

**RISK MANAGEMENT STRATEGIES:
CASE OF BANK FOR AGRICULTURE AND AGRICULTURAL COOPERATIVES**

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INTRODUCTION

How BAAC handle customer's risk?

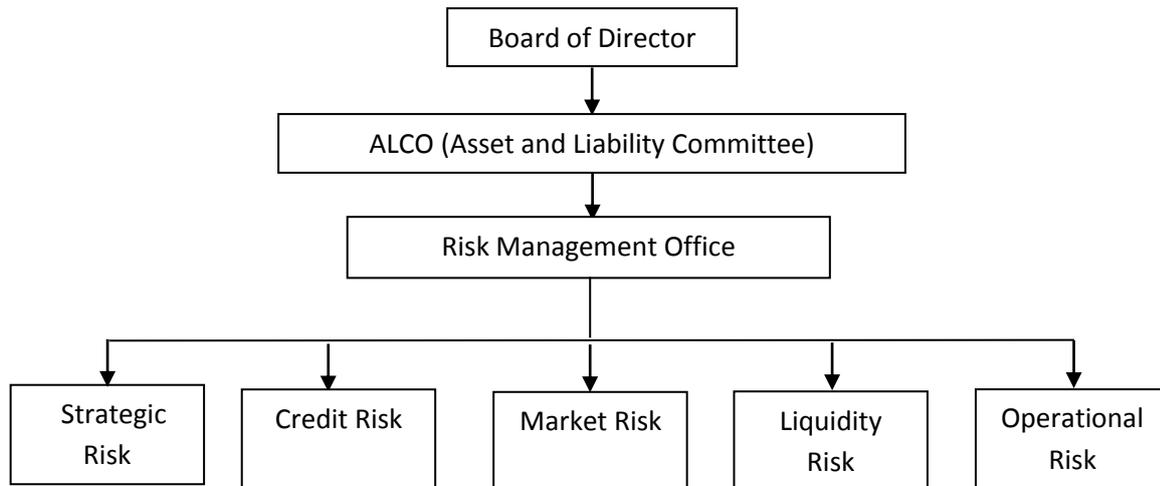
As it has been obviously perceived that agricultural produce has been playing a significant role for Thailand's economy. Additionally national security relies on the security of farmers' standard of living. Consequently, the quest for means of protecting farmers' income has been set on the Bank for Agriculture and Agricultural Cooperatives (BAAC)' s agenda which gives top priority to this particular issues on which country's sustainable development is based on.

Stating in BAAC vision, BAAC aims at promoting a sustainable livelihoods for client farmers. Therefore, BAAC, collaboration with government and others agencies such as Thai insurance companies, the World Bank, GIZ, FAO, APRACA and most importantly IFAD have initiated various strategies and tools to cope up with RISK. BAAC risk management practices are increasingly important. Her risk management operation is for not only her organization but also link to farmer clients as well.

As a financial institution and its' readiness to move forward to play the roles of Rural Development Bank which will focus on strengthen rural sector of the country, BAAC is aware of the importance of efficient risk management to respond to stakeholders including the Ministry of Finance, agricultural cooperatives, depositors and farmer clients. The banking businesses always confront risk arising from customers, natural disaster, economic changes, competition, technology, regulations and work process. BAAC must control risk to be under acceptable level. The objectives of risk management are focusing on firstly reduce or control damages affecting the operation arising from uncertainty event or unexpected event. Secondly, BAAC's operation has to be in line with good governance.

One of BAAC's risk management strategies approaches is beginning with organizing the structure of risk management cluster. In BAAC case, we establish the Risk Management Department to responsible for preparing policy framework, implementing according to the plans and monitoring and set up of the overall scope of the organization. This framework has to submit to the Board of Director for approval, whilst the Audit Committee is responsible for the audit of effectiveness and sufficiency of risk management process of the organization and various hosts to set up risk management policy and practices in their own responsibility in line with the bank's policy. Every workplace handles its own risk evaluation and control self-appraisal. The Audit Department is responsible for the review of every unit's operation and appraises the sufficiency of the bank's risk management system.

