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ISLAMIC FINANCE, RURAL COOPERATIVE FINANCIAL INSTITUTIONS (CREDIT UNIONS) AND MICRO FINANCING STRATEGIES

Mo Vaziri

Abstract

The size of Islamic country's underground economy on the whole depends on the burden and complexity of its tax system, the severity of its penal code, and the enforceability of its financial regulations. But what sets the Islamic Country's case apart from most others is that its underground economy is not an aberration, but a natural offshoot of its "Islamic" ideology and its unique political structure.

This paper analyzed the Islamic finance, rural cooperative financial institutions (Credit Unions) and micro financing strategies of such Islamic structure. The paper also identified the principal players and high-stake operators, roots and causes of the existence of underground economy, Islamic injunction against interest payment, the rise in total liquidity, and how offering banking services in compliance with Islamic law.

JEL classification: G18, G21, G28.

Introduction

The size of Islamic country's underground economy on the whole depends on the burden and complexity of its tax system, the severity of its penal code, and the enforceability of its financial regulations.

A highly distinctive feature of Islamic Country is the relatively large size of its informal, parallel, unofficial, unregistered, gray, and a host of other labels, the underground economy refers to activities – both lawful and unlawful – that elude taxation or escape registration in the country's gross domestic product (GDP). But what sets the Islamic Country's case apart from most others is that its underground economy is not an aberration, but a natural offshoot of its "Islamic" ideology and its unique political structure. It reflects a symbiotic relationship between the ruling theocratic oligarchs and their business supporters in the bazaar. Unlike the case in advanced liberal democracies where such unregistered activities are closely watched and the unlawful segment diligently dealt with, in Islamic Countries politico-judicial authorities knowingly or otherwise spawn and nurture them by either tolerating or only selectively punishing some of their glaring indiscretions. And, while often widely reported in the press, and publicly deplored by all political factions, these activities have rarely been seriously scrutinized or sufficiently exposed due to the power and influence of their principal beneficiaries

Bazaar Credit Network

The extra-legal portion emanates from state-sanctioned private monopolies in foreign trade, exclusive franchises in domestic distribution, the bazaar credit network outside the state banking system, influence peddling within the bureaucracy; and a raft of "rent-based" transactions involving access to privileged information and arbitrage opportunities. Some activities in this extra-legal category are of a hybrid nature, and may fall somewhere in between legal and illegal due to the unclear reading of the law: their categorization, therefore, should be considered somewhat arbitrary.

Principal players

Principal players and high-stake operators consist of scores of state-sponsored "private" enterprises engaged in money-making activities; a number of large quasi-public "charitable" bon-

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yads and several hundred parastatal entities; some old private endowments (waqf); a large network of non-transparent credit markets in the bazaar; religious shrines receiving sizeable cash donations from the faithful; several thousand non-bank banks, Qarz al-Hasanah windows, and "not-for-profit" credit unions; and the private fiscal household (bayt) of the major clerics.

Roots and Causes

In addition to the universal and familiar reasons for the existence of underground economy, there are other factors behind the Islamic Republic's own case. History, the Shi'a traditions, state sponsorship of non-transparent activities, misguided economic policies.

Islamic Injunction against Interest Payment

An interest-free loan in Islamic Countries is called Qard al-hasanah, Malaysia uses Al-qardhul hasan, Pakistan uses Qarz-e-hasna, Bangladesh uses Qard-e-hasana and Jordan – Al-qird al-hassan. In this work the term Qard hassan was chosen, as it seemed simplest and it is often used in literature

The constitutionally mandated Islamic foundation of these governments tacitly allows and even encourages the continuation of an informal economy. Devout Muslims among the bazaaris and other traditional classes tend to justify their camouflage of business transactions and non-payment of taxes to the treasury by claiming to pay their dues in Islamic taxes of zakat and Khoms directly to their religious marja' (sources of emulation) as the so-called Imam's share. Currently, huge donations from wealthy merchants to individual clerics or the religious shrines in Mashad, Qom, Shiraz, Ray, and others are seldom, if ever, documented, acknowledged, or publicized by the donors or the recipients. These donations are a kind of slush funds or cash boxes at the disposal of religious divines to be used for educational, charitable, and religious purposes as they see fit – without any control or supervision by the state. Islamic injunction against usury (reba), and the limits imposed on nationalized banks in regard to interest payments and charges have spawned a thriving informal and somewhat extra-legal credit market in the bazaar which totally escapes taxation and GDP accounting.

