatives: to close or reform ACC. Along these lines a decision had been taken in a *Draft Declaration on Rural Finance of 1993*: to transformed ACC into a sound and growing, profitable rural bank, which mobilizes its own resources, covers its costs, has its loans repaid, and finances its expansion from its profits. This, however, was not implemented. Meanwhile, a decision has recently been made at highest level to convert ACC into a bank and transform it along the lines of the declaration of 1993. Transformation requires:

¹⁴ According to an internal report, repayment rate of four branches in the Jordan valley averaged 33% during 1987-94.

- ◆ enforcing timely repayment rigidly and revoking all kinds of loan forgiveness, including rescheduling and interest exemptions
- ◆ cleaning up its portfolio: enforcing recovery of arrears; initiating judiciary process against defaulters; writing off bad debts (overdue longer than one year); having the government-shareholder replenish the capital
- ◆ adopting prudential norms enforced by internal control and central bank supervision
- ◆ adopting bank status under the banking law and central bank supervision
- ◆ diversifying ownership and governance by opening the bank and its board to private shareholders
- ◆ increasing its outreach to all segments of the rural population, including small producers, the landless, low-income groups, and women
- ◆ building up wholesale in addition to retail lending and providing banking services to rural microfinance institutions (MFIs) and self-help groups (SHGs) [*linkage banking*]
- ◆ expanding its delivery structure with sub-branches
- ◆ decentralizing the organization, converting branches into profit-centers
- ◆ providing a full range of financial services, including deposit-taking, lending, money transfer and checking accounts (later also insurance, leasing)
- ◆ offering deposit services, thereby mobilizing its own resources and strengthening the self-financing capacity of small farmers, rural microenterprises and rural industries
- ◆ offering loan products ranging from short-term micro-loans to longer-term medium and big loans, expanding in particular its microlending to women and the poor
- ◆ diversifying its portfolio in response to rural diversification, providing loans for a variety of purposes according to demand
- ◆ rationalizing its procedures for efficient local services
- ◆ adjusting its interest rates to market levels, covering all costs, risks and subsidies and financing its expansion from profits
- ◆ introducing substantial performance incentives tied to real profits of organizational units (thereby capitalizing on the abolishment of civil service status in 1999)
- ◆ retraining its staff.

Given the directives from above, the crucial issue is no longer the political will to transform ACC into a viable and sustainable rural bank, but to actually implement that decision and free the bank from political interference.

6.2. Banks undergoing reform

6.2.1. Bank Keshavarzy, Iran: towards sustainable Islamic banking

History and reform: Bank Keshavarzy (BK) is a dynamic and innovative agricultural bank in government ownership, with a 74-year history. The first window for agricultural credit in Iran was opened in 1930 by the National Bank of Iran (Bank Melli). In 1933, the Agricultural and Industrial Bank was established as a credit fund which neither mobilized savings nor covered its costs. It underwent several changes in structure and name, until it

became the Agricultural Cooperative Bank of Iran (ACBI) in 1969, with the mandate to enhance the state of rural cooperatives and provide short-term credit to small farmers. This was paralleled by the establishment of the Agricultural Development Fund of Iran in 1968 as a financial institution for the emerging commercial farming sector after land reform, converted into the Agricultural Development Bank of Iran (ADBI) in 1972. After the Islamic Revolution of 1979, the banking sector was nationalized, and numerous mergers took place, among them the merger of ACBI and ADBI. Thus originated the Agricultural Bank, or Bank Keshavarzi (BK), in 1979. A new phase started in 1992 when the Bank was transformed into a deposit bank with the mandate to mobilize its own resources and carry out profitable banking operations. This transformation has gained momentum, with self-reliance through resource mobilization and profitable operations and expansion of outreach as top priorities. Among the highlights of the new phase were: expanding the number of branches from 480 to 1700; providing commercial banking services; rationalizing all procedures; retraining staff; computerizing the branches. A proposal for partial privatization and trading at the stock exchange has been submitted to parliament.

Dual mandate: On principle, BK functions as a financial intermediary and universal bank, founded on the ideal of self-reliance. BK's mission is twofold: acting as a development bank implementing the government's objectives; and a commercial bank maximizing shareholder value. While these two objectives are not fully compatible, there is an emerging awareness that commercial banking with its higher profit margin is a prerequisite for the expansion of the bank's business into agriculture, poverty alleviation, microenterprise development and the promotion of women's income-generating activities. Its dynamics are driven by incentive payments through branches as profit centers; incentives include bonuses and extra salaries, through which staff can more than double their regular salary.