Risk Management Structure



Strategic Risk: Risk occurred from inappropriate strategic planning, non-conformity of policy, goals, strategy, organization structure, etc. impacting on operating fund and revenue

Credit Risk: Risk from default caused by customers' inability to repay or unwilling to repay

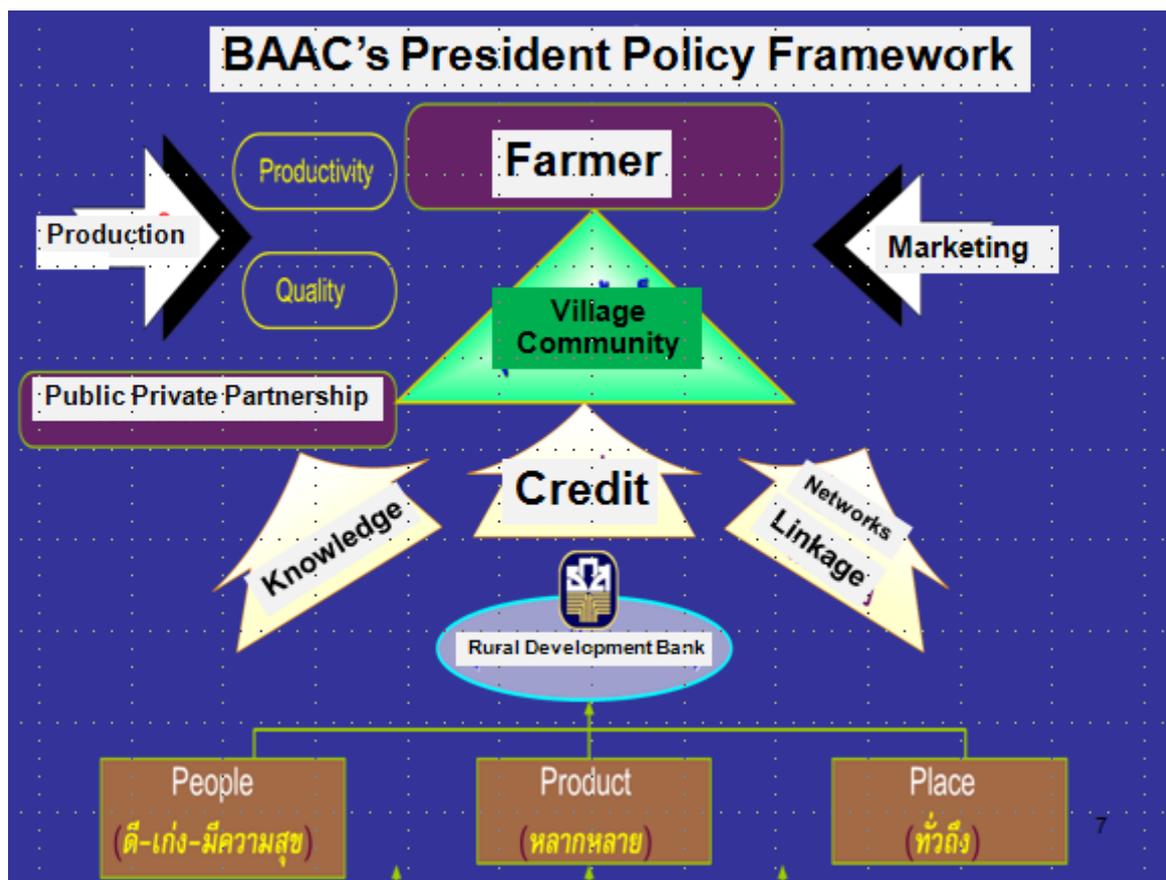
Market Risk: Risk from movement of interest rate, foreign currency exchange rate

Liquidity Risk: risk from the bank's inability to pay debt or liability caused by inability to change assets to cash on time or cannot find sufficient fund, etc.

Operational Risk: Risk from inefficiency or inadequacy of internal control system, staff, work system, technology, abnormal event, etc.

These risk management practices are well aware for most of financial institutions. Therefore, it will be essential to focus on BAAC's farmer clients risk management. According to BAAC's Rural Development Plan and together with Mr.Luck Wajananawat, BAAC's president, policy announced since fiscal year 2009, BAAC aimed at supporting her assistant through village community. These assistant comprised of supporting knowledge, credit and link with farmer's networks such as Thai Agri-Business Co.,Ltd. (TABCO), Agricultural Marketing Cooperatives (AMC.) Community Enterprise, Village Fund etc..

These supports are focused on firstly increasing liquidity in rural area. Secondly, the knowledge, which transfers by public or private organizations and BAAC's Farmer Schools, will help the farmers to increase their productivity and quality together with decreasing cost for producing agriculture produces. Lastly, linking the farmers through their network, which using collective buying and collective selling approaches, can be able to ensure bargaining power and bring back benefit to the community.