Inflexibility and inefficiency of the nationalized banking system, combined with inadequacies of a functioning money market, have led to the rise of a large-scale and resilient informal credit network in the bazaar. Reluctance on the part of the state banks to lend to the more risky small borrowers without adequate collaterals and their preference for large and virtually secure loans to state enterprises has driven petty producers and up-start young entrepreneurs to resort to informal credit sources. By one private estimate, some 20-25% of annual agricultural credit is supplied by the bazaar. As a result, while no more than 20% of total annual private sector credit came from these sources.

Sources of Liquidity

A method chosen by one of the country's own Central Bank economists relies on two general indices to figure out its approximate magnitude: the aggregate annual demand for money; and the excess of "average" family expenditures over family incomes. The rise in total liquidity is taken to indicate an expansion in the size of the underground economy on the assumption that nearly all unregistered transactions are customarily conducted in cash. Similarly, when expenditures by households perennially exceed their declared incomes without corresponding increases in their debt, a logical inference would be that the gap is filled by earnings from undeclared sources.

Both of these proxy indicators lead to a similar conclusion. Data published by Islamic Countries Central Bank for example, show that the ratio of liquidity to real GDP which stood at 15.8 in 1979 (when a parallel economy was probably at its lowest level) rose to 244.35 in 1991 and reached 573.3 in 2001. Needless to say, this colossal increase is not all due to the expansion of the underground economy, but probably a good indication of its possible steady rise. Periodic surveys of household budgets, published by Islamic Countries Statistical Center, also show a sizeable gap between annual incomes and expenditures in all household categories since the revolution. The latest survey conducted in 2001 shows that incomes of the average urban household covered only 92% of its total expenditure, and the figure for the average rural household was 87%. The gap

– officially shown as filled by "other sources" – indicates the part of the underground economy. Although the figure for urban families seems to have narrowed since 1991, there is some evidence that the cause may have been a forced curtailment of family expenses rather than the shrinkage of the shadow economy.

Offering Banking Services in Compliance with Islamic law

No financial institution is existent in devolved which offers banking services in compliance with Islamic law. It make sense to introduce financial instruments in a market which accommodates millions Muslims in developed countries. Are the hurdles for introduction too high or is the financial potential of the Muslim population too low to care about such questions?

Islamic financial Products

Mudarabah and Musharaka: The concept of musharakah and mudarabah envisaged in the books of Islamic Fiqh generally presumes that these contracts are meant for initiating a joint venture whereby all the partners participate in the business right from its inception and continue to be partners upto the end of the business when all the assets are liquidated.

Murabaha: ("Deferred Sale Finance")

Murabaha was first introduced in 1997 and is a simple method of financing the purchase of your house according to Islamic principles.

The procedure is very straightforward and although the documentation is different to normal mortgage documents the process is not more complicated or time consuming than buying a property in any other way.

The key features of Murabaha are described below:

- Suitable for the purchase of a house or flat; Property registered in your name or names;
- Maybe fully paid at anytime; Payments are fixed for the entire payment term;
- Maximum payment term is 15 years.

How it works

You identify the property you wish to buy and agree the purchase price with the seller of the property in the normal way.

You approach us for assistance and complete an application form (see section ‘do I qualify’).

If we are able to help, the bank will buy the property, after solicitors confirmed that everything is in order, and immediately sell it to you at a higher price.

The higher price is calculated depending on the value of the property, the number of years you wish to pay us over and the amount of your first payment (see ‘payment calculator’ for an indication of the higher price).

When purchased, the property is registered in your name and the sale between yourself and the bank is recorded in the Murabaha Contract.

Your first payment to the bank is made on the day of completion and is your initial contribution, normally a minimum of 17% of the purchase price.

One month after completion your regular monthly payments will commence. These will be claimed by Direct Debit automatically from your normal bank account.

Qualifying for Manzil

Manzil represents a long-term financial commitment and the legal contracts we will ask you to sign should not be entered into unless you are sure that you understand what they mean and feel confident that you will be able to afford the monthly payments.

To help assess whether you can afford the financial commitment, we will ask you to complete a detailed application form which will give us information about yourself, your employment, your other financial commitments and the house you wish to purchase. We will ask you to submit the application form together with other information, such as bank statements, to help us assess your financial position.