Products: Within its rural-agricultural mandate, the bank offers an exceptionally broad array of more than 70 financial products to all segments of the population: mainly small-holders, but also women, low-income groups and commercial farmers. Among them are 19 types of deposit products and 11 types of credit products; BK is also the first Iranian bank to offer web-based services. Deposits are the Bank's main source of funds, accounting for 42.5% of all funds. Domestic borrowings account for 38.2%. In 1999-2000, 66% of loans disbursed went into agriculture including animal husbandry. The Bank divides its lending operations into two major areas, although they are not differentiated in the balance sheet: retail and wholesale loans through cooperatives. Because of excessive defaulting, cooperative lending has declined from 20% of loans disbursed in 1996-97 to 8% in 1999-2000. In addition, BK acts as a handling bank for off-balance sheet government loans to small farmers; and to the private sector within the framework of government projects, in which BK also plays a supervisory role. Through these off-balance sheet operations, BK almost doubles the volume of its lending operations.

Outreach: BK's potential is enormous, but hampered by a combination of macroeconomic factors and government control over banking. BK has a strong orientation to deposit mobilization and self-reliance, portfolio diversification, and profit-making. With 1,700 branches and close to 10m client accounts (in a population of 65m), its saver outreach

(7.7m) and borrower outreach (1.04m) is vast. In a macroeconomic situation of incipient liberalization, it is ready for the transition to sustainable universal banking in rural and urban areas, with a continued focus on agriculture.

Financial performance: Loan collection is in the hands of 1500 collection units, one per branch. During 2000-01, 9.8% of the outstanding portfolio was in arrears (after rescheduling). Rescheduling, combined with interest exemptions at government expense, is decided by parliament in response to natural calamities which are not covered by the Relief Fund. During three out of the four preceding years, loans were rescheduled, affecting about 50% of the portfolio and 589,000 clients during 1999/2000. BK as a government bank is considered a lenient lender, and late repayment is a calculated act: At an interest rate of 16% and a penalty of 6%, total costs of funds to the defaulter are 22%, while the value of the funds on the money market is 40%-50%, depending on the risk of the investment. Over the past six years, BK operated, in nominal terms, at marginal profits and losses. The value of the bank's equity has been substantially reduced through losses and inflation. In 1998-99, paid-up capital stood at RI 419.5bn, while losses amounted to RI 307.4bn, reducing shareholder equity to a mere RI 112.9bn. In 1999-2000, losses amounted to RI 258.9bn. In 2000-01, losses were brought down to RI 2bn. At the same time, government recapitalized the bank, bringing the capital up to RI 755bn (US\$ 93.7m). Capital now amounts to 3.1% of total assets, which is not adequate. To maintain its real value, capital would have to increase at least by the rate of inflation every year.

Making savers and the bank poorer: A major inequity results from a contradiction between a high inflation rate and controlled *profit rates* (the Islamic equivalent to interest rates) on deposits and loans, resulting in negative real returns on deposits and in capital erosion. With real inflation rates around 40% in recent years, depositors lose 40% of the value of their funds every year. At *profit rates* between 0% (Qarz-Al-Hasanah) and 20%, depositors lose between 40% and 20%, respectively, of the value of their money every year. To the same extent, the state unintentionally gains what may be seen as a usurious inflation tax. Borrower-investors are charged 13%-25% by BK. They either gain unduly at the expense of the depositors and the bank; or they invest in low-return activities, thereby hampering personal income and economic growth. The results of this situation are contrary to the principles of Islamic banking and may be interpreted as unintended usury. Gains and losses are unduly and unequitably distributed between depositors, borrower-investors and the state. The gains of the state from the inflation tax and of diligent borrower-investors from loans prized below the real costs of funds are at the expense of vast numbers of depositors and consumers, and of bank capital. This has hampered deposit mobilization and the overall volume of financial intermediation between depositors and borrowers; it has eroded the value of the capital of depositors and the bank; it has slowed down the growth of the Bank's services; and it has restricted the Bank's microfinance services the cost of which cannot be covered from the income of financial operations. Ultimately, this has distorted rural financial markets and undermined development. Low-income groups have been particularly affected: either by the negative real returns on their savings; or by the lack of access to credit.

