



Handbook on Best Practices in Agri/Rural Finance



Agricultural Credit Department
State Bank of Pakistan
www.sbp.org.pk

The Team

Name	Designation	Contact
Muhammad Ashraf Khan	Director	(92-21) 9217216 ashraf.khan@sbp.org.pk
Kamran Akram Bakhshi	Joint Director	(92-21) 9217241 kamran.akram@sbp.org.pk
Abdus Saboor	Assistant Director	(92-21) 2455934 abdus.saboor@sbp.org.pk
Syed Ali Raza	Agricultural Credit Officer	(92-21) 2455934 raza.syed@sbp.org.pk

Preface

The provision of affordable financial services to the rural population has been a prime component of development strategy for several decades. Governments, development agencies, and other donors have supported various agri/ rural financial institutions to accelerate the rate of growth and alleviate poverty, especially in the rural areas.

Financing development in rural areas, where majority of the poor in developing countries lives, is one of the most pressing concerns of governments. The agri / rural sector in developing world not only generates employment, income, and foreign exchange from agriculture and off-farm rural activities, but also provides markets, labor & raw material inputs to manufacturing and other urban industries. Failure of the agri/ rural sector to grow along with other sectors impedes the overall progress of an economy.

Like many developing countries, agriculture is the backbone of Pakistan's economy. Agriculture in Pakistan provides food to consumers and fibre for domestic industry; it provides livelihood and employment to the majority of the country's population, and is the major source, directly and indirectly, of the country's export earnings.

State Bank of Pakistan, in line with government's declared priority for agriculture sector, has been endeavoring for the past so many decades to ensure flow of sufficient, timely and cost effective funds to agriculture sector. While substantial progress has been made in this respect, there is still ample room for further improvement. With the expansion in the size of the agriculture sector, the financing needs of the sector are also increasing and there are significant opportunities for banks to deploy their funds in such remunerative avenues. SBP has created a Development Finance group for the development of banks' financing in the areas of agriculture, SME, microfinance, and infrastructure & housing. Further, Development Finance Support Department has been established at SBP-BSC for the effective implementation of policies/ schemes in the areas at grass root level. Under restructuring, the role of ACD has been enhanced to meet farm as well as non farm credit requirements of the people living in rural areas. For awareness building and research on international best practices vis-à-vis Pakistan's experience in agri/rural finance, the Governor, State Bank of Pakistan has desired the publication of a handbook by the Agricultural Credit Department (ACD). This Handbook provides an overview of the policies and strategies of some of the successful institutions in the field of agri/ rural finance and highlights their key achievements in terms of vast outreach, high rate of recovery, sustainability as well as profitability, and most importantly the increasing level of confidence of their clients in those institutions which is depicted in their vertical & horizontal expansion. This Handbook will help banks to revise and devise their lending strategies to grasp the vast untapped agri/ rural market.

XXXXXXXXXX

Table of Contents

1. Introduction.....	1
2. Conceptual Framework	2
2.1. Rural Finance.....	2
2.2. Agriculture Finance.....	2
2.3. Agricultural Microfinance.....	2
2.4. Rural Finance Innovations	2
2.5. Best Practices	2
2.6. Financial Sustainability	3
2.7. Client Outreach	3
3. Paradigm Shift	4
3.1. Old Rural Finance Paradigm	4
3.2. New Rural Finance Paradigm.....	5
3.3. Value Chain Approach	5
4. Agri/ Rural Finance Institutions in Pakistan.....	6
4.1. Historical Background	6
4.2. Importance of Agri/ Rural Finance	7
4.3. SBP’s Initiatives in Agri/Rural Credit	7
4.4. Impact of SBP’s Initiatives	8
4.5. Constraints Issues in Agri/rural Financing	8
4.6. Future Outlook	9
5. International Best Practices.....	10
5.1. Bank for Agriculture and Agricultural Cooperatives (BAAC), Thailand	10
5.2. Land Bank of the Philippines.....	14
5.3. Bank Rakyat Indonesia.....	17
5.4. Grameen Bank, Bangladesh	20
5.5. BANRURAL S.A. Guatemala	23
5.6. ACLEDA Bank, Cambodia	25
6. Conclusion	28
7. Summary of Operating Methods, Performance, etc. of Financial Institutions	30

Acronyms

ABL	Allied Bank Limited
ACD	Agricultural Credit Department
ADB	Asian Development Bank
BAAC	Bank for Agriculture & Agricultural Cooperatives
BRI	Bank Rakyat Indonesia
FAO	Food & Agriculture Organization
FBC	Federal Bank for Cooperatives
GB	Grameen Bank
HBL	Habib Bank Limited
MCB	MCB Bank Limited
MFI	Micro Finance Institutions
MINFAL	Ministry of Food, Agriculture & Livestock
NBP	National Bank of Pakistan
PPCBL	Punjab Provincial Cooperative Bank Limited
RF	Rural Finance
RFIs	Rural Finance Institutions
SBP	State Bank of Pakistan
SMEs	Small and Medium Enterprises
UBL	United Bank Limited
WB	World Bank
ZTBL	Zarai Taraqiati Bank Limited

1. Introduction

Notwithstanding a worldwide recognition of the fundamental importance of rural sector in an economy, the state of rural financial markets in developing countries is characterized by low and decreasing availability of financing for both agricultural and non-agricultural activities. In developing countries and transitional economies, only a very few rural masses have access to financial services. Rural areas are often characterized by a paucity of viable financial institutions and lack of variety of financial services available. Rural communities often do not have access to saving options, credit services, insurance, or transaction services. Besides, limited access to long-term financing needed for agriculture, land improvement and other rural activities is also a hindering factor in the improvement of agri/rural sector. With these odd features, the agri/rural sector presents a real challenge to the design of sustainable financial intermediaries.

Since the emergence of financial inclusion as an effective tool for sustained economic growth, social stability and poverty reduction, it has become imperative to devise a result oriented agri/rural finance strategy in developing economies. With the aim in mind, State Bank of Pakistan is striving to develop a sound and sustainable agri/ rural financial sector in the country. It stands to reason that SBP has taken many initiatives to create an enabling environment for banks to adopt agri/ rural credit as a viable business line. These initiatives have resulted in substantial increase in agri. credit in the last 6-7 years; however, outreach remained almost stagnant. This appears to be only one manifestation of banks' reliance on traditional lending approaches and their lack of awareness

regarding international best practices in agri/ rural finance. Therefore, for capacity building of financial institutions, this Handbook has been prepared comprising of some very important lessons that have been learnt from the experiences of different financial institutions, which can provide such useful guidelines to banks that could help them adopt agri/ rural finance as a viable business line.

The information has been taken from various publications of World Bank, FAO, ADB, and other International Organizations in addition to websites of financial institutions. The Handbook examines the lessons from best practices in agri/ rural finance. It identifies recent advances, current issues, major gaps, challenges, opportunities and efforts to expand and strengthen banks' financing to rural community. It is hoped that it will help and enable banks working in Pakistan to improve the services and products they offer to rural clients in the country.

The Handbook is divided into six sections. After Introduction, the second section briefly describes the terminologies of agri/rural finance. Section three elaborates different paradigms and emerging policy framework in rural finance. The fourth section provides an overview of Pakistan's agri. financing structure, issues and constraints in enhancing agricultural credit through financial sector, followed by the fifth section, describing successful practices of financial institutions in agri/ rural finance. Conclusion has been drawn at the end comprising of summary of key learnings from the financial institutions, which can benefit the banks likely to go in a big way in agri/rural finance in the country.

2. Conceptual Framework

There has been a tendency among researchers and practitioners to interchangeably use the terms rural finance, agriculture finance and microfinance. Nevertheless, there is an agreement on the term 'rural finance' as covering the broad range of financial services to the rural masses i.e. the finance is not limited to credit only. The range of services includes the following:

- Intermediation, which involves mobilizing and transferring of savings from surplus to deficit units.
- Safe, liquid and convenient savings (deposit) facilities.
- Access to credit facilities tailored to the needs of rural population.
- Systems for effecting payments and transferring remittances as well as general insurance cover against variability in output, price and market uncertainties.

In this book, the following operational distinctions of various terms used, have been adopted:

2.1. Rural Finance

Rural finance, as defined by the World Bank (WB Report-2004), includes a range of financial services such as savings, credit, payments and insurance to rural individuals, households, and enterprises, both farm and non-farm, on a sustainable basis. It includes financing for agriculture and agro-processing/ agribusiness.

2.2. Agriculture Finance

Agriculture finance is defined as a subset of rural finance dedicated to financing for agricultural related activities viz. input supply, production, processing, and marketing.

2.3. Agricultural Microfinance

Microfinance is the provision of financial services for poor and low income people and also covers the lower ends of both rural and agriculture finance. It includes financing both in rural and urban areas. Consistent with these operational distinctions, agricultural microfinance can be defined as referring to the overlap of agriculture finance and microfinance dedicated to providing financial services to poor agricultural households.