Once we receive the completed application form we will ask for references from your employer or accountant (if self-employed), your bank, your current lender (if appropriate) and your landlord (if you are renting). We will also undertake a credit search on all applicants.

Based on the information we receive, we will normally help you with an amount of up to 2.5 times your gross annual salary plus one times any other salary if the application is in joint names.

Type of Investment

There are various types of Investment in Islamic Banking branches as per Islamic Shariah. These may be classified as follows:

1. Buying-Selling System:
   (a) Bai-e-Murabaha, (b) Bai-e-Muazzal, (c) Bai-e-Salam.
2. Partnership Business:
   (a) Mudaraba, (b) Musharaka.
3. Hire Purchase Sirkatul Melk- Izara.
4. Hire Purchase.
5. Post Import Finance.
6. Purchase and negotiation of Export bills.
7. Inland Bills Purchased.
8. Murabaha Import Bills.
9. Bai Muazzal Import Bills.
10. Pre-shipment Finance.
11. Quards.

Prime Bank has a program to open more Islamic Banking branches to fulfill the demand of the people of the country.

Bai Salam:

A sales contract where the buyer pays in advance for the goods, which are delivered in the future. This type of financing is most often used when a manufacturer needs capital to manufacture a final product for the buyer. In return for paying in advance, the buyer receives a more favorable price (i.e. splits the profit margin with the manufacturer).

Istisna (Progressive Financing):

A contract of acquisition of goods by specification or order where the price is paid progressively in accordance with the progress of a job. An example would be for the purchase of a house to be constructed, payments are made to the developer or builder according to the stage of work completed. This type of financing along with bai salam are used as purchasing mechanisms, and murabaha and bai muajjal are for financing sales.

Istisna: A contract of acquisition of goods by specification or order, where the price is paid in advance, but the goods are manufactured and delivered at a later date.

Ijara:

Lit: letting on lease. Technically, sale of a definite usufruct in exchange for a definite reward. Commonly used for wages, it also refers to a contract of land lease at a fixed rent payable in cash. It is contrary to "Muzarah" when rent is fixed as a certain percentage of the produce of land. It also refers to a mode of financing adopted by Islamic banks. It is an arrangement under which an Islamic bank leases equipment, a building or other facility to a client against an agreed rental. The rent is so fixed that the bank gets back its original investment plus a profit on it.

Ijara (Leasing):

Leasing is also a lawful method of earning income, according to Islamic law. In this method, a real assets such as machine, a car, a ship, a house, can be leased by one person (lessor) to the other (lessee) for a specific period against a specific price. The benefit and cost of the each party are to be clearly spelled out in the contract so as any ambiguity (Gharar) may be avoided.

Leasing is emerging as a popular technique of financing among the Islamic banks. Some of the Islamic banks that use this technique include Islamic Development Bank, Bank Islam Malaysia and many commercial banks in Pakistan.

Under this scheme of financing an Islamic bank purchases an asset as per specification provided by the client. The period of lease may be determined by mutual agreement according to nature of the asset. During the period of the lease, the asset remains in the ownership of the lessor (the bank) but its right to use is transferred to the lessee. After the expiry of the lease agreement, this right reverts back again to the lessor.

Leasing as a technique of Islamic finance holds a lot of promise and potential to develop into a viable and power tool of financing. At present many Islamic banks are experimenting with various forms of leasing one of which is the lease purchase agreement. In this scheme, the lessee can purchase the equipment at the end of the lease period at a price that is agreed in advance. In most cases, the payment may constitute of the two components: rent and a portion of the price to be paid in the instalments. In another variant of lease purchase agreement, the rent may itself constitute the part payment of the price.

Ijara (Leasing):

A contract under which a bank purchases and leases out equipment required by its client for a rental fee. The duration of the lease and rental fees are agreed in advance. Ownership of the equipment remains in the hands of the bank.

Ijara wa Iqtina (Lease to Purchase):

The same as ijara except the business owner is committed to buying the equipment at the end of the lease period. Fees previously paid constitute part of the purchase price. This type of lease to purchase agreement is commonly used for home financing.

Ijara-Wa-Iktina (Lease Purchase):

Like Ijara, except that the client is committed to purchase the equipment at the end of the rental period. It is pre-agreed that at the end of the lease period the client will purchase the equipment at an agreed price from the bank, with rental fees paid to date, forming part of the price.

Qard Hassan:

An interest-free loan given for either welfare purposes or for fulfilling short-term funding requirements. The borrower is only obligated to repay back the principal amount of the loan.