Two related strategies are suggested: (a) bringing down the inflation rate; and (b) adjusting the *profit rate* structure, setting rates on deposits above the inflation rate and equating them with cost of funds in the determination of lending rates. This would create a conducive environment in which BK would then vigorously mobilize its own resources, remunerate its depositors fairly and adequately, provide a full range of financial services to all segments of the population, have its loans repaid on time, increase the income and motivation of its staff through higher incentive payments, and finance its expansion from its profits while preserving the value of its capital. (Seibel 2002b)

6.2.2. Bank for Agriculture and Agricultural Cooperatives (BAAC), Thailand: gradual reforms against obstacles of financial repression

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:

- ◆ 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: 88% 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)

6.3. Reformed banks

6.3.1. Bank Rakyat Indonesia (BRI), Microbanking Division: an Asian flagship of reform

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, 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 3,000-plus rural outlets (*unit desa*, established at sub-district level) of hitherto subsidized credit into self-sustaining profit centres (Kuiper, 2004).

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: From the inception of the reformed scheme in 2/1984 until 6/2003, a total of 31.5m loans were made. As of 6/2003, it served 3.0m borrowers; loans outstanding amounted to Rp. 13.18tr (US\$1.6bn; or \$527 per borrower). The number of savings accounts had grown to 29.2m, amounting to Rs. 24.68tr (\$3.0bn; or \$102 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).¹⁵

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 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 2003¹⁶. After 20 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.

¹⁵ Outside the formal and semiformal sector are some 800,000 channeling groups and the ubiquitous *arisan*, a grassroots institution of most of the poor as well as the non-poor. Despite the extraordinarily high level of institutional differentiation, some 50% of rural households are reported to remain without access to formal and semiformal finance.

¹⁶ 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.

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 KUPEDDES 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.

Strong microfinance units in a weak bank: 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 it is only one of three divisions, accounting for 34% of total assets, 31% of loans outstanding and 41% of deposits in 2001. However, the bank as a whole had accumulated losses in 1999, 2000 and 2001 of US\$3.98bn, 2.81bn and 2.51bn, respectively. The units have cross-subsidized the bank in two ways: through the continual transfer of profits from the units to the consolidated bank; and through the siphoning off of savings mobilized at village level to the branches.

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 ten years consistently above US\$1bn per year. These levels have been highest during the crisis years 1998 and 1999, with \$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. The units are required to place their excess liquidity with the BRI branch system; net placements amounted to \$1,60bn in 1999, \$1.24bn in 2000 and \$1.23bn in 2001 (Hiemann 2003:83). With its individual lending technology and no outreach mechanism to villages beyond the subdistrict towns, 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, among them the poor and the near-poor).

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.

Table 21. Performance data of BRI units, 1984-6/2003

Year	Savings deposits		Loans outstanding		Savings to loan ratio	* Excess liquidity in bn US\$	12-month loss ratio	Arrears ratio**	Return on assets
	No. of accounts	Amount in billion Rp	No. of accounts	Amount in billion Rp					
1984	2,655	42.2	640,746	111.1	38%	(0.06)	1,0%	5.4%	n.a.
1985	36,563	84.9	1,034,532	229.0	37%	(0.13)	1,8%	2.1%	n.a.
1986	418,945	175.8	1,231,723	334.3	53%	(0.10)	2,7%	4.5%	n.a.
1987	4,183,983	287.5	1,314,780	429.6	67%	(0.09)	3,0%	5.8%	n.a.
1988	4,998,038	493.0	1,386,035	542.3	91%	(0.03)	4,6%	7.4%	n.a.
1989	6,261,988	959.1	1,643,980	846.5	113%	0.06	2,3%	5.4%	n.a.
1990	7,262,509	1,694.8	1,893,138	1,381.8	123%	0.16	2,0%	4.1%	3.0%
1991	8,587,872	2,540.5	1,837,549	1,455.7	174%	0.54	4,9%	8.6%	2.7%
1992	9,953,294	3,399.1	1,831,732	1,648.5	206%	0.85	3,4%	9.1%	2.6%
1993	11,431,078	4,325.2	1,895,965	1,957.4	221%	1.13	2,2%	6.5%	3.3%
1994	13,066,854	5,231.9	2,053,919	2,458.1	213%	1.26	0,7%	4.5%	5.1%
1995	14,482,763	6,015.7	2,263,767	3,191.2	188%	1.24	1,1%	3.5%	6.5%
1996	16,147,260	7,091.7	2,488,135	4,076.2	174%	1.29	1,6%	3.7%	5.7%
1997	18,143,316	8,836.5	2,615,679	4,685.4	189%	1.14	2,2%	4.7%	4.7%
1998	21,698,594	16,146.0	2,457,652	4,696.8	344%	1.43	1,94%	5.7%	4.9%
1999	24,235,889	17,061.4	2,473,923	5,956.5	286%	1.56	1.72%	3.1%	6.1%
2000	25,823,228	19,114.8	2,715,609	7,827.3	244%	1.17	1.11%	2.5%	5.7%
2001	27,045,184	21,990.6	2,790,192	9,873.1	223%	1.17	0.53%	2.2%	5.8%
2002	28,262,073	23,480.4	3,056,103	12,010.8	195%	1.28	1.66%	1.6%	6.4%
6/2003	29,201,210	24,683.1	3,028,633	13,175.0	187%	1.39	1.83%	2.2%	5.4%

Source: Laporan Statistik BRI Unit, June 2003

* Calculated by the author on the basis of year-end exchange rates.

** Total payments overdue one day or more in % of total loans outstanding, excluding loans written off.

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, which went public in October 2003, what the answer should be to the question, *Agricultural Development Banks: Close Them or Reform Them?*¹⁷ It is this experience which BRI is prepared to share with others through an institutionalised exposure visit and training program.¹⁸

¹⁷ 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.

¹⁸ International Visitor Program SBU Micro Banking, BRI, Jakarta. Fax 62-21-2511644, 2513013; ivp@bri.co.id, ivpbri@cbn.net.id.

6.3.2. Centenary Rural Development Bank (CRDB), Uganda: an African flagship of reform

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 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;¹⁹ (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 low²⁰ 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 4: 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 acquired a 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 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.

¹⁹ This compares favorably to commercial bank prime rates of 25-26% in 2000.

²⁰ Reasons are a banking crisis and excessively high TB rates in the latter 90s.

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.

6.3.3. 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)²¹ 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.

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

²¹ Exchange rate on 31/12/2000: \$1 = DT 1.3683; DT1 = \$0.733.

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 in the 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. If its exposure-training services are to be used systematically, they would have to be provided on a professional, cost-covering basis. The establishment of such a service could greatly benefit, during the start-up phase, from donor support, until it attains self-sufficiency.

7. Reforming agricultural development banks

7.1. New initiatives by donors and agricultural bank associations

How best to initiate reform is an issue to be discussed in a participatory manner, in two forums: 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:

- ◆ Various German Government financed projects in Asia with APRACA member institutions (BAAC, NABARD, People's Bank of Sri Lanka, Agricultural Development Bank of Nepal) implemented by GTZ in order to support savings mobilization, linking self-help groups with AgDB and introducing microfinance technology
- ◆ A joint IFAD/FAO/World Bank initiative on the restructuring of AgDBs in 1999-2000²²
- ◆ The establishment of a CGAP Working Group on AgDB Reform in 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)
- ◆ Preliminary agreements with the regional agricultural credit associations as partner organizations of FAO, IFAD and GTZ: AFRACA (Nairobi), APRACA (Bangkok) and NENARACA (Amman) on workshops to initiate reform among member AgDBs; and presentations at their respective regional and subregional workshops during 2000 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
 - 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

²² 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.

- ◆ A conference in January 2003 on public banks with a rural-agricultural mandate, held in Sri Lanka with support from GTZ in cooperation with APRACA.

These discussions have intended 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 including GTZ with the concerned governments.

The three RACAs summarized their appeal for agricultural bank reform as follows:

AFRACA:

(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*)

APRACA:

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*)

NENARACA:

(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*)

These appeals were followed by a number of studies of agricultural and public banks, supported mainly by IFAD and GTZ, some of which have been summarized in the previous chapter.

7.2. A Planning Framework for Rural and Agricultural Development Bank reform

In the deliberations on agricultural bank reform by the three RACAs, their member organizations and several donor agencies including FAO, IFAD and GTZ, the following **objective** was agreed upon:

Rural, agricultural and agricultural development banks (AgDBs) 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** are to be achieved:

- ◆ activating the political will to reform or to close down the banks
- ◆ 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 agricultural banks a planning framework has been prepared (IFAD 2000; Ijioma 2000; Mustafa 2000; Seibel 2000, 2001). (**Annex 2**)

AgDB reform exceeds the capacity of any single donors and will require **partnerships** between several financial and technical assistance agencies. Close cooperation of donors with agencies such as multilateral and bilateral donors, CGAP, the RACAs and other agencies is expected to contribute to the generation of the political will to reform. Some donors, like the World Bank, may concentrate on the reform of the relevant policy and legal environment; regional development banks may focus on the restructuring and recapitalization of the banks; bilateral donors, like USAID and GTZ, together with bank associations in their respective home countries, may concentrate on the professionalization of management; others, like IFAD and UNCDF together with bilaterals and perhaps international NGOs, may put a special focus on the reform of the banks' microfinance services, retail and wholesale, to smallholders, micro-entrepreneurs and the poor, including their self-help groups, informal financial institutions, business associations and supporting NGOs.

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Annex 1: Names and abbreviations of banks in the *AgriBank-Stat* inventory

NAME	COUNTY, ABBREVIATION
Agribank of Namibia	Namibia, AN
Agricultural Bank of China	China, ABC
Agricultural Bank of Iran	Iran, AB/I
Agricultural Bank of Libya	Libya, ABL
Agricultural Bank of Sudan	Sudan, ABS
Agricultural Bank of Turkey	Turkey, AB/T
Agricultural Bank of Zimbabwe	Zimbabwe, ABZ
Agricultural Coop Bank Syria	Syria, ACB
Agricultural Credit Corporation Jordan	Jordan, ACC
Agricultural Dev. Bank Ghana	Ghana, ADB/G
Agricultural Dev. Bank Nepal (ADBN)	Nepal, ADB/N
Agricultural Dev. Bank of China	China, ADB/C
Agricultural Dev. Bank of Pakistan	Pakistan, ADB/P
Agricultural Finance Corporation Kenya	Kenya, AFC
Banco Agraio de Colombia	Colombia, BAC
Banco Agrícola de la República Dominicana (BAGRICOLA)	Dominican Republic, BAGRICOLA
Banco de Desarrollo Agropecuario Panama	Panama, BDA
Banco de Fomento Agropecuario El Salvador	El Salvador, BFA
Banco del Estado del Ecuador (BEDE)	Ecuador, BEDE
Banco Desarrollo Rural Guatemala	Guatemala, BDR
Banco Multisectorial de Inversiones (BMI) El Salvador	El Salvador, BMI
Banco Nacional de Desarrollo Agrícola (BANADESA) Honduras	Honduras, BANADESA
Banco Nacional de Fomento (BNF) Ecuador	Ecuador, BNF
Banco Nacional de Fomento (BNF) Paraguay	Paraguay, BNF
Banco República Uruguay	Uruguay, BRU
Bank BUKOPIN Indonesia	Indonesia, BUKOPIN
Bank for Agriculture and Agricultural Cooperatives (BAAC) Thailand	Thailand, BAAC
Bank Pertanian Malaysia	Malaysia, BP
Bank Rakyat Indonesia - Unit Desa	Indonesia, BRI-Units
Banque Agricole et Commerciale du Burkina	Burkina Faso, BAC
Banque de l'Agriculture et du Développement Rural Algeria	Algeria, BADR
Banque Nationale Agricole Tunisia	Tunisia, BNA
Banque Nationale de Développement Agricole Mali	Mali, BNDA
Bhutan Development Finance Corporation	Bhutan, BDFC
Caisse Nationale de Crédit Agricole (CNCA), Morocco	Morocco, CNCA
Caisse Nationale de Crédit Agricole du Sénégal	Senegal, CNCA
Centenary Rural Development Bank Ltd (CERUDEB), Uganda	Uganda, CERUDEB
Cooperative & Agricultural Credit Bank, Yemen	Yemen, CACB
Co-operative Bank of Kenya Ltd	Kenya, CBK

Co-operative Central Bank Ltd, Cyprus	Cyprus, CCB
Corporación Financiera Nacional	Ecuador, CFN
Corporación Financiera de Desarrollo S.A. (COFIDE), Peru	Peru, COFIDE
Crédito Agrícola de Habitación, Paraguay	Paraguay, CAH
Development Bank of Ethiopia	Ethiopia, DBE
Development Bank of Solomon Islands	Solomon Islands, DBSI
Farmer's Commercial Bank, Sudan	Sudan, FCB
Federal Bank for Cooperatives, Pakistan	Pakistan, FBC
Fideicomisos Instituidos en Relación... FIRA, Mexico	Mexico, FIRA
Fiji Development Bank	Fiji, FDB
Fondo de Desarrollo Agropecuario, Pesquero, Forestal y Afines (FONDAFA), Venezuela	Venezuela, FONDAFA
Fondo Ganadero del Paraguay	Paraguay, FGP
Islamic Cooperative Development Bank of Sudan	Sudan, ICDB
Joint-Stock Commercial Pakhta - Bank of Uzbekistan	Uzbekistan, Pakhta Bank
Kafo Jiginew, Mali	Mali, KJ
Kenya - Rep Bank	Kenya, K-Rep
Kyrgyz Agricultural Finance Corporation (KAFC)	Kyrgyzstan, KAFC
Land Bank of the Philippines	Philippines, LBP
Land Bank South Africa	South Africa, LB
Moldova-Agroindbank	Moldova, MAIB
Myanmar Agricultural Development Bank	Myanmar, MADB
National Agricultural Cooperative Federation (NACF), South Korea	South Korea, NACF
National Bank for Agriculture and Rural Development (NABARD), India	India, NABARD
National Development Bank, Botswana	Botswana, NDB
National Financiera Boliviana SAM (NAFIBO)	Bolivia, NAFIBO
Nigerian Agricultural and Co-operative Bank Ltd	Nigeria, NACB
Oman Development Bank (S.A.O.G.)	Oman, ODB
Oriental Bank of Commerce, India	India, OBC
People's Bank, Sri Lanka	Sri Lanka, PB/SR
Philippine National Bank	Philippines, PNB
Planters Development Bank, Philippines	Philippines, PDB
Principal Bank for Development & Agricultural Credit, Egypt	Egypt, PBDAC
State Bank of India	India, SBI
Tonga Development Bank	Tonga, TDB
Uganda Women Finance Trust Ltd.	Uganda, UWFT
Vietnam Bank for Agriculture and Rural Development	Vietnam, VBARD

Annex 2: Rural and agricultural development bank reform: a participatory planning framework

Objective: Rural and agricultural development banks (AgDBs) are transformed into sustainable providers of financial services to the rural population	Steps taken
Key results and outputs:	
1. The political will to reform the AgDB is activated: <ul style="list-style-type: none"> 1.1 The political decision is taken by government to reform its AgDB 1.2 A 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: <ul style="list-style-type: none"> 2.1 Alternative reform strategies are examined including: 2.2 government-owned AgDB under autonomous management 2.3 government-owned AgDB under commercial bank management 2.4 full or partial privatization 2.5 transformation of microbanking operations into user-owned local financial institutions 2.6 closure or fusion 2.7 Appropriate reform strategies are selected 2.8 Adequate process technologies are developed 2.9 Implementation phases of the reform process are determined and periodically revised 2.10 Logistic support of multilateral institutions is secured 2.11 Reform strategies of international financial institutions are coordinated 	
3. The planning process is implemented: <ul style="list-style-type: none"> 3.1 A feasibility study is carried out 3.2 An operational plan for the implementation of the reform process is prepared 3.3 External 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: <ul style="list-style-type: none"> 4.1 The AgDB is granted operational autonomy 4.2 A commercially experienced, politically independent general manager is appointed 4.3 The Central Bank or Bank Superintendency enforces the attainment of operational autonomy 	
5. An appropriate legal and regulatory framework is provided: <ul style="list-style-type: none"> 5.1 A dialogue is initiated on the policy, legal and regulatory framework conducive to AgDB reform 5.2 The ADB law is revised 5.3 Politically motivated loan forgiveness is excluded by law 5.4 Prudential norms are defined and enforced 	
6. The AgDB's finances are restructured: <ul style="list-style-type: none"> 6.1 The portfolio is cleaned 6.2 The bank is recapitalized 	

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