Bringing Inclusive Rural Financial Services in the Asia Region to Centre Stage: *Cases of Good Practices from China, India, Indonesia, Philippines and Thailand*

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Bringing Inclusive Rural Financial Services in the Asia Region to Centre Stage

Cases of Good Practices from China, India, Indonesia, Philippines and Thailand

Prasun Kumar Das and **Michael Hamp**

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Foreword

Promoting pro-poor growth is a pattern of growth that is inclusive and enhances the ability of impoverished people to participate, benefit in, and contribute to the growth process. Rural Finance, particularly an inclusive rural finance system, is one important ingredient for stimulating local production and processing of commodities, encouraging more intensive use of productive inputs, promoting investment in modern technologies, and providing financial opportunities to marginalized rural people, pro-poor rural finance is a critical factor for developing countries to achieve a sustainable way out of poverty and to enable achievement of the Sustainable Development Goals.

The causes of poverty are complex and multi-dimensional. They involve, among other things, climate, gender, markets, access to finance and public policy. Likewise, the poor are quite diverse in both the problems they face and the possible solutions to these problems. Poverty remains a predominantly rural problem with a majority of the poor in developing countries living in rural areas. It is estimated that 76 percent of the developing world's poor live in rural areas whereas only about 58 percent of the overall global population lives in rural areas. Because of the complexity of rural poverty, each country needs to evolve its own strategy for addressing the concerns of rural poor that is in tune with its socioeconomic ethos.

APRACA has been in the forefront to lead access to finance in the rural areas through its member institutions in the Asia-Pacific region by providing technical assistance in capacity building, research and knowledge management. We are fortunate enough to receive generous funding from International Fund for Agricultural Development (IFAD), the global leader in development finance and inclusive financial system development, for implementing a project to 'Document Global Best Practices on Sustainable Models of Pro-Poor Rural Financial Services in Developing Countries (RuFBeP project)'. The knowledge gathered will help APRACA and ultimately its member institutions in 21 countries across the region in disseminating the information that promotes innovations, productivity, inclusive growth, self-reliance, and welfare of the rural poor in the region. We are confident that documenting the best practices on sustainable practices of pro-poor rural financial services in the countries like China, India, Indonesia, Philippines, and Thailand will be extremely useful to the countries in the Asia-Pacific region to draw lessons in evolving suitable strategies for the benefit of their people and will add value to global knowledge resources.

It was observed that there is a massive gap on the documentation of the good practices of rural finance in Asia. I am the view that this synthesis report on the good practices of rural financial services in the select countries of Asia will fill in the knowledge gap in this particular area. This report is the final part of the series of country reports published by APRACA with the financial support from International Fund for Agricultural Development (IFAD).

SHITANGSHU KUMAR SUR CHOWDHURY

Deputy Governor, Bangladesh Bank and Chairman, APRACA

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This report has been made possible with the support and advice of several individuals and organizations and we would like to take this opportunity to express our heartfelt gratitude to all of them. The authors would like to acknowledge and thank particularly the following experts of the members of the five country teams: Dr. Enjiang Cheng and Ms. Dan Wang from China, Mr. Anil Kumar Singh, Mr. Vivek K. Sinha, Dr. K.S. Mahesh from India, Dr. Nunung Nuryartono, Dr. Manuntun Parulian Hutagaol, Ms. Triana Anggraenie, Mr. Bintan Badriatul Ummah and Ms. Rima Rosita from Indonesia, Dr. Gilberto M. Llanto and Ms. Jocelyn Alma R. Badiola from Philippines, Research team of Bank for Agriculture and Agricultural Cooperatives (BAAC, Thailand) and Department of Agricultural Extension, Government of Thailand led by Dr. Surangsri Wapet.