Qard Hasan (Interest free loans):

Most of the Islamic banks also provide interest free loans (Qard Hasan) to their customers. If this practice is not possible on a significant scale, even then, it is adopted at least to cover some needy people. Islamic view about loan (Qard) is that it should be given to borrower free of charge. A person is seeking a loan only if he is in need of it. Hence, it is a moral duty of the lender to help his brother who may be in need. The borrower should not make an effort to take advantage of somebody needs. He should help the needy by lending him money without any charge. The reward of this act is with the God. Hence, it is referred to as Qard Hasan (benevolent loan) which signifies the benevolent nature of the act of lending.

The practices of various Islamic banks in this respect differ. Some Islamic banks provide the privilege of interest free loans only to the holders of investment account with them. Some extend to all bank clients. Some restrict it to needy students and other economically weaker sections of the society. Yet some other Islamic banks provide interest free loans to small producers, farmers and entrepreneurs who are not qualified to get finance from other sources. The purpose of these loans is to help start them their independent economic life and thus to raise their incomes and standard of living.

Qard Hasan:

An interest-free loan given mainly for welfare purposes. The borrower is only required to pay back the amount borrowed.

New Methods of Financing

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,
- Paralleled by a deregulation of foreign exchange and the trade regime.

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.

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 through savings;
- 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 savings mobilized.

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.

What matters to the poor

- First of all, client experience matters. Clients have experienced in projects that credit can make them poorer or richer.
- 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 and credit matters – far more than interest rates.
- Rural enterprise viability matters and is mutually reinforcing with R/MFI viability.
- Household portfolio diversification matters; but group enterprises have usually failed.

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.
- Capital matters, but should be mainly used in bridging temporary shortages in funds.
- 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 deposits matter, preventing the erosion of capital.
- Interest rates on loans matter, covering all costs.
- Institutions matter (projects don't, providing continuity and efficiency). Donors must abstain from perverse incentives which enable institutions to maintain unviable operations.
- Competition matters, entailing institutional diversity and pressures to perform.
- Prudential regulation and supervision matter, requiring the political will and institutional capacity to enforce standards in rural banks, SACCOs, AgDBs, other R/MFIs.
- Knowledge matters. Effective knowledge management is urgently needed.

What matters at the level of institutions

- Institutional reform matters: There are striking cases of reform of very different types of institutions, with great benefit to the poor, leaving no excuse for continual support to unviable institutions.
- Ownership and institutional autonomy matter; but management autonomy in terms of customer selection and loan decisions may be more important than ownership.
- Viability, efficiency, sustainability and self-reliance matter. Donors should support domestic resource mobilization, cost-effectiveness, and profitability.
- Saver and borrower outreach matter, which is compatible with sustainability.
- Sustainable outreach to marginal rural areas requires support for the primacy of savings and self-financing; and of member-owned SHGs operating at low costs.
- Lending technology matters – and should not be a matter of ideology: group technologies for the very poor; Individual technologies for graduating to larger loans.
- MFI portfolio diversification matters as a risk management strategy.
- Good practices matter, not best practices, which lead to inappropriate replications.
- Institutional size matters. There is no best practice in terms of size; both small and large institutions can be feasible.
- Profits matter, as a source of capital and a major determinant of growth of outreach.
- Incentives matter, as a major determinant of quality of performance and profits.
- Repayment matters. Many institutions now know how to reach repayment near 100%.
- Financial products and delivery systems matter: demand-oriented and cost-effective.
- Loan protection matters. Insurance is a service.

Risk management strategies

The issue is thus not whether rural and micro 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:

***Managing systemic risks*:** Co-variance of risks: Portfolio diversification. Weather-related risks.

***Expansion of outreach to wider area and different crops Market-related risks*:** Contract farming; commodity price risk insurance. Policy-related risks.

***Policy dialog and policy adjustment Political risks*:** Insisting on institutional autonomy. ***Managing idiosyncratic customer risks*:** Adverse selection: Incremental lending based on track record Moral hazard: Rigid loan examination, monitoring and enforcement. ***Financial technology*:** Graduating from small group loans to larger individual loans. ***Investment failures*:** Spreading the risk through household diversification Inadequate customer self-financing capacity: Providing opportunities for savings accumulation. ***Inadequate skills*:** Linking financial services with training and technical services (BDS). ***Managing credit risks*:** Loan examination. Meeting solvent demand only. Establishing total track record Loan terms. Appropriate loan sizes and disbursement times. Timely repayment: Customer incentives for timely repayment. Instant recovery action.