2.4. Rural Finance Innovations

A financial innovation can be defined as something new that resulted from a deliberate change to an existing financial product, process or delivery system. The innovation can take the form of a new financial product or financial service (product innovation), a new process or methodology (process innovation) or a new organizational form or structure of delivery system (system or institutional innovations).

The innovation is understood to have occurred or have operated within a particular context or environment. The particular relevant context may be at macro (national level) or meso level (at the immediate environment, e.g. communities where the organization operates). A particular innovation needs to be contextualized under these particular enabling conditions (or constraints) in which it operates.

2.5. Best Practices

An innovation is considered a "good practice" if such innovation has produced positive outcomes in terms of financial sustainability and improved client outreach. "Best practice" on the other hand is

understood as the outstanding practice in the particular process or function, i.e. producing the best results, among those in the same industry.

2.6. Financial Sustainability

Financial sustainability means that the organization is able to continue the financial services on a long term basis. Two core

measures in this regard are; sustainability of operations, and sustainability of fund base.

2.7. Client Outreach

Client outreach would include either or both “breadth” (number of rural clients serviced) or “depth” (how poor the clients were that are being serviced).

3. Paradigm Shift

Several paradigms and policies have been used in developing countries to address the difficult and costly problems of providing financial services in rural areas. The old rural finance (RF) paradigm dates back to 1960s and 1970s. Based on lessons learnt from the old paradigm and revised financial systems approach, the new RF paradigm emerged in the late 1980s which gained a broader consensus in the 1990s.

3.1. Old Rural Finance Paradigm

Rural Finance got momentum in 1960s and 1970s all around the world, particularly in Asia and Latin America. Many rural credit projects were taken up under public sectors. Since the special costs and risks were involved in RF that made formal financial institutions reluctant to extend & expand credit facilities in rural areas, therefore, governments and donors were urged to intervene in rural financial markets. Following types of interventions were advocated by the researchers/practitioners under this paradigm:

- lending quotas on banks and other financial institutions,
- refinance schemes,
- loans at preferential interest rates,
- credit guarantees,
- targeted lending by development finance institutions (DFIs)

These targeted RF programs were expected to promote agricultural development. The interventions were intended to increase rural lending by reducing costs and risks to lenders that made loans preferable to rural clients and sectors. Subsidized interest rates and loan waivers or write-offs were also used to reduce the debt burden of priority-sector borrowers, especially followed by natural calamities such as floods, droughts, and periods of low farm prices. Credit was regarded as an important means to speed up agricultural

development, promote small farmers, reduce poverty, and ensure cheap food supplies to urban areas. This approach was invariably supported by multilateral and bilateral donors.

This approach helped some developing countries, especially in Asia, to improve agricultural yields in the short-term. But it was not sustainable over the long term. It was also costly, and failed to reach the majority of rural households. As such, it was unable to achieve the intended objectives of increasing rural incomes, reducing rural poverty and stimulating asset formation. The focus on lending to agriculture sector, for farming purposes only, ignored the potential benefits of supporting growth-intensive investments in rural areas which would be more appropriate for the rural poor or small non-farm rural enterprises/ activities.

Subsidized interest rates did not cover the costs, as such rural financial institutions (RFIs) became unviable and they lost the confidence of depositors. There was a huge build up of non-performing loans since cheap credit encouraged unprofitable investments and led to a concentration of loan portfolios in hands of the rich and powerful. Subsidized agricultural credit often resulted in production inefficiencies by targeting the wrong products and creating artificial preference for capital-intensive investments that “crowded out” abundant labor in rural areas. In some cases borrowers intentionally defaulted because they believed that governments would waive or write-off their loans or not take action against defaulters in priority sectors. Financial discipline was damaged and intermediaries weakened. Several development finance institutions became insolvent and were closed or had to be reorganized.

3.2. New Rural Finance Paradigm

After the ill-fate of majority of the RF programs under the old paradigm, microfinance providers, such as NGOs and credit unions emerged in the late 1970s. They targeted the unbanked poor, who had been left out by the huge investments made in financial market under old paradigm. These microfinance institutions in fact brought about the revolution by proving that the poor are bankable, but the customary banking system had failed to serve them appropriately.

Based on the lessons learnt from the old paradigm and the emerging microfinance revolution, the new RF paradigm began to emerge in the late 1980s which gained momentum in the mid 1990s. The new paradigm adopts a financial systems approach, using market principles to deliver financial services in rural areas. This system is aimed at facilitating rural development that, in turn, will promote asset creation and poverty reduction. The new paradigm treats finance as a way to expand and integrate markets, rather than as a policy tool for targeting a specific segment of the market. The new RF

paradigm is based on the principle that a commercial and market-based approach is most likely to reach large numbers of clients on a sustained basis. It recognizes that financial services are part of an interactive system of financial infrastructure and social and cultural norms. Government has a role to play in establishing a favorable or “enabling” policy environment, infrastructure & information systems, and supervisory structures to facilitate the smooth functioning of rural financial markets, but it should play a more limited role in direct interventions.

3.3. Value Chain Approach

The value-chain approach is currently emerging as an important tool to study the new production and marketing relationships that have evolved due to economic globalization and the commercialization of agriculture. The value-chain approach considers economic activities, clusters, and sub-sectors as a continuous chain with value addition at each successive link. It helps analyze the value added at each chain link related to the rural economic activities and clusters of activities that convert raw materials into finished products and then market them.

4. Agri/ Rural Finance Institutions in Pakistan

4.1. Historical Background

In Pakistan, agricultural credit market consists of formal and informal providers of credit. Formal lenders are: specialized banks like Zarai Taraqiati Bank Ltd. (ZTBL) and Punjab Provincial Cooperative Bank Ltd. (PPCBL) and commercial banks, while the later comprises of illegal money lenders, friends and relatives, village shopkeepers and commission agents, etc. The predominant share of credit is provided by the informal sources of credit in the country.

In order to overcome this inadequacy, two specialized institutions i.e. Agricultural Development Finance Corporation and the Agricultural Bank were established in 1950s. Subsequently, these institutions were merged to form the Agricultural Development Bank of Pakistan (ADBP) in 1961 (Now called ZTBL).

Prior to 1972, commercial banks' loans portfolio in agriculture was nominal and bulk of the credit to this sector was provided by ADBP. With the introduction of banking reforms in 1972, several institutional and policy changes were made with the objective of a more equitable distribution of banks' credit among various sectors and groups. Towards the end of 1972, SBP started assigning mandatory agricultural credit targets to five big banks viz. ABL, HBL, MCB, NBP and UBL with provision for penalizing institutions that do not meet the targets.

The legislation on Co-operative Credit System was introduced in the subcontinent in 1904. At the time of independence, co-operative banks were mainly engaged in financing commercial

activities and neglected the financing to co-operative societies. In 1976, with enactment of Co-operative Banking Ordinance, the "Federal Bank for Co-operatives" (FBC) was established to finance provincial cooperative banks for further lending to cooperative societies. Subsequently, provincial cooperative banks were amalgamated to provide agricultural credit at grass root level and to encourage the cooperative societies' structure in the country. However, the system did not achieve its goals due to default of the provincial cooperative banks and a number of fake cooperative societies. Various steps undertaken by the government over subsequent years failed to revive the role of cooperatives in financing the agriculture sector. Resultantly, FBC was liquidated in 2001 followed by liquidation of provincial cooperative banks' except PPCBL. After liquidation of FBC, financing to PPCBL was diverted to SBP under the guarantee of Punjab Government.

Informal credit market is characterized by low transaction costs, very high interest rates and rapid disbursement of credit. Although, its share in total credit has declined, it is still a major source of agri. credit in the country. The close familiarity of borrowers with informal lenders in conjunction with coercive loan recovery methods and the inability of formal institutions to reach to the poor have brought about heavy dependency of the rural population on the informal markets. This trend has continued despite higher interest rates ranging from yearly rates of 50% to 100%. Most informal lenders have limited loan portfolios and operate within the narrow area of their influence.

4.2. Importance of Agri/ Rural Finance

Availability of agri/rural credit is a prerequisite for enhancing productivity and improving standard of living by breaking the vicious circle of poverty of small farmers. It has been observed that farmers usually utilize the credit facility to meet short term credit needs mostly for purchase of inputs. The banks are also interested in extending short term credit. The experience of developed economies shows that agri/rural credit for investment in the form of machinery, equipment and infrastructure has played major role in increasing productivity and future cash flows. Therefore, banks need to increase the supply of credit in the form of medium to long term investment in the farm and non farm sector. Farmers can also avail the opportunity to transform their lands into mechanized farming units to reduce cost and increase profitability.