The authors would also like to extend their sincere gratitude to the individuals and the financial institutions who shared their experiences and helped to prepare the case studies. Without the openness to generously sharing their insights and supplying the requisite information and data with the researchers, contributing their time, guidance and support by the following financial service providers and initiatives in China, India, Indonesia, Philippines and Thailand this regional research would not have been possible: China Banking Regulatory Commission, Chongqing Rural Commercial Bank and CFPA Microfinance Institution from China; NABFINS, Kudumbashree, SKDRDP, SERP, SAMRUDDHI, Bandhan FSPL, HDFC Bank, Bank of India, Bank of Baroda from India; INTERCAFE IPB staff members of Bogor University, Indonesia; CARD-MRI and ASKI from Philippines; Community Financial Institutions namely Sarng Thor Noi Community, Na Koh Sak Saving Community Enterprise, Don Moo Community Fund, Suk Samran CFI from Thailand. We greatly appreciate their support, which were critical to the success of the series of country reports.

This research draws on interviews with representatives from different APRACA member institutions during the period of the field studies (ADBC, CFPA Microfinance Institution, NABARD, Bank Indonesia, Agricultural Credit Promotion Council, CARD-MRI, NLDC, PCIC, BAAC, Thailand Ministry of Finance). Finally, our appreciation is extended to the IFAD Country Programme Managers, Country Programme Officers and IFAD project directors for extending their explicit support during the course of the study made by the country teams.

Prasun Kumar Das (APRACA)

Michael Hamp (IFAD)

Abbreviations

ABC	Agricultural Bank of China
AC	Agricultural Cooperative
ACPC	Agricultural Credit Policy Council, Indonesia
ADB	Asian Development Bank
ADBC	Agricultural Development Bank of China
AgDB	Agricultural Development Banks
AGFP	Agricultural Guarantee Fund Pool
AMC	Agricultural Marketing Cooperative
AMCFP	Agro-Industry Modernization Credit and Financing Programme, Indonesia
APRACA	Asia-Pacific Rural and Agricultural Credit Association
ATM	Automated Teller Machine
B&DC	Business and Development Correspondent
BAAC	Bank for Agriculture and Agricultural Cooperatives, Thailand
BLP	Bank Linkage Programme
BOT	Bank of Thailand
BPD	Bank Pembangunan Daerah (Regional Development Bank)
BPR	Bank Perkreditan Rakyat/Rural Bank
BRI	Bank Rakyat Indonesia
BSP	Bangko Sentral ng Pilipinas
BTPN	Bank Tabungan Pensiunan Nasional
CARD	Centre for Agriculture and Rural Development
CB	Commercial Bank
CBRC	China Banking Regulatory Commission
CDA	Cooperative Development Authority
CFI	Cooperative/Community Finance Institution
CFPA	China Foundation for Poverty Alleviation
CRCB	Chongqing Rural Commercial Bank
DAEO	District Agricultural Extension Office
DFI	Development Financial Institution
DFID	Department for International Development
FAO	Food and Agricultural Organization
FFMC	Full-fledged money changers
FMC	Forward Markets Commission, India
FSA	Financial Services Authority
GO	Government Organization
Ha	Hectare
ICT	Information and Communication Technology
IDR	Indonesian Rupiah (1 US$ = 13,176.50 IDR as on 18 September, 2016)
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IMF	International Monetary Fund
INR	Indian Rupees (1 US$ = 67.09 INR as on 18 September, 2016)
IRDA	Insurance Regulatory and Development Authority, India
JFC	Jolleybee Food Corporation
JLG	Joint Liability Group
Kalasag	Kalasag Farmers Producers Cooperative
KCC	Kisan Credit Card