Lack of collateral: Warehouse receipts; non-formal collateral; joint liability. Lack of enforcement: Cooperation with local authorities to enforce repayment. Staff ability: Capacity building through training, distance learning, exposure training. Institutional efficiency: Rationalizing products and procedures. Financial innovations: Market research; pilot-testing of new products. Access to internet resources: http://www.common-fund.org; http://www.cgap.org; http://www.fao.org/ag/ags/agsm/RuralFinance; http://www.ifad.org

Managing transaction costs

Remote areas: Linking with SHGs; out grower schemes.

High operational costs: Wholesaling; economies of scope through savings, credit and insurance.

Tied lending: Financing provided through corporations Managing resource risks. Inadequate equity. Equity participation by customers.

Inadequate funds: Mobilizing savings; refinancing on national capital markets.

Interest rate risks: Matching fixed vs. variable interest rates of assets and liabilities Liquidity risks. Liquidity exchange.

Lack of term finance: Increasing equity and quasi-equity; promoting term savings.

Donor funding: Inviting equity participation, term loans, bridging loans.

Managing legal and institutional risks: Lack of legal framework. Introducing appropriate legislation for rural banks and other MFIs Absence of lobbying. Enhancing networks and associations of financial institutions Lack of R&S. Promoting effective regulation & supervision of rural banks, AgDBs, MFIs Lack of collateral. Liberalizing collateral legislation jointly prepared with Frank Hollinger (2003).

There are a number of other shortcomings, which render our analysis tentative:

- A confusion of savers and savings accounts;
- A confusion of borrowers and loan accounts;
- A lack of a clear definition of a development bank and a commercial bank, which may or may not overlap with registration under special law and banking law;
- Lack of information on the date of the exchange rate used for conversions.

Case Studies

1. Agricultural Cooperative Bank (ACB), Syria

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 of 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. Their main outreach instruments 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 are 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% are 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 1995-1996 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 was 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, i.e., 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.

Proposed Reform of ACB

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 micro entrepreneurs 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 micro entrepreneurs;
- 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.

2. Bank Keshavarzy, Islamic Countries

Bank Keshavarzy, Islamic Countries: 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 Islamic Countries was opened in 1930 by the National Bank of Islamic Countries (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 Islamic Country (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 Islamic Countries in 1968 as a financial institution for the emerging commercial farming sector after land reform, converted into the Agricultural Development Bank of Islamic Countries (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 there are 19 types of deposit products and 11 types of credit products; BK is also the first Islamic Countries' 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 2000-2001, 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 1998-1999, 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 2000-2001, 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 inequitably 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.

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

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.

Reform of BAAC

There were four major phases of reform:

- 1966-1974, laying the foundation for individual lending to farmers through joint liability groups;
- 1975-1987, expanding its lending operations through access to commercial bank and donor funds and consolidating its operations by substantially reducing loan channeling through cooperatives;
- 1988-1996, 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 of 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 (i.e., 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 (i.e., 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, and 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 (i.e., 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 Baca'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).

4. Bank Rakyat Indonesia (BRI)

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, and 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 centers. 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 installments 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 1997-1998 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). Outside the formal and semiformal sector are some 800,000 channeling groups and the ubiquitous arisen, 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.

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 of 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 of 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 of 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 200315. 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. Agricultural finance: Under the subsidized BIMAS program handled by the units until 1983, an average of $101m was lent over a 14-year period, part of which flowed into non-agricultural activities. Under BRI's nonsubsidized KUPEDES scheme, about 20% of loans are directly invested in agriculture, that was $384m (out of total disbursements of $1.92bn) in 1996; and $338 of loans outstanding (out of a total of $1.60bn) as of 6/2003. 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 sub-district 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). 15 Consolidated profits before tax reported by the bank as a whole were Rp1,545bn, or $187m, during the first half of 2003; i.e., about half that amount was earned by the units.

Conclusion and 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 1

Performance data of BRI units, 1984-6/2003

Year		Savings deposits				Loans outstanding			
No. of accounts	Amount in billion Rp	No. of accounts	Amount in billion Rp	Savings to loan ratio		* Excess liquidity in bn US$	12-month loss ratio	Arrears ratio**	Return on assets
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?" 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.

It is this experience which BRI i prepared to share with other.

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