BAAC's Risk Management Tools For Farmer Clients

Agricultural Marketing Cooperatives (AMC.) and Thai Agri-Business Co.,Ltd. (TABCO)

According to the World Bank Report No. 32727-GLB on "Managing Agricultural Production Risk Innovations in Developing Countries" stated that agricultural risk is associated with negative outcomes that stem from imperfectly predictable biological, climatic, and price variables. They also include adverse changes in both input and output prices. Input and output price volatility are important sources of market risk in agriculture. Prices of agricultural commodities are extremely volatile. Output price variability originates from both endogenous and exogenous market shocks. Since BAAC proclaimed that, the success of the farmer clients is BAAC's success, thus, the BAAC's president policy is become BAAC's risk management strategies for its clients.

Since the start of BAAC's operations in 1966 the credit operation was restricted to cash only. The loans extended to farmers were sufficient for seasonal production expenses and carried low interest and fair terms and conditions compared to local private moneylenders. The loans provided by BAAC were used mainly to acquire farm supplies from local merchants. Under this system, some farmers were cheated because some merchants supplied inferior quality farm supplies at high prices. In 1980, BAAC introduced the credit - in - kind system by acting as intermediary in providing farm supplies to its farmer clients. Most of the farm supplies were provided directly from producers or dealers. By this system, BAAC could supervise and assist client farmers to have good quality farm supplies at reasonable prices. The credit - in - kind system has been used for almost ten years and it has been appreciated among the client farmers. In 1988, the volume of business peaked at 3,500 million Baht or 16 percent of the total credit disbursed.

However, the credit - in -kind system could not overcome all of client farmers' problems. It is true that with credit - in -kind, the client farmers can get good quality farm supplies at reasonable prices. But for farm product marketing they still depend on the private local merchants where the rate of exploitation is high, for example they offer low prices, they cheat in weighing the produce and insist on unfair payment or delivery condition. Therefore, in 1984 BAAC started to launch the farm products collection program by encouraging and supporting the client farm products. BAAC has assisted its clients in negotiating with buyers on prices, delivery and payment procedures.

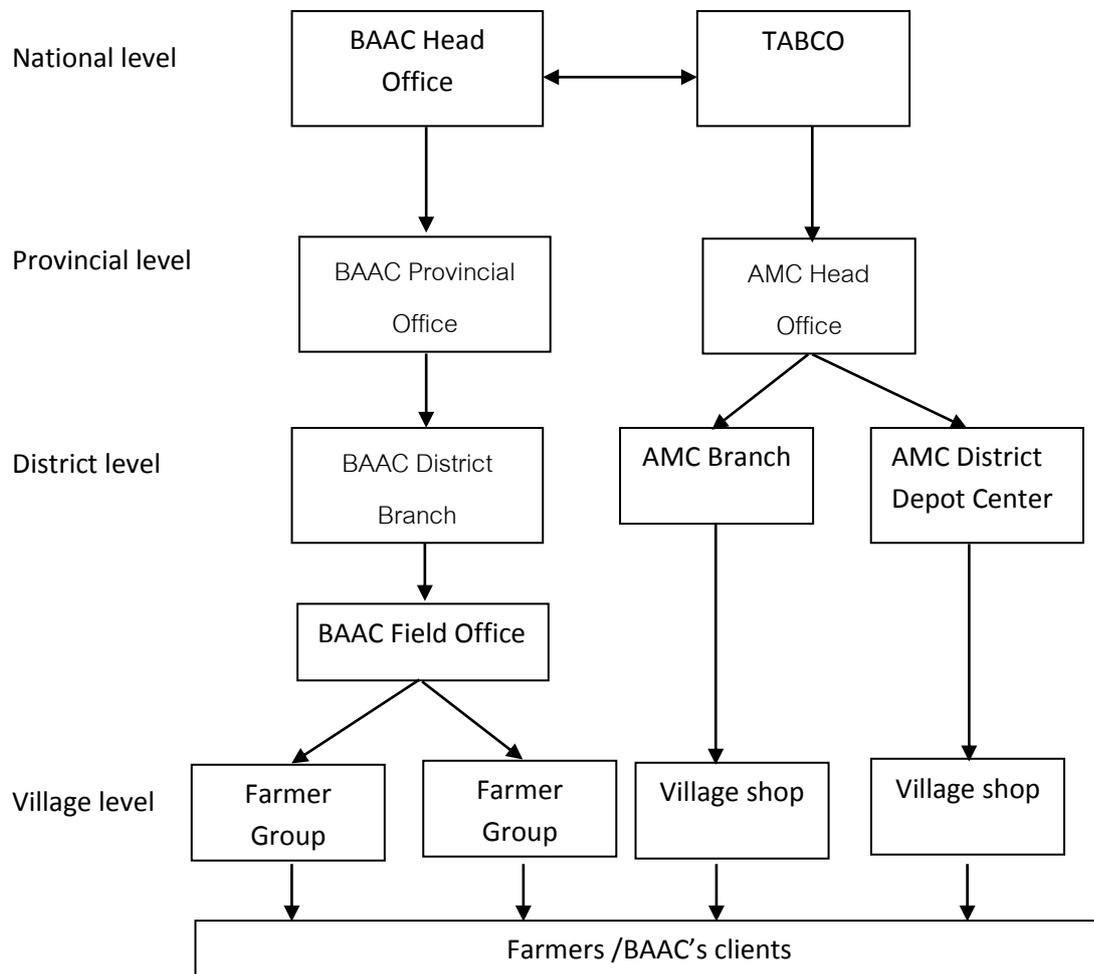
As mentioned above the client farmers need to handle the business of farm supplies and farm product marketing on their own. At present, BAAC credit services reaches over 4.7 million farm families with a total need for farm supplies valued at over one thousand million Baht. The value of farm products produced by client farmers is more than one hundred thousand million Baht. There should be an organization to handle this business.

Formerly, the job of supplying farm inputs to farmers and supporting the farm product collection scheme, was undertaken by BAAC credit officers. BAAC attempted to encourage farmers to form themselves into farmers clubs or "Chom Roms" where the client farmers develop the potential to act collectively and provide some level of assistance in development both the pre - harvest and post - harvest management of farm products. However, these clubs are informal groups, which have been successful to some extent because the membership of each club is only 50 - 60 families. With such small numbers, their bargaining power is still weak.

After dealing in this business for some time the client farmers realized that, they should have their own organization to arrange supplies of farm inputs and farm product marketing. So everyone agreed in principle that it is good idea for farmers to organize themselves into formal groups to handle the activities of securing farm inputs, to get credit on reasonable terms, to absorb new farming technology and to market their farm products. With the encouragement of BAAC, supported by the Cooperative Promotion Department and Cooperative Auditing Department, the client farmers have discussed and seen that it should be possible to organize their own societies, in the form of the Agricultural Marketing Cooperatives (AMCs) where their problems of farm product marketing can be overcome. These AMCs could also get assistance from BAAC. So in 1989 the client farmers in Chiangmai Province set up their own organization which was the first AMC in Thailand.

Structural Organization of the AMCs movement

The AMC movement can be classified into four levels as follows:



With this system or BAAC's farmer clients risk management tool, the client farmers have an opportunity to learn how to market their farm products and buy farm input by their own organization. At present, some AMCs are advanced enough to undertake bargaining and to set up marketing conditions by themselves. This cooperative movement is not only minimize the volatility of input and output price but also increasing bargaining power of small scale farmer through their own organization.

Funeral Association

Funeral or burial societies have a long tradition in rural Thailand and are deeply rooted in the village community. The funeral society represents the most widespread and popular micro insurance institution as its major function lies in pooling resources to cover funeral costs of its members. In its original form, membership is compulsory and includes everyone in the village aged over one month. Every time there is a death in the village, the members must provide a contribution of a fixed amount.

Based on these traditional funeral societies, BAAC started to promote funeral associations among its borrowers in a pilot project in Nan province in 1980. The pilot project was successful and was replicated throughout the BAAC branch network from 1981 onwards. The rationale for BAAC was two-fold: (a) to secure loan repayment in case of the borrower's death and (b) to provide its clients with a highly valued financial service on a larger scale. Since 1992, BAAC has also promoted the establishment of depositor associations. There has been a steady growth in the number of associations and members, even in recent years.

The BAAC-sponsored funeral associations are self-help organizations of the clients, independent from BAAC. The legal foundation for the funeral associations is the Funeral Associations Act of 1974. The associations are registered with the Department of Welfare. The role of BAAC vis-à-vis the funeral associations is that of a promoter and supporter. The bank provides them with office space for rent, usually in a building in the backyard of the branch office. Furthermore, bank staff provides technical assistance in management and administration. BAAC has developed specific accounting software for the funeral associations. Finally, the bank provides essential payment services through the branch office.

At the end of 2002, there were 405 borrower and 116 depositor associations throughout the country with a total membership of nearly 5.5 million people. The vast majority (90.3 percent) of the 5.4 million members are in borrower associations which consist of BAAC clients and their spouses. Of the 4.9 million members of the borrower associations, 3 million or 62 percent consisted of BAAC clients and 1.8 million or 37 percent of spouses of BAAC clients.

Strictly speaking, membership in the funeral association is not compulsory for BAAC clients but regarded as a "duty". In fact, for many people the membership in the funeral association is more important than a loan from BAAC. In terms of membership, borrower associations with 12,300 members on average are about three times the size of depositor associations with about 4,600 members.

The funeral associations provide mutual benefits for the members and for BAAC. The major benefits for the bank are in terms of (i) loan recovery and (ii) deposits. While important for BAAC, debt settlement is not the major aspect for the members. Out of Bt 6.7 billion paid out to members in 2002 only 18 percent was used for debt settlement while the loan share of 82 percent was at the free disposal of the members' families. In fact, the utilization of the compensation amount is left to the members' decision. BAAC does not have a legal claim on the proceeds. However, most but not all members fulfil their obligations towards the bank. The other major advantages for BAAC are the savings deposits maintained by the funeral associations.

Weather Index Insurance

Bank for Agriculture and Agricultural Cooperatives (BAAC) in cooperation with the General Insurance Association (GIA), the Department of Insurance (DOI), the Thai Meteorological Department (TMD), the Royal Irrigation Department (RID) held a ceremony of presenting crop insurance certificate on July 26th, 2007. It is the outcome of the project called the Weather-based index crop insurance which aimed to equip Thai farmers with an agricultural-related risk tool to cope with natural disaster especially drought in Pakchong District, Nakhonratchasima Province. The project is the first ever crop-production protection program which launched in Thailand and in the South East Asian countries. It has been supported by the Commodity Risk Management Group (CRMG) of the World Bank in term of technical assistance. There are 35 farmers who purchase the policies and the total of 962 Rais (1 Rai = 0.4 acre) are insured with a maximum compensation of approximately 1,332,000 Baht.

The weather-derivative-indexed crop insurance scheme for Thai farmers enable them to do better agricultural production risk management especially weather-related risk in particular of flood and drought which are the predominant sources of income instability. Retail agricultural insurance policies are sold in order to protect and stabilize farmers' income from the uncertainty of rainfall during the agricultural production period in Year 2007. Actually, the initiative followed a feasibility study in Year 2005 and piloted in Year 2006 which suggesting weather insurance to farmers in the context of self-activated agricultural immune system by reducing the exposure to weather-based risk.

Prior to the introduction of weather-indexed crop insurance, crop production is subject to be influenced by adverse weather condition, which has detrimental impact on crop yields. Unfortunately, there is little option with farmers to protect their crop against it. As a result, need arises to devise a system that can monitor the impact of uncontrollable weather on crop production, both in terms of acreage and production. Such system can be devised by making use of a beauty of state-of-the-art 3-S technology including Geographic Information System (GIS), Remote Sensing (RS) and Global Positioning System (GPS) respectively.

As payouts of the crop insurance policy are based on a calculation of an average of standard costs of good practice for agricultural production undertaken, farmers are encouraged and assured to employ new technologies and agricultural good practices so that they could get best yields as they expected with no worries with natural disaster events. By the way, of reducing the degree of risk in agricultural production, farmers are empowered to focus more on maximizing the output of the insured crop, rather than on diversifying the weather risk through the cropping system. They are enabled to alter their production strategies toward maximizing their output.

CONCLUSION

From 45 years of BAAC's experiences, we found that credit alone could not overcome all of farmer problems. Creating good combination between providing credit service, knowledge transfer and marketing support is one of key success factors that BAAC was adopted as a tool to come across these problems. To achieve goal of better living of farmer, it needs integration of non-financial services (technical assistance, insurance services, market information, etc) and finance services (efficient provision of loan, deposit, payment, and enables entrepreneurship, innovation) to help farmers improve productivity and quality, and find improved market channels. This is the key element of BAAC's risk management strategies and it can conclude that the "Customer success is BAAC success".

Reference

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