KJKS	Koperasi Jasa Keuangan Sharia/Islamic Financial Services Cooperatives
KKPE	Kredit Ketahanan Pangan dan Energi (Credit for Food Security and Energy)
KUD	Koperasi Unit Desa/Village Cooperative
Land Bank	Land Bank of the Philippines
LGOPR	Leading Group Office for Poverty Reduction
LKMA	Lembaga Keuangan Mikro Agrbisnis (Microfinance Institution for Agribusiness)
MBO	Micro-Banking Office
MCCs	Microcredit Companies
MFI	Microfinance Institutions
MoF	Ministry of Finance, India
MTO	Money Transfer Operators
NABARD	National Bank for Agriculture and Rural Development, India
NABFINS	NABARD Financial Services Nonbank Limited
NBFI	Non Bank Financial Institution
NCC	National Credit Council, Indonesia
NEFT	National Electronic Funds Transfer
NGO	Non-Governmental Organization
NHB	National Housing Bank, India
OBO	Other Banking Office
OF	Overseas Filipinos
OJK	Otoritas Jasa Keuangan (Financial Services Authority)
PBC	People's Bank of China
PFRDA	Pension Fund Regulatory and Development Authority, India
PHP	Philippine Peso (1 US$ = 47.83 PHP as on 18 September, 2016)
PO	Producer Organization
PRC	People's Republic of China
PSBC	Postal Savings Bank of China
PT	Limited liability company
RBI	Reserve Bank of India
RCB	Rural Commercial bank
RCC	Rural Credit Cooperative
RCCU	Rural Credit Postal Savings Bank of China cooperative union
RCOB	Rural cooperative banks
RFM	Rural Financial Market
RFS	Rural Financial System
RLF	Revolving Loan Fund
RMB	Chinese Yuan (1US$ = 6.67 RMB as on 18 September, 2016)
RTGS	Real-time Gross Settlement
RuFBeP	Project to Document Global Best Practices on Sustainable Models of Pro-Poor Rural Financial Services in Developing Countries
SBLP	SHG-Bank Linkage Programme, India
SEBI	Securities and Exchange Board of India
SEC	Securities and Exchange Commission, Indonesia
SFF	Small farmers and fishers
SFI	Specialized Financial Institution
SIDBI	Small Industries Development Bank of India
SMS	Short Messaging Service
SPP	Simpan Pinjam Perempuan (Women's Savings and Loans)
THB	Thai Bhat (1 US$ = 34.93 THB as on 18 September, 2016)
UGT	Usaha Gabungan Terpadu (Integrated Joint Business)
UPK	Unit Pengelola Kegiatan (Activity Management Unit)
USAID	United States Ageny for International Development
VCF	Value Chain Finance
VF	Village Fund

Executive Summary

It is widely recognized that the lack of access to a range of financial services is a major hindrance to lifting the typical rural smallholder out of poverty. Without access to financial capital, poor farmers and small entrepreneurs are unable to buy the inputs necessary to augment production and increase income. Furthermore, the limited availability of credit in general has held back the rural and agricultural sectors of many countries within the Asia-Pacific region, which has negatively affected the overall development of national economies. Yet, the ability of many governments and rural finance service institutions to effectively facilitate/provide such services on a sustainable basis has proved elusive. Among others, high transaction costs to cater to the large rural population and the problems of providing collateral by the rural clientele emerged as the major barriers to improving the impact of the pro-poor rural finance programme in the Asia-Pacific region. The risks associated with smallholder agricultural production include natural disasters, unforeseen declines in prices, low yields because of several factors, etc. All of these factors can result in low revenue, which in turn may lead to high default rates on loans and a limited use of other services, such as savings and insurance, thus aggravating the situation.

This report at an analytical level attempts to familiarize its readers with the present pattern of rural financing in select countries of South Asia and bring forth the factors contributing to the success of financial support systems based on the country-specific studies conducted by APRACA. It thereby explores the best practices and systems prevailing in the (rural) financial market and establishes their scope for replication and scaling up in wider contexts. The case studies in this report cover a cross section of institutions and target groups toward a wider understanding of the scope of rural financing options and their levels of impact in a causation framework. Further, the country-specific reports have adopted mixed methods of desk research and primary-level interaction with different stakeholders to establish the supply and demand side authenticity and relevance of the financial products and services being offered by the rural financial institutions in the country. Focus group discussions and in-depth interviews undertaken in the specific countries consisted of major stakeholders in the financial network for their views and ideas are also a part of the methodological design. The discussions focused on the best practices of farmers' organizations that provide financial services and funding support to the community groups.