4.3. SBP's Initiatives in Agri/Rural Credit

With the liberalization of financial sector, there was a paradigm shift in the roles of SBP and banks. Under the new paradigm, SBP was committed to creating an enabling environment for banks to adopt agri. / rural finance as a viable business line. The major initiatives taken during last 7-8 years are briefly described as under: -

- Inducted 14 Domestic Private Banks into Agri Credit Scheme apart from 7 Banks (5 Major & 2 Specialized)
- Guidelines for Livestock, Fisheries, Poultry and Horticulture Financing were issued to diversify banks credit to non-farm sector activities.
- Introduced three years revolving credit scheme, with one time documentation and automatic renewal on annual cleanup of principal plus mark-up for production loans to farmers.
- Issued draft Guidelines for Islamic Agri Finance to facilitate banks to develop their own Shariah compliant products for financing to agriculture sector.
- Strategy in place to Expand Agri Finance to 3.3 Million Borrowers from the Existing 2 Million Borrowers, to Meet 75% of the Credit Needs (from Existing 45%) in next 3-4 years.
- To mitigate the risk of losses to farmers due to natural calamities and risk of nonpayment to banks in such cases, Crop Loan Insurance Scheme (CLIS) has been introduced from Rabi Crop 2008-09. This scheme will not only safeguard the interests of banks and farmers, but it will also save huge amount of funds spent by the Government of Pakistan in the shape of frequent write-offs / waivers of agri. loans of ZTBL's borrowers.
- Allowed banks to finance against two personal sureties upto 500,000 in addition to passbook of the land.
- Issued Financing Scheme for Small Farmers on group based lending methodology whereby members of the group can borrow up to Rs 200,000/- without any collateral from financial institutions.
- Compiled and released district wise data of agri. credit for the first time to facilitate the policy makers.
- For effective implementation of SBP's initiatives, a separate Development Finance Support Department (DFSD) and its subsequent units were established at SBP BSC Offices. These units would focus on developing a network in collaboration with local banks and farming community.
- In order to increase the rural branch net-work, SBP has made it mandatory for banks to open at least 20% rural branches while opening their new ones.
- To reduce operational / administrative costs of agri/ rural financing and increasing outreach of financial services to rural community, SBP has allowed banks to adopt concepts of branch-less banking and open sub

branches, special booths and service centers in remote areas.

- Published Handbook on Agri. Finance Products of banks for guidance of banks and other stakeholders.
- Special Training and Awareness Programs underway for farmers and bankers.
- Updated report for estimation of agri. credit by including 150 additional items eligible for financing i.e. complete value chain from production till export by the farmers/growers.
- Rationalized agri. credit data returns to facilitate banks and other stakeholders.
- Booklets & Brochures of SBP's schemes and policies have been translated & published in Urdu & other regional languages
- Separate Prudential Regulations for Agri Financing issued.

4.4. Impact of SBP's Initiatives

The initiatives have paid dividend in the form of robust increase in agri. credit disbursements to Rs. 212 billion in FY08 from Rs. 39 billion in FY01. The target for FY09 has been fixed at Rs. 250 billion. The number of borrowers has also increased to 2 million from 1.3 million.

With the induction of 14 domestic private banks into the agricultural credit scheme in 2002 and the removal of mandatory credit targets for five big banks, viz. Allied Bank Ltd, Habib Bank Ltd, MCB Bank Ltd, National Bank of Pakistan, United Bank Ltd, from 2005, the share of commercial banks has shown significant rise in the overall agri. credit disbursement. The share of specialized banks, viz. ZTBL & PPCBL in agri. credit has declined from 73% in FY01 to 38% in FY07. The trend shows that banks are continuously surpassing their indicative credit targets, since 2003-04 and the actual disbursement in 4 years has increased by 186% from FY03 to FY07.

4.5. Constraints Issues in Agri/ Rural Financing

Notwithstanding, the sharp increase in agri. credit disbursement, banks are meeting only around 45-50% of the agri. credit requirements and the number of borrowers are around 2 million out of 6.6 million farmers in the country. The credit is highly concentrated in crop sector (production loans), which is around 75% of the agri. credit disbursement and there is an uneven geographical distribution with more than 80% of the credit going to the province of Punjab. Moreover, agri. credit is only 6% of the credit portfolio of banks. As a result, there is lack of ownership and commitment among the banks' management and non-availability of innovative lending products.

Banks do not seem keen on accepting agri. finance as a viable business due to intrinsic risks and weird nature of agriculture, non-viability of farmers, non-availability of collateral with most of the farmers, subsidized credit, frequent announcement of write-offs & waivers by the Government, etc. Besides, the late issuance of pass book and non-cooperation of revenue authorities with banks / farmers for creation of charge & verification of documents of pass books, and non-availability of one window operation in Sindh and Baluchistan are making access to credit a difficult proposition for banks. There is no automation of land record and the existing manual system of revenue authorities is rather erratic. The ratio of non-performing agri. loans is terribly high due to the culture of write-offs/ waivers. In case of defaults, the sale of agri. land for realization of banks' outstanding loans almost become impossible for banks. This sector is also susceptible to risks on account of natural hazards, unreliable infrastructure, poor pricing policies, insufficient & improper marketing mechanism, low quality of seed, low yield per acre and lack of coordination among government agencies which dampen

down banks' interest in expansion of credit to the farming community.

4.6. Future Outlook

In response to the initiatives taken by SBP to create an enabling environment for agri. finance, banks are also in the process of revamping/restructuring their agri. financing infrastructure e.g. ZTBL has planned to open 200 online branches in the rural areas, 5 major banks are hiring agri. graduates to strengthen their field force, domestic private banks are establishing separate agri. credit departments and most of the banks are developing specialized products for

agriculture, livestock, fisheries, etc.

The Government is also investing for the development of agriculture sector and rebuilding the revenue departments through automation of land record. Farming community and their representative forums/associations have also become instrumental in sharing their requirements and issues with the authorities and banks.

It is hoped that the success stories in the following section will facilitate all stakeholders and will ultimately establish a well organized market based agri. finance sector in the country.

5. International Best Practices

During the past two decades several rural finance institutions (RFIs) have emerged as success stories. They have not only achieved the primary objectives of high outreach and self-sustainability, but have also been very helpful in reducing the poverty. In this chapter we will briefly discuss the strategies and achievements of a few top performing RFIs. Among them, BAAC and Land Bank of Philippines have a holistic approach of lending, with emphasis on agri. finance, while BRI, Grameen, BANRURAL, and ACLEDA Bank are micro finance institutions with a wide array of activities in different sectors.

5.1. Bank for Agriculture and Agricultural Cooperatives (BAAC), Thailand

Bank for Agriculture and Agricultural Cooperatives (BAAC), Thailand is one of the biggest names among the most successful agri/ rural finance institutions (RFIs). BAAC was established under the “Bank for Agriculture and Agricultural Cooperatives Act” in 1966 as a government owned bank to stimulate agriculture by extending financial services to the agriculture sector. It replaced the Bank for Cooperatives, whose funding was limited and whose lending activities were restricted to agricultural cooperatives.

The BAAC enjoys substantial autonomy in setting its operational and financial policies. It has focused mainly on lending to borrowers in the low- to medium-income range. This strategy has been supported by a progressive cross-subsidizing interest rate policy, with higher interest rates charged on larger loans, ceilings placed on loan amounts, and loans offered to small farmers without traditional collateral through joint liability groups. At first, BAAC lent mostly

through large agricultural cooperatives, but repayment problems led the bank to increase its direct lending to individual farmers.

During the past four decades, BAAC underwent transformation from a specialized agricultural lending institution to a diversified rural development bank. It underwent a gradual process of reforms:

- 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 channeling 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 these gradual reforms has helped the bank in enhancing outreach to small farmers. It provides credit access to 98% of total farmers in Thailand, while maintaining the institutional viability.

Presently, it has 908 branches and 945 field offices which cover the entire rural area of the country. It is also known to be the largest formal Micro Finance Institution (MFI) in Thailand with an outreach of 5.68 million farm households (98.1% of total farm households). The

loan outstanding is 12,245 million US\$ as on 31-12-2007. Its main source of funds is the deposits from general public which is 87.7% of the total operating funds of the bank.

5.1.1. Financing Policy

Since its establishment in 1966, and upto 2005, BAAC was only allowed to provide loans to Agriculture sector-individual farmers for their agricultural activities, or agricultural cooperatives for onward lending to their members. From 2006 onwards, it has also been allowed by way of an amendment in its Act, to provide loan to non-agriculture sector, but the volume of loan to non-farming borrowers must not exceed 20% of the total loan volume at any point of time.

5.1.2. Methodology

Among the lending approaches of BAAC, the most extensively used is retail loans through Joint Liability Groups (JLG). Under this scheme, BAAC extends non-collateralized loans through groups of farmers who are made co-liable for each other's loan. A typical group has 12 to 15 members. In addition to JLG, BAAC also finance farmers against individual landholdings and may require the deed for "safekeeping" of produce as added loan security. Loan size is set at about 60% of the projected revenue from sale of the crop.

5.1.3. Risk Management Strategy

Despite being solely concentrated to farm households, BAAC was able to maintain a non-performing loan ratio within manageable level. Starting 1999, BAAC also began to rationalize its interest rate policy, adopting a risk-based loan pricing—that is, pricing interest rates based on repayment performance classification of borrowers, instead of the previous system where small loans were charged sub-economic price and cross-subsidized for larger loans.