The rural financial markets in Asia have been struck by several major events during the past few decades. The financial institutions catering to the rural populations in collaboration with the central banks and national governments in the region have tried their best to meet economic and social objectives, first to support the Green Revolution and more recently to aid in pulling their people out of poverty. The approaches of the countries in the region were also different, ranging from massive inflow of subsidized funds (as in the case of India, Indonesia, and Thailand) to a market-led interest regime (in the case of the Philippines). New specialized development financial institutions (ADBC in China, NABARD in India, BAAC in Thailand, Land Bank in the Philippines, etc.) have emerged to deliver credit to targeted clients when commercial lenders failed to serve rural clients adequately. There are instances when many of the institutions have failed, many have been recapitalized, and many of them became weak because of the accumulation of large non-performing portfolios.

Obstacles to sustainable rural financial services for meeting the changing demand remain in China. On the whole, the financial markets in China are dual: large- and medium-size enterprises (MSEs), especially state-owned enterprises (SOEs), have access to cheap credit from formal banks while the privately owned small and micro-enterprises and farmers either have very limited access to formal credit or have access to formal credit at a much higher cost. Many MSEs and small farmers are dependent on finance from informal sources to meet their demand. Based on the experiences documented in the specific case studies, it is recommended that the pilot on mobile banking undertaken by CRCB be replicated by RCCs and other RFIs in other parts of China and in the region, especially for the institutions that serve remote rural communities and households. More efforts should be given to promoting agricultural chain finance, which involves financing within the chain and from outside the value chain but fitted to the nature of the value chain and actors involved.

Important challenges for rural finance in India stem from the dependence of agricultural production on natural vagaries, high elasticity of the prices of produce, a lack of marketable collateral, high transaction costs resulting from low amount and scale of credit, weakness of the legal framework, a lack of credit information, a lack of suitable products, distance from banking outlets, and also little financial relation with the formal financial sector. This makes the development of suitable financial products and practices a difficult task. The financial environment has brought about regular efforts and innovations on the part of the government of India, state governments, regulators, NABARD, NGOs, and others to create different types of suitable rural financial practices and systems in India. Numerous types of products have emerged for microfinance. The early nineties was a watershed regarding the development of microfinance, when NABARD/RBI introduced the SHG-Bank Linkage Programme on the one hand and also helped NGOs to experiment with other microfinance products. Starting in 2005, serious discussion on financial inclusion led to the development of other financial services such as deposit accounts, micro-insurance, remittance support, and micro-pension.

As a common phenomenon in many member countries within the Asia-Pacific region, in Indonesia, poverty is still a major problem with 27.2 million out of its total population of about 250 million still living in poverty. The majority of these poor people live in rural areas where agriculture is the primary source of employment and livelihood. The low income flow from agriculture forces most of the rural inhabitants to find work in the agricultural as well as non-agricultural sector, either as laborers or small business operators. The three case studies presented in this report (BMT UGT Sidogiri, LKMA Pincuran Bonjo, and Grameen Scheme of KUD Mina Samudera) have no visible weaknesses and have proved to be quite successful in the country. However, it is also not yet clear to what extent these institutions can be adapted to different socioeconomic environments. All these issues can be studied through a pilot project, which can be used as a means for the learning process to find answers. To replicate or scale up the three rural finance best practices, they need some adjustment and adaptation to the local political/ economic/social and environmental circumstances of the areas where they are intended to be introduced or replicated. Geographic and regional diversity with its unique cultural, social, and economic values should be considered while thinking about any scaling-up exercises.

A distinct lesson coming from the Philippine experience is the importance of giving private financial institutions a greater role in rural financial markets, and of the retreat of government into a role that it alone can effectively play, namely, that of providing a policy and regulatory environment conducive to private-sector participation in the markets. The Philippine experience also shows that private financial institutions can lend and provide a variety of other financial services to areas or clients for which risks (e.g., loan default risk) can be assessed and mitigated. The case studies indicate that credit enhancements such as loan guarantees and risk protection schemes such as micro-insurance play a critical role in overcoming perceived risks in smallholder lending. The best practices in sustainable rural finance that are encapsulated in the four case studies are really different types of innovations that have been instrumental in providing the excluded segment of the population with access to financial services. Consumption smoothing, investments and risk-taking, and protection of families and individuals from catastrophic losses were made possible through the documented best practices. It is noted that collaborative effort by government, the private sector, donors, and the microfinance and micro-insurance communities was indispensable in developing and implementing those best practices.

The financial landscape of Thailand under the supervision of the Bank of Thailand provides a clear-cut and proactive policy framework for the rural financing systems and institutions in enhancing the national development goal with rural inclusion. Four rural financial institutions from four geographic locations are covered for an in-depth documentation of the best financing patterns for rural development in diverse environments. The best practice elements of Suk Samran CFI, for instance, have been that it is community-oriented and evolves a holistic welfare approach to its members. It acts as a contingency source of finance for the members and caters to the exigencies of the local communities. Don Moo CFI, on the other hand, covers the entire province of Ubon Ratchathani, where livelihood is primarily agriculture based. It supports the heterogeneous groups in operational spaces such as the flood-prone and drought-prone areas for farming operations. It seeks to promote agriculture and agribusinesses. Na Koh Sak CFI is essentially a farmer-based community financial institution. The members raise funds through savings and the same are loaned for financing productive enterprises within the community system. It follows the self-sufficiency approach as well as Islamic teachings. The financial product of BAAC, "Thaweesook Deposit," is highly innovative and caters to the aging population in the countryside that is mainly farmers and farming communities. Because no strong social security net prevails in the rural areas, this deposit product establishes a savings and future well-being for senior citizens. It links the farmers with the bank consortium through savings.

From a policy perspective based on the country-specific experiences, it emerges that more efforts should be given to promoting agricultural chain finance, which involves financing within the chain and from outside the value chain but fitted to the nature of the value chain and actors involved. For financing outside the value chain, processing machines, inventory, and receivables, the important assets of agro-processing plants, should be accepted as collateral for loans, and purchase orders provided by the agro-processors or farmers could also be accepted as collateral for loans under certain conditions. For financing inside the value chain, first, RFIs can use value chains to reduce credit diversion by farmers so as to improve loan repayment rates.

There is also a need for innovation, adoption, and expansion of existing best practices to ensure meaningful and complete financial inclusion. Although access to a bank account for transaction banking is extremely important for all households, including poor households, on the lending side, the Indian experience shows that providing collateral-free loans works better through using social capital and group guarantees. In fact, such a model supported by non-financial services, for linkages to livelihoods and markets from NGOs/government departments, can have a meaningful impact on poverty. The growth of microfinance institutions in the past 15 years also shows the scope available to fill the unmet credit needs of the poor, not only in areas that do not have deep banking infrastructure and are backward but also in well-banked regions. Developing countries strongly emphasize empowering their people, particularly the rural poor. Many efforts have been made in terms of financial and technical services to enhance their income and quality of life. However, the lack of access to formal financial services makes the exploitation persist. The CFI therefore is considered as an alternative in empowering rural people by providing them with the opportunity to manage their own resources, using local wisdom supported by modern knowledge and technologies. It is therefore highly recommended that this be applied and replicated across countries in the region for improved and sustainable growth in human development. Moreover, these models have become the channel for members/clients and their dependents to avail of the benefits of micro-insurance. This strategy therefore calls for collaboration between regulators and the MFI. There is a view in this context that the regulators need to be open and encouraging to innovative measures in the rural sectors.