But apart from loan diversification and risk-based loan pricing, BAAC has operated a unique "unconventional" risk contingency system to address loan delinquency. The system allows restructuring of accounts not paid due to force majeure, principal and/or interest, up to three times. BAAC may be provided either a grant or subsidized loan by the government to compensate for the loan loss. BAAC is also compensated for the differences in interest rates between what BAAC normally charges and the low interest rate offered to farmers as part of rehabilitation program for farmers in cases of large scale natural calamities. In other words, BAAC has a "built-in insurance system" that protects itself from "excessive loan loss" that may arise due to covariant risks (climatic and economic risks) faced by its agricultural borrowers.

5.1.4. Distinctive Features

BAAC has achieved some remarkable results in terms of agri/rural finance, which are as under:

- **Outreach:** The most notable achievement of BAAC is its largest outreach. It provides credit access to 5.68 million farm households (98.1% of total farm households). BAAC has 908 branches and 945 field offices which adequately deal with the needs of the entire rural community of the country. More than 80% of its clients are small farmers.
- **Collateral Free Lending:** One of the major achievements of BAAC is its extension of loan without obtaining tangible collateral/ security. Around 70% of BAAC loans portfolio is collateral free based on Joint Liability Group methodology.

Recovery: Recovery rate of the bank is 95% of the total disbursement. The main reason for high recovery rate is bank's tight monitoring, follow-up and recovery policies and good risk

management systems like funeral funds, insurance, peer pressure under joint liability group scheme, etc. The bank keeps close & regular interaction and also holds meetings with farming community by way of its field officers. It not only facilitates in the resolution of community issues relating to farm/non-farm activities, but it also keeps track of the cash flows and proper utilization of loans by the borrowers which help them get repayment in time. To keep track of cash flows, the field officers make collection/ recovery from the sale points of products directly, and for proper utilization of loans, the loans are generally disbursed in installments, with the disbursement of every new installment depending on the proper & optimal utilization of previous installment.

- **Sustainability:** Over the years, BAAC has been successfully providing the necessary banking & credit services to rural community on sustainable basis. The loan outstanding is 12,245 million US\$ as on 31-12-2007. Its main source of funds is the deposits from general public which comes to 87.7% of the total operating funds of the bank.
- **Financing for Rural Development:** BAAC has played a vital role in rural development of the country. It not only provides the required agricultural loan to farmers for cropping, but has also promoted non-agricultural economic activities in rural areas, which has been extremely helpful in reducing poverty and uplift of rural community. This, in return, has also attracted more private investment towards rural areas.
- **Character Building:** BAAC tries to inculcate in its clients a respect for moral values. In this regard, it also obtains the services of Monks

(spiritual leaders) to persuade people to adopt good habits. It motivates the existing or prospective borrowers to abstain from adopting bad habits or involving in unhealthy activities; like gambling, drinking or any other social evils.

- **Farmers' Education, Coaching and Training:** BAAC aims to be a strong financial based rural development bank with modern management to enhance the quality of life of farmers and rural entrepreneurs through the provision of financial assistance in the form of loans for agricultural production, investment and marketing purposes. BAAC has launched a live radio program called BAAC-Friends of Farmers which is broadcasted every week. This 30 minutes program is full of knowledge and information about BAAC activities and projects. BAAC also supports the development of production and marketing network to assist farmers and other entrepreneurs at the grass root level. It is a market phenomenon that prices are lowest at the time of harvest and farmers have to suffer in case of forced sale of their produce. Therefore, to facilitate farmers from forced sale of produce, BAAC provides loans to meet their financial needs in the meantime. It also coordinates in formulation of marketing cooperatives/ committees and also provide them financing for the purpose. It also supports rural learning process which strengthens communities. BAAC provides technological advices to farmers as to how they can reduce their cost of living & cost of farming, and as to how they can improve the productivity. Loans are not provided for activities which have negative effect on natural resources and environment. It promotes clean farming technology amongst the farmers, and also advise (give signal to) them about sunset and sunrise crops / farm products.

- **Incentives for Regular Borrowers:**

In order to encourage borrowers in regular repayment of their loans, BAAC has a policy to give discount to regular / old borrowers on their previous repayment performance. This has benefited BAAC not only in reducing its Non-performing Loans (NPLs) but also in increasing the saving of its clients.

5.2. Land Bank of the Philippines

Land Bank being the largest government-owned bank is also the fourth largest bank in terms of assets in the Philippines. It is also one of the biggest government-owned or controlled corporations in the Philippines. Land Bank has an extensive rural branch network. It serves many rural sector clients in areas where banking is either limited or is non-existent. Bank's performance has been remarkable and it has continued to serve a large and diverse rural clientele successfully for 45 years.

5.2.1. History

Land Bank was established on August 8, 1963 as part of the Agricultural Land Reform program, especially to help the purchase of agricultural estates for division and resale to small landholders and the purchase of land by the agricultural lessee.

By 1973, Land Bank was in financial distress. It lacked the resources and the capital needed to implement the land reform programs and lacked the structure to implement the programs efficiently. On July 21, 1973 President signed a Decree which revitalized the bank. The decree granted Land Bank a universal banking license (the first bank in the Philippines to be issued such a license) with a social mission to spur countryside development. The decree expanded Land Bank's powers to include lending for agricultural, industrial, home-building and home-financing projects and other productive enterprises, as well as lending to farmers' cooperatives and associations to facilitate production, marketing of crops and acquisition of essential commodities. Land Bank was also required by the decree to provide timely and adequate support in all phases involved in the execution of agrarian reform and also increased its authorized capital to 3 billion pesos. It also became exempted from all

national, provincial, city and municipal taxes and assessments.

In 1977, Land Bank was reorganized and it was divided into three sectors to better assess the needs of its customers. It was divided into Agrarian, Banking and Operations sectors to strengthen operations and ensure long-term viability.

In 1982, the Agricultural Credit Administration (ACA) was also merged with Land Bank. ACA's function was to extend credit to small farmers. Land Bank became the financial intermediary for the Comprehensive Agrarian Reform Program (CARP) in 1988.

5.2.2. Financing Policy

Land Bank of the Philippines was established with a special focus on serving the needs of farmers and fishermen. While it provides the services of a universal bank, it is officially classified as a "specialized government bank" with a universal banking license.

In the last one decade, Land Bank has focused its efforts on diversifying and expanding its loan portfolio within identified priority sectors, including farmers and fisherfolk, micro and small and medium-sized enterprises (SMEs), income-generating projects, commonly known as livelihood projects, agribusiness, agri-infrastructure, and other agri-related and environmental conservation projects.

To strengthen and expand its credit program, Land Bank grants development assistance to farmers and fisherfolk cooperatives. The Bank provides various forms of technical assistance to promote technology transfer and to improve productivity, product quality, and value-adding operations. The Bank also provides marketing capability-building assistance to enhance the competence of bank-assisted cooperatives in preparing and implementing a marketing plan.

Presently, Land Bank is recognized as one of the top universal banks in the country - offering a complete range of commercial banking products and services - with solid financial resources to back its operations. In 2007, Land Bank was among the top 5 Philippine commercial banks.

5.2.3. Methodology

Land Bank has both retail and wholesale lending programs, depending on type of clientele. It provides retail loans directly to individual SMEs and institutional borrowers including Local Government Units (LGUs) through its own branch network/ field offices located all over the country. On the other hand, Land Bank also provides loans indirectly to individual small farmers, fisherfolk, and microenterprises through wholesale loans to cooperatives and Corporate Financial Institutions.

The diversification of Land Bank's loan portfolio catering to a wide array of clients has been made possible through the intensified implementation of varied lending facilities and arrangements. The Bank's credit facilities vary, depending on the type of projects, clients, delivery (wholesale or retail), and source of funds. Despite the diversity, these programs are nonetheless deemed consistent with its key mandate of stimulating countryside development and targeted to priority sectors with economic activities converging in rural areas.

5.2.4. Distinctive Features

- **Capability-Building Assistance Programs:** To strengthen and expand its credit program, Land Bank grants development assistance to farmers and fisher-folk cooperatives. The Bank provides various forms of technical assistance to promote technology transfer and to improve productivity, product quality, and value- adding operations. The Bank also provides marketing capability-building assistance to enhance the competence

of bank-assisted cooperatives in preparing and implementing a marketing plan. The aim of the bank is to support the government's thrusts of poverty alleviation and jobs generation.

- **Deposit Mobilization:** Land Bank is a major deposit service provider in rural areas. Land Bank has almost 180 billion pesos (\$3.2 billion) on deposit in just more than 2 million accounts (with foreign currency deposits adding another 10 percent). Because of Land Bank's role as a government depository, government entities - mainly, local government units - account for about two-thirds of the Bank's peso deposits. The private sector holds the remaining one third of deposits.
- **Revenues and Profits:** Over the last 14 years i.e. from 1993 to 2006, Land Bank generated annual gross at modest growth of around 9 percent per annum. (www.landbank.com)
- **Loan Availability & Access to Small Borrowers:** With the availability of microfinance services in the rural areas, small scale borrowers such as small farmers and micro-entrepreneurs were able to easily access loans to finance their micro-enterprises and small businesses. Moreover, it has allowed farm households to diversify, so as to enable them to raise their income levels and improve their quality of life.
- **Simplified Lending Procedures:** There is increased accessibility to microfinance loans due to minimal documentary requirements and simplified lending procedures. Loan borrowers are exempted from submitting the usual documentary requirements for credit evaluation and approval, e.g., audited financial statements or statements of income and expense which borrowers find

hard to comply. Loans are given even without collateral, and loan repayment is adjusted to the cash flow of the borrower to encourage timely payment. The incidence of borrowing from formal sources among small farmers has increased significantly mainly because of the increased accessibility of microfinance services in the rural areas.

- **Zero Tolerance for Loan Defaults:** A common denominator of successful MFIs' operations is their zero tolerance for loan defaults. This ensures borrower discipline and sustainability of the MFI. Prior to lending, borrowers undergo social preparation and are given technical assistance to assist them in handling microfinance loans. Furthermore, MFIs use a variety of lending mechanisms such as group lending, individual lending, and market-based incentives to motivate good financial discipline among clients and loan officers. Other mechanisms such as the use of collateral substitutes like peer pressure and joint liability as well as focus on lending to women clients are key factors in the success of MFIs and the Program.
- **Avoiding behest loans:** A combination of strong leadership, board structure and its orientation as an agricultural reform bank with a constituency of restive farmers helped shield the Land Bank from corrupt politicians using the public bank to make behest loans.

Moreover, the market orientation of financial and credit policies, as mandated under the Agriculture and Fisheries Modernization Act of 1997 and a subsequent Executive Order (1999), reduced political pressure on Land Bank to provide subsidized lending itself.

- **Portfolio Diversification:** Learning from the experience of the costly bailouts of Philippine National Bank (PNB) and Development Bank of the Philippines (DBP), the Land Bank's capitalization was increased, and it was given free rein to diversify its loan portfolio. Thus, Land Bank has seized opportunities to create new loan products and to develop lending programs for LGUs, local housing, and rural infrastructure.
- **Good risk management and internal audit and control:** Land Bank has adopted good risk management practices and internal audit and controls, as required by the BSP in the wake of the 1997 Asian financial crisis. To its credit, Land Bank was especially serious about these aspects of effective bank management even before the Asian financial crisis. Its long association with the donor community has strengthened this crucial aspect of Land Bank's management and operations because loan covenants with multilateral and bilateral lenders require the presence of effective risk management and internal audit and controls as a condition for financial assistance.

5.3. Bank Rakyat Indonesia

Bank Rakyat Indonesia (BRI) has accumulated more than 100 years of experience in serving the micro-banking needs of the people. It has over 300 branches and over 4,000 BRI Units and Village Service Centers across the country. With latest technology, BRI has been able to streamline its nationwide infrastructure to accommodate the changing business requirements of agri / rural community.

BRI is one of the largest commercial banks in Indonesia, and the most profitable and efficient bank. Its repayment rate has been over 99%. Non-performing loans level is less than 6%, while for microcredit, it is less than 3 %. BRI successfully realized an Initial Public Offering and share listing on the 10th November 2003, with shares oversubscribed by 15.4 times. In 2003, BRI issued a 10 years subordinated note for US\$150 million, and a subordinated bond of Rp. 500 billion.

5.3.1. Brief History

BRI's ancestor, the Priyayi Bank of Purwokerto, was created in 1895 by Raden Wiriamadaya, a Javanese government official. In 1897, the Dutch administration reorganised it as a cooperative bank, following the example of those that appeared in Europe after 1850. In 1946, it changed its name to Bank Rakyat Indonesia (BRI) and in 1950 it became a state-owned commercial bank. At the beginning of the 1970s, 3,600 BRI Unit Desas (village banks) were created as part of a government program called 'BIMAS', whose aim was to provide inputs for the rice-green revolution. Those Units were then used as channelling agents for different subsidized government lending programs, but all of them failed to reach sustainability. In 1984, the Unit Desas were completely restructured: each unit became an individual profit centre and adopted a commercial approach to microfinance (no

subsidies, sustainable interest rates, efficient management, saving mobilization) which led them to financial profitability from 1985 onwards. Today, BRI's microfinance system is the world's largest and most profitable microfinance network in the world. In 1992, BRI became a limited liability corporation and a public company in 2003.

5.3.2. Methodology

BRI is divided into four Strategic Business Units: Micro Banking, Retail Banking, Corporate Banking and Investment Banking. Its microfinance services are provided through the Micro Banking Unit, also known as BRI Unit.

BRI has only one micro-loan product, KUPEDES, designed for working capital or investment purposes. Carefully selected, the borrowers are given loans whose amount depends on the borrower's current income flow and always require some form of collateral (a SIMPEDES account, land, furniture, motorcycle, etc.). The minimum amount is Rp.25,000 (US\$3), and the maximum is Rp.50,000,000 (US\$5,000). The minimum loan term period is one month and the maximum is 24 months for working capital loans or 36 months for investment loans. Loans can be repaid in monthly, quarterly or bi-annually installments. The interest rate increases by 0.5% if the repayment is not made on time. The repayment rate is very high: 98.34%.

The main saving products available are:

- SIMPEDES or Simpanan Pedesaan (Village Savings), a deposit instrument allowing an unlimited number of transactions and, therefore, favoured by low-income households that need full liquidity. There is no fee to open an account, and except for the smallest balances (less than \$10), it has a positive real interest rate. Aimed at attracting new customers, lotteries are organized every six months with

prizes in kind. 75.7% of BRI micro-banking accounts are SIMPEDES.

- SIMASKOT is the equivalent of SIMPEDES for urban areas with an emphasis on security.
- TABANAS BRI, a government saving program, offers similar features than SIMPEDES but is not as popular. It can be explained by the fact that until a few years ago, no more than two withdrawals per month were allowed and, moreover, its lottery offers prizes in cash whereas most depositors favour prizes in kind.

In order to encourage more clients to open saving accounts, BRI launched bi-annual lotteries for SIMPEDES accounts' holders in 1984. Each saver receives free lottery ticket depending on their minimum monthly account balances. As the lotteries are held in the branches, winners are located within a small area, so most people either won or know someone who won and it makes these lotteries very popular.

BRI also introduced unlimited withdrawals for savers in Indonesia after field studies showed that a limit was the main obstacle preventing people to open saving accounts in rural banks. Contrary to what many people feared, the number of withdrawals did not increase as a result. It showed that savers didn't want to withdraw more frequently but simply to have the freedom to do so.

Since 2002, BRI started to put online its unit network, with already around 10% (450) effectively on-line by August, 2004. BRI introduced a new facility called Simpedes Berkartu, or Simpedes with a card in 2004.

5.3.3. Distinctive Features

The founding objectives of the BRI-UD were to replace directed agricultural credit with broad-based credit for any type of

rural economic activity; to replace subsidized credit with positive lending rates with sufficient spreads to cover all financial and operational intermediation costs; and to provide a full range of financial services (savings as well as credit) to the rural population. All these objectives were achieved only a few years after the program's inception. Following are the key features of BRI's success:

- **Effective Management:** The management of each unit is extremely effective. Functioning as individual profit centers, their performance is monitored and specific staff incentives implemented. In addition, the Units are allowed to move their excess funds to BRI branches, where they are well remunerated, encouraging saving mobilization in Units.
- **Incentive for repayment:** Units have an excellent repayment rate of over 98%, partly thanks to an incentive system for repayment. Indeed, 25% of the interest paid is repaid to the borrower when installments are made in time during the six consecutive months. Also the borrowers, who do not fail to pay, have had the possibility of being granted bigger loans.
- **Savings Mobilization:** The emphasis on savings is another secret of BRI's success: four savings instruments were available from the beginning, each aiming at different targets, filling a gap for the poorest households. This allowed the Units to increase the number of loans and to be more sustainable. Deposits went past the outstanding loan portfolio in 1989 and the deposit-to-loan ratio is now over 225%. The BRI-UD's phenomenal success in the mobilization of its savings is a distinguishing achievement.
- **Sustainability & Profitability:** BRI had succeeded in attaining financial

sustainability while providing credit and savings services to the rural low income families that previously had no access to formal financial services. Moreover, it had achieved unprecedented level of profitability while providing such services to the rural poor. The most fundamental policy change in the BRI village banking program was the shift from “disbursing credit” to “motivating loan recovery and mobilizing savings”.

- **Poverty Focus:** The BRI-UD is a nationwide network of small village banks which target the extremely poor among Indonesia's rural population. At the end of September 2004, BRI had 87% of its loan portfolio in micro, small and medium enterprises, while the corporate lending represented the remaining 13%. A large proportion of BRI's clients are in the middle and upper end of the poor class in Indonesia. The Income Generating Program for Small Farmers and Fishermen (P4K) is supervised and administered by BRI's branches, which targets explicitly poor farmers.
- **Autonomy of Village Bank System:** Key to the operational success is the autonomy of the village bank system to operate as an independent profit center. Village banks are free to set

their own loan terms with transfer prices as the ones negotiated with the management. Loan processing is quick- taking only about a week for new borrowers and less time for repeat borrowers.

- **Operations Standards:** BRI imposed rigid standards on its operations. Loan loss provisioning of BRI is higher than most state owned banks in other countries, e.g. general loan loss provision of 3% (compared to 2% in other countries), 100% reserves against loans that are three months and above overdue. As to attaining financial sustainability, BRI only took three years to shed off its subsidies.
- **Wide Network:** BRI has the widest network in Indonesia with 13 Regional Offices, 324 Domestic Branches, 4,049 BRI Units (96% of which are profitable), 148 Sub-Branch Offices and 240 Village Service Posts.
- **Full Range of Financial Services in Rural Areas:** One of the key features of BRI is its full range of banking services to its clients in rural areas. Along with lending facility, it accepts deposits – both short term & long term - from the customers and also provides all sorts of remittance services to general public.

5.4. Grameen Bank, Bangladesh

Bangladesh is one of the poorest countries in the world. In 1994, annual per capita income was US\$223, and more than 70 percent of the population lived in poverty. However, over the past few years, Bangladesh has shown steady economic growth (5-6 %) and its per capita GDP has risen to US\$ 475 in 2007.

Most of the population lives in rural areas: agriculture accounts for around 20 percent of the GDP and more than 60 percent of employment. However, the population is growing at a rate of 1.8 (Fig:2008) percent per year, resulting in increasing pressure and decreasing farm size.

Professor Muhammad Yunus started the Grameen Bank (GB) as an experimental project in 1976 in the village of Jobra. The project was financed by a commercial bank and was personally guaranteed by Professor Yunus. In 1983, Grameen was established as a specialized financial institution under the Grameen Bank Ordinance. The Grameen Bank is not subject to the Banking Companies Ordinance or to any other law related to financial institutions in Bangladesh, nor is it subject to interest rate ceilings. It has also been partially insulated from other government policies. Lion's share of the Grameen Bank is owned by members; and the rest is owned by the government.

5.4.1. Methodology

Thus far, the Grameen microfinance methodology has been the most popular and widely replicated model in Asia with considerable consistency in attaining successful results, particularly in achieving greater outreach and high repayment rate. Grameen Bank, as of December 2006, has \$475 million in loan outstanding, 6.9 million borrowers from 74,462 villages and repayment rate of 98.8% (source: www.grameen-info.org). The Grameen Trust alone has helped out

replication projects in 37 countries around the globe. Among countries where there has been considerable replication of the model are: Philippines, Malaysia, India, and Indonesia. Microfinance in China also started with a pilot replication project on the Grameen model.

David Gibbons (2006), one of the pioneering replicators in Southeast Asia, cited the following as the 'essential Grameen': (a) exclusive focus on the poor with priority on the 'poorest' women, (b) financial services delivery that facilitates participation and ensures timely repayment (small loans payable in periodic, mostly, weekly installments; formation of solidarity groups, self-choice of loan activities, loans for income generation only, eligibility of succeeding loans based on repayment of previous loans); and (c) attainment of financial self-sustainability. Gibbons recognized that replication is an art and most replicators adjusted the model to fit particular local contexts. However, he cited that operational sustainability in poverty density areas and freedom to create self-employment are among the essential conditions for successful replication of the model.

The new innovation in Grameen is in the transfer of technology. In the early 1990s the mode of technology diffusion was "exposure-then-training" – i.e., early innovators in one country were sent for exposure followed by training in Bangladesh. These innovators then became the resource institutions in extending the technology to other financial institutions in their respective countries. The new mode of technology transfer is "Build-Operate-Transfer" that has been piloted by Grameen Trust (Morshed, 2006). The approach was noted to have contributed to the expansion of microcredit in the countries where the model does not exist and where there are very few rural financial institutions. The Grameen Trust reported good results with their pilot "Build - Operate-Transfer"

projects in Turkey, Myanmar, Kosovo and Zambia over the last nine years. Myanmar project, for instance, has reached 95,000 clients as of 2006.

5.4.2. Distinctive Features

- **Collateral free Lending:** GB provides credit to the poor of the poorest in rural Bangladesh, without any collateral. It has reversed conventional banking practice by removing the need for collateral and created a banking system based on mutual trust, accountability, participation and creativity. Because of the low incomes of GB clients and their lack of access to traditional collateral, lending is done exclusively through joint liability groups, tied to compulsory savings. The GB has achieved phenomenal success with this approach thereby inspiring many other countries to copy its efforts.
- **Owned by the Poor:** Grameen Bank Project was initiated in the village of Jobra, Bangladesh, in 1976. In 1983 it was transformed into a formal bank under a special law passed for its creation. It is owned by the poor borrowers of the bank who are mostly women. It works exclusively for them. Borrowers of Grameen Bank, at present, around 94 per cent of the total equity of the bank. Remaining is owned by the government.
- **Banking with Poor:** From the start, the bank's main goal has been to improve the conditions of the rural poor by providing them with access to credit, savings facilities, and some non-financial social programs. Its focus is on the lowest social strata, and the income level of its clientele is lower than that of the BAAC and the BRI-UD. At GB, credit is a cost effective weapon to fight poverty and it serves as a catalyst in the over all development of socio-economic conditions of the poor who have been kept outside the banking orbit on the ground that they are poor and hence not bankable. Professor Muhammad Yunus, the founder of "Grameen Bank" and its Managing Director, reasoned that if financial resources can be made available to the poor people on terms and conditions that are appropriate and reasonable, "these millions of small people with their millions of small pursuits can add up to create the biggest development wonder."
- **No Collateral/ Guarantee:** Grameen Bank does not require any collateral against its micro-loans. Since, the bank does not wish to take any borrower to the court of law in case of non-repayment; it does not require the borrowers to sign any legal instrument. Although each borrower must belong to a five-member group, the group is not required to give any guarantee for a loan to its members. Repayment responsibility solely rests on the individual borrower, while the group and the centre oversee that everyone behaves in a responsible way and none gets into repayment problem. There is no form of joint liability, i.e. group members are not responsible to pay on behalf of a defaulting member.
- **Outreach:** As of March 2008, it has 7.49 million borrowers, 97 percent of whom are women. With 2,511 branches, GB provides services in 81,752 villages, covering more than 97 percent of the total villages in Bangladesh. Total staff is more than 25,156.
- **Sustainability:** By the end of March, 2008 total deposits in Grameen Bank stood at Tk. 52.45 billion (US\$ 764.82 million). Members' deposit constituted 56 per cent of the total deposits. Balance of member deposits has increased at a monthly average

rate of 0.50 percent during the last 12 months. Grameen Bank finances 100 per cent of its outstanding loan from its deposits. Over 56 per cent of its deposits come from bank's own borrowers. Deposits amount to 137 per cent of the outstanding loans. If we combine both deposits and own resources it becomes 152 per cent of loans outstanding.

- **Attractive Rates on Deposits:** Grameen Bank offers very attractive rates for deposits. Minimum interest offered is 8.5 per cent. Maximum rate is 12 per cent.
- **Exceptional Recovery Rate:** Loan recovery rate is 98.22 per cent which is remarkable/ tremendous by all means.
- **Low Interest Rates on Loans:** Government of Bangladesh has fixed interest rate for government-run microcredit programs at a flat rate of 11%. It amounts to about 22 per cent at declining basis. Grameen Bank's interest rate is lower than government

rate. There are four interest rates for loans from Grameen Bank : 20% (declining basis) for income generating loans, 8% for housing loans, 5% for student loans, and 0% (interest-free) loans for Struggling Members (beggars). All interests are simple, calculated on declining balance method. This means, if a borrower takes an income-generating loan of say, Tk 1,000, and pays back the entire amount within a year in weekly installments, she'll pay a total amount of Tk 1,100, i.e. Tk 1,000 as principal, plus Tk 100 as interest for the year, equivalent to 10% flat rate.

- **Profit Earning:** Ever since Grameen Bank has come into being, it has made profit almost every year except the years 1983, 1991, and 1992.
- **Poverty Reduction:** According to a recent internal survey, 65 per cent of Grameen borrowers' families have crossed the poverty line. The remaining families are moving steadily towards the poverty line from below.

5.5. BANRURAL S.A. Guatemala

BANRURAL is a leading banking institution in Guatemala focused on the rural development of Guatemala by providing loans and credits to small and medium size businesses throughout the largest network in Guatemala of 320 offices. BANRURAL is now one of the top 10 banks in Central America and will continue its growth in the rural areas.

5.5.1. History

BANRURAL S.A. was formed in 1998 after transformation of its predecessor, BANDESA which was a government-owned development bank founded in 1970 with the objective to promote and manage the credit aid of the Guatemalan government toward the farm sector. BANRURAL S.A. initiated operations in January 1, 1998. It is the most profitable commercial bank in Guatemala and the third largest in terms of assets. It has over 300 agencies and conducts the majority of its operations in rural areas. It grew out of the reform of a failed state agricultural bank, maintained a mission to serve rural entrepreneurs.

5.5.2. Financing Policy

BANRURAL S.A. has as its main objective “to promote the economic and social development of rural areas through the stimulus and facilitation of savings, credit services, and other financial services to credit unions; non-governmental organizations (NGOs); small size farmers associations; micro, small and medium size entrepreneurs; both directly or indirectly through other legally recognized institutions”.

5.5.3. Methodology

Contrary to most banking institutions, BANRURAL S.A. mission is to generate a fair profitability without neglecting its social mission i.e. to promote the integral development of the country with universal

banking services, preferably directed towards farmers, merchants, artisans, and small and medium size entrepreneurs. The behavior of the members of BANRURAL S.A. is guided by a set of moral values, which are constantly reinforced. The bank applies a set of principles to manage and absorb credit risks. The common elements are: an appropriate credit evaluation technology given the operating environment and constraints; reliance on portfolio diversification; limits on agricultural lending; and adequate provisioning.

5.5.4. Distinctive Features

- **Successful Transformation:** The process of transformation and privatization of BANDESA into BANRURAL S.A. has been extremely successful and according to some observers, possibly even unique due to its results and the economic, social, political, and especially cultural conditions of the Guatemalan environment in which it was implemented. During its first decade BANRURAL S.A. has performed extremely well in terms of profitability, self-sustainability, and outreach.
- **Profitability:** BANRURAL S.A. has experienced a significant and sustainable increase in its profits. It has more than doubled its profits during the last four years. Also, after only a few years operation, BANRURAL S.A. has become one of the most profitable banks of the Guatemala banking system. It is, in fact, the third most profitable bank in terms of Return on Equity (ROE). The profitability registered by BANRURAL S.A. confirms that the financial services to the poor, if they are done correctly, can be profitable; and that promoting micro, small and medium size enterprises, and rural development DFIs must be profitable.

- **Self Sustainability:** BANRURAL S.A. has not only been a profitable banking institution but also a self-sustainable institution. It did not have any explicit subsidies over the past many years which indicate that BANRURAL S.A. generates enough income to cover its costs and that it does not depend on explicit subsidies to survive.
- **Outreach:** BANRURAL S.A. has been profitable, self-sustainable, and very successful in achieving its social mission by obtaining very good results in terms of the extent, depth and quality of outreach. BANRURAL has shown that it is possible to provide credit services to a significant number of clients and to mobilize a large amount of savings (especially small scale savings). Unlike some government owned public development banks, BANRURAL S.A. has been able to significantly increase its geographical coverage. Currently, BANRURAL S.A. is the largest bank in terms of geographical coverage in Guatemala, and the largest bank in terms of number of points of service in any country in Central America. The major growth in points of service has been in the rural areas. BANRURAL S.A. provides financial services to different segments of the population. Its clients are not only from the metropolitan area, but also, more importantly, from the interior of the country. Likewise, the extensive coverage and geographical distribution of its points of service have been a key factor for the popularity of the financial services of BANRURAL S.A. and the financial intermediation between the metropolitan area and the non-metropolitan area.
- **Growth of the Volume of Services:** The high growth in real terms registered in the average volume of credits, suggests that the credit

services by BANRURAL S.A. have had a high demand due to their good quality, generating appreciation by their clients. Likewise, the real rates of growth registered in the volume of liabilities also suggests that the creditors of BANRURAL (mainly the depositors) not only have trust in BANRURAL S.A. but are satisfied with the quality of the financial services of intermediation offered by the institution.

- **The Effective Rates of Interest:** The growth in real terms in the volume of credits of BANRURAL S.A. is not due to the fact that this institution is charging subsidized interest rates but to the fact that it is charging competitive and effective interest rates—the effective active rate of interest charged by BANRURAL S.A. is below the average market rate. The effective rate of interest charged by BANRURAL S.A. has always been lower than the average market rate of interest and has moved according to it.
- **Striking Recovery Rate:** To evaluate the quality of credit services of a bank, it is not enough for the bank to have positive growth in their credits; because the positive growth might be due to the fact that it is charging subsidized rates of interest. This positive growth may be due to a bad selection of its clients, or to “adverse selection” if the bank is charging interest rates that are too high. Therefore, it is necessary to evaluate the institution in terms of the recovery of its loans. In contrast to the majority of public banks BANRURAL S.A. has had good performance in its credit recovery.

BANRURAL S.A. has managed to reduce its rate of losses in the concept of non-recovered credits to a minimum thus increased its recovery rate to 98.82% in addition to decline in defaulted credits.

5.6. ACLEDA Bank, Cambodia

The mission and vision of ACLEDA Bank is to market a superior nationwide delivery of high-quality bank products and services at premium prices to meet the needs of the financial and commercial sector and the general public throughout Cambodia in a context where such products and services are presently of indifferent quality and limited to only a very few major towns.

The objective of ACLEDA Bank is to maximize shareholder value by providing and selling ACLEDA Bank's commercial and retail products and services targeted at the general public and MSE/ SME segments as well as selected services such as Cash Management specially developed for the larger organizations in the financial and commercial sector (e.g. banks, microfinance institutions, NGOs, national, multinationals and government).

5.6.1. History

ACLEDA was established in January 1993, as a national NGO for Micro and Small Enterprises Development and Credit. From the earliest days ACLEDA received the support of a number of major international development agencies. Two factors, namely expansion of network and ability to operate at a profit to ensure sustainability, led the management international partners to conclude that ACLEDA should be transformed into a bank. This would not only provide a secure regulatory framework lacking under previous status but would enable it to enlarge its range of funding options (e.g. equity injection, taking public deposits, obtaining commercial inter-bank loans) to support expansion of its core micro-finance business.

ACLEDA completed the transformation from NGO to a bank and the National Bank of Cambodia granted ACLEDA a license on October 7th, 2000. Under the

process, the existing NGO transferred the assets and on-lent its liabilities (long term loans from donors) to the new ACLEDA Bank. In return, it received 32% of the Bank's capital of US\$4 million; the ACLEDA Staff Association, established a trust to give its staff an equity interest up to 19% and the remaining 49% has been taken up in equal parts by four foreign investors, namely the International Finance Corporation (part of the World Bank), DEG-German Investment & Development Company, FMO-Netherlands Development Finance Company and Triodos Doeun (Netherlands).

Since transformation ACLEDA has expanded its business achieving an average portfolio growth rate of over 15% p.a. since 1997.

5.6.2. Financing Policy

ACLEDA Bank is endeavoring to market a superior nationwide delivery of high-quality bank products and services at premium prices to meet the needs of the financial and commercial sector and the general public throughout Cambodia in a context where such products and services are presently of indifferent quality and limited to only a very few major towns.

5.6.3. Methodology

ACLEDA Bank targets the lower segment of the market and provides loan to both individual (small business loan) and group (micro business loan). It caters to the banking needs of both urban and rural population without discrimination. To be eligible for individual loans, the applicants must qualify according to the following criteria:

- a) Land and building or substitute owners
- b) Resident in the areas where a branch office is operating.
- c) Unwilling to move from the areas until the loan is completely collected.

- d) Their ability to repay their loans through profitable businesses or secure sources of income.

5.6.4. Distinctive Features

- **Outreach Structure:**

Geographically, ACLEDA Bank has expanded to have the largest network in Cambodia, which will benefit savings, transfer, and other financial services. More district offices and service posts got established to be at closed length to the customers in order to be more convenient and serve them quickly. ACLEDA Bank's management believes that having offices closed to the customers, the Bank can serve the customers better and faster. It is more convenient to both ACLEDA Bank and customers. Furthermore, this is the competitive advantage of ACLEDA Bank where other commercial banks cannot do the same at this stage.

- **Access to Clients:** ACLEDA Bank can guarantee that the customers can always have access to ACLEDA Bank's financial services in both rural and urban areas. ACLEDA Bank has noted that financial intermediation is a vital element in developing local economies and reduces the relative dependence of the country on foreign capital by utilizing domestic savings for investments.

- **Customers' Benefits:** All ACLEDA Bank's target groups are the entrepreneurs of micro and small businesses, and medium sized enterprises; and the general public who are living in both urban and rural areas including the farmers in Cambodia. The customers of small and micro businesses can have the place where they can depend on, in terms of financial services, they can either borrow or deposit with the ACLEDA Bank. Furthermore they don't need to travel from their

business location to the suppliers or the other way round. If they want to pay off the purchase on credit or collect the sale on credit, ACLEDA Bank is the meeting point for the service payment and fee collection for those entrepreneurs and companies.

- **Products and Service:** ACLEDA Bank provides loans to service, trade, manufacturing, agriculture, and agriculture related activities. All loans are provided at ACLEDA Bank branches and offices, and the loan repayment is also done at ACLEDA Bank branches and offices. ACLEDA Bank credit officers only collect the loan repayment after they are defaulted.

- **Micro-business or Group Loan:** It is a group guaranteed loan whereby the members guarantee each other. Loan amount shall not exceed US\$380. In case one member cannot pay, the other members will pay for them.

- **Small Business Loan:** It is an individual loan. Loan size ranges from US\$380 to US\$10,000. In order to have access to this loan, the customer must have business ideas, technical skills, permanent location (residence at least of one year). Small business loan is a collateralized loan.

- **Medium Size Business/ Small-scale Industry Loan:** The loan size is from US\$10,000 up to US\$70,000. It is collateralized loan.

- **Training and Education:** - After the customers have filled in the format of the business plan, ACLEDA Bank provides basic training (business consultancy service) on business plan development to the customers of small and micro businesses. For the matter of convenience, most of the training is done at the customers' houses. The training is very simple, whereby the

customers can bring their literate relative with them to help them with the reading and writing, and calculation for those who are illiterate. The training for business plan development lasts about two hours in total. ACLEDA Bank provides basic training on business plan development that is used to determine how much loan each customer should obtain, and explain the customers the importance of using banking service to manage their capital properly (information on savings/ deposit); fund transfer; and other bank products.

- **Management Capacity:** ACLEDA Bank executive management is responsible for the day-to-day management of ACLEDA Bank and their policy is guided by the board of directors with a broader range of skills and experiences. In order to have the banking operation run smoothly, the executive management establishes all policies in place, such as: credit, financial, cash management, customer service, internal control, human resource, and staff regulation policies and make sure that all branches and offices of ACLEDA Bank implement

them strictly. These policies help a lot in decentralizing structure of decision making, especially in the geographical, far remote outreaches, where infrastructures are limited. A more sophisticated organization like ACLEDA Bank requires more sophisticated IT and MIS systems and the information produced. The IT demands a more disciplined approach to managerial responsibilities in particular the use of management reports. With the sophisticated system, ACLEDA executive management can track down the deficiencies and solve them in time, before the problems become bigger. As for the branches and offices staff, they can work much more productively. ACLEDA Bank Management has and continues to focus on the key management areas: Operational Risk; Asset & Liability Management; Internal Control & Audit and Information Technology have all fully justified the effort invested in them – some times in the most trying circumstances. Human Resources of ACLEDA Bank set great store by the quality of its training both for novices as well as regular refresher programs for all senior staff.

6. Conclusion

An assessment is made of the various strategies that these case study institutions use, to manage the specific costs and risks in agricultural lending. Guiding principles or “better” practices in agricultural lending have been drawn up from these experiences. It is firmly believed that there are really no “best” practices that can be applied to all circumstances. Instead, the development of better rural and agricultural lending technologies is seen as a dynamic and ongoing process that guides the lending institution towards meeting the specific demands of the rural clientele. Guiding principles can be deduced from the institutions' operations, but care must be taken in replicating their operations: a solution adequate in one socioeconomic environment will not necessarily be suitable in another. It should not be forgotten that the income levels and income-generating activities of the target clientele largely determine the effectiveness of specific modes of operation.

After analysing the salient features, lending methodologies, modes of operations, clientele base, sustainability, outreach, recovery mechanisms, etc. of these model financial institutions, some lessons can be drawn which will perhaps work as useful input in future policies undertaken by banks and other financial institutions. These are;

- A decentralized structure enables broad client coverage.
- Delegation of loan authority can effectively cut loan administration costs.
- Qualified, well trained and highly motivated field staff has a positive impact on the lending productivity.
-
- Simplified loan appraisal procedures reduce the time required for loan processing, loan approval and loan disbursements.
- Close contacts with local organizations and networks provides relevant client information.
- Effective management information systems provide crucial information.
- Diversification of the rural loan portfolio in terms of location and lending purposes helps to balance the uneven staff work load due to the seasonality in agricultural lending.
- A solid background in agronomy, farm management and rural economy is a prerequisite for good loan appraisal.
- Realistic agricultural loan demand assessment is crucial for a good loan portfolio planning and administration.
- An assessment of the specific risks that are associated with different agricultural production activities is essential in determining the potential risk exposure of lenders.
- Loan appraisal should include a thorough assessment of the borrower loan repayment capacity and his creditworthiness; also external risk factors of farm production should be taken into account.
- Collaboration with organizations which know farmers well reduces client information costs and risks of lenders.
- Agricultural lending should start in production zones that present low risks; operations can then gradually be expanded to more risky areas.
- Individualized loan products and loan repayment schedules that are set in accordance with the loan repayment capacity of the borrower reduce the risk of loan default.

- Loan portfolio diversification serves to protect agricultural lenders against covariant risks.
- Managing of external risks through loan rescheduling, agricultural insurance and emergency assistance can assist both the farmer-borrower and the agricultural lender.
- Staff incentives systems motivate staff and effectively increase their lending productivity.
- Close monitoring of markets and exposure to lending risks is essential for agricultural lenders.
- Clear information should be given to borrowers on the financial conditions of loans and loan repayment obligations.
- Close contacts between the lender and the borrower are conducive for an atmosphere of mutual trust that improves credit discipline.
- Agricultural lending institutions should be free of political interference in their daily management.
- Agricultural lenders as part of their risk management strategy need to monitor policy and market changes that affect their agricultural clientele.
- Collateral substitutes replace more conventional types of loan guarantees and can provide important loan repayment incentives.
- Collaboration with local organizations can be extremely useful to reduce client information costs. Farmer-borrowers can be provided with essential non-financial support services such as agricultural extension, and business and financial management training.
- New information technologies provide significant scope for the adoption of innovations in bank automation, electronic data processing and development of new agricultural loan products. For instance, a rural bank in India sponsored by the Bank of Baroda has launched a credit card scheme. Farmers who are credit card clients may get advances up to a certain limit per acre of land without additional formalities. Another example is the use of smart cards that allow farmers to draw loans on retailers of fertilizers and other agricultural inputs. For the lender, significant cost efficiency can be affected by using this form of loan disbursement.

These points coupled with other desirable policy inputs can help banks devise policies that will improve not only their risk management techniques but will also have a healthy impact on agriculture finance as a whole. However, to bring agriculture sector at par with other sectors of Pakistan, all the stakeholders; including banks, MINFAL, SBP, etc. need to perform their roles effectively and efficiently.

XXXXXXXXXXXXXXXXXXXX

7. Summary of Operating Methods, Performance, etc. of Financial Institutions

Item	BAAC	Land Bank	BRI-UD	GB	BanRural <i>Banco de Desarrollo Rural, S.A.</i>	ACLEDA Bank
Country	Thailand	Philippines	Indonesia	Bangladesh	Guatemala	Cambodia
Year of Establishment	1966	1963 Transformed to Universal Bank in 1973	1895	1976	1970 Restructured in 1998	1993 as NGO Transformed to Bank in 2000
Ownership	Government	Government/ State	Government (70%)	Semi-Government	Government	Semi-Government
Source of Funds	Savings/ Deposits	Govt. + Deposits	Savings/ Deposits	Deposits	Savings/ Deposits	Donors/ Deposits/ Savings
Objective	To stimulate agriculture through extending financial services to farming community.	To serve rural sector clients in areas where banking is either limited or is non-existent.	To provide broad-based credit for any type of rural economic activity	To improve conditions of rural poor by providing them access to credit, saving facilities, etc.	To promote economic and social development of rural areas through facilitation of savings, credit service, etc.	To maximize shareholder value by providing all banking services targeted at general public, MSE/SME segments, etc.
Nature of Institution	Agri Bank	Specialized Government Bank with Universal Banking License.	Commercial Bank	Microfinance Bank	Commercial Bank	Transformed from NGO to Specialized bank and now a commercial bank, oriented towards micro-finance.
Target Clientele	Agri/ Rural population	Rural farmers and fisherman	Agri/ Rural population	Poorest of the poor with handsome portfolio in Agri/	Farmers, merchants, artisans, and small and medium size	Lower segment of the market - both urban and rural

Item	BAAC	Land Bank	BRI-UD	GB	BanRural <i>Banco de Desarrollo Rural, S.A.</i>	ACLEDA Bank
				Rural sector	entrepreneurs	population
Outreach	98%	NA	98-99%	98%	NA	NA
Recovery rate	95%	75%	98%	99%	99%	NA
Collateral requirements	Yes for individual loans and No for groups	Yes	Yes	No, but compulsory savings tied to loan	Yes	Group guarantee, and sometimes, collateral
Management information system	Well developed	Well developed	Well developed	Well developed	Well developed	Well developed

Websites

- <http://www.baac.or.th/> or http://www.baac.or.th/baac_en/
- <http://www.landbank.com/>
- <http://www.bri.co.id/english/index.html>
- <http://www.grameen-info.org/>
- <http://www.banrural.com.gt/> [Banco de Desarrollo Rural, S.A. (Banrural)]
- <http://www.acledabank.com.kh/EN/index.asp>

XXXXXXXXXXXXXXXXXXXXXXXXXXXX