Further, it is established that great potential remains for the financing models explained in the case of specific countries to be expanded because agricultural value chain financing can be viable if the market for agricultural produce is assured. This involves linking small producers to lead actors in the value chain to enable them to secure technical, financial, and marketing assistance. The microfinance systems are relatively less complicated and demand fewer innovations. This is because they are mainly deposit/savings mobilizers and do not really engage in the enterprising mode. This, however, offers less return than an enterprising structure that is market linked and value adding in nature for higher returns to the members and the community. Establishing financial structures for the elderly is highly innovative. In essence, the piloting of the community financial services and products detailed in this report reveals the imperative of financial inclusion in social development. The empowerment of the people and the community has multiple advantages in ensuring desired outcomes. On the one hand, it enables the mobilization of resources and leadership for socially inclusive development programme. It also enables the platform for growth-oriented investments for employment and income generation. This automatically leads to an improved standard of living of the people and the community to create social and economic mobility in a cohesive and sustainable manner.

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CHAPTER 1
Introduction

1.1 Background

It is widely recognized that the lack of access to a range of financial services is a major hindrance to lifting the typical rural smallholder out of poverty. Without access to financial capital, poor farmers and small entrepreneurs are unable to buy the inputs necessary to augment production and increase income. Furthermore, the limited availability of credit in general has held back the rural and agricultural sectors of many countries within the Asia-Pacific region, which has negatively affected the overall development of national economies. Yet, the ability of many governments and rural finance service institutions to effectively facilitate/provide such services on a sustainable basis has proved elusive.

The reasons for the lack of success in delivering rural financial services and the risk associated with this are well researched and documented. Among others, high transaction costs to cater to the large rural population and the problems of providing collateral by the rural clientele emerged as the major barriers to improving the impact of the pro-poor rural finance programme in the Asia-Pacific region. The risks associated with smallholder agricultural production include natural disasters, unforeseen declines in prices, low yields because of several factors,[1] etc. More recently, adverse impacts emanating from climate change have also been seen as a constraint, especially for smallholder farmers in the developing and least developed nations (climate change not only enhances the existing risks faced by smallholder farmers but also limits coping and adapting to the shocks). All of these factors can result in low revenue, which in turn may lead to high default rates on loans and a limited use of other services, such as savings and insurance, thus aggravating the situation. Hence, many financial institutions[2] are often reluctant to extend credit services to smallholder farmers and other rural entrepreneurs. Despite these barriers, innovative ideas and good practices are constantly being developed and tested that nonetheless achieved success in many countries of the Asia-Pacific region.

1.2 Rationale, Purpose and Objectives

The extensive experience of the International Fund for Agricultural Development (IFAD) in the sector demonstrates that both agriculture and rural finance can be profitable businesses if they receive proper impetus from all stakeholders responsible for local and regional development. Furthermore, it was believed that the new and innovative approaches should be given both the opportunity and the appropriate resources to show their true potential to help lift smallholders out of poverty. In response to address the specific needs of the member countries in the Asia-Pacific region, IFAD partnered with the Asia-Pacific Rural and Agricultural Credit Association (APRACA) to implement the RuFBeP project[3] involving five major countries[4] in the region. It is expected that the outputs of the project will enrich the body of knowledge in this sector and support financial institutions in expanding access to rural financial services for the poor. During the first phase of the project, the country status on rural financial

[1] They are poor rainfall, lack of access to markets, or crop loss due to numerous other agronomic factors.
[2] This includes those that are specifically created to cater to rural clients, such as state-owned development banks, rural cooperatives/commercial banks, etc.
[3] RuFBeP project: "Project to Document Global Best Practices on Sustainable Models of Pro-Poor Rural Financial Services in Developing Countries."
[4] The five project countries are China, India, Indonesia, the Philippines, and Thailand.

services and good practices[5] were documented.[6] It was believed that a synthesis report compiling the good practices of the countries studied and relating them to other global good practices could help the member countries to respond to the immediate needs for scaling up the proven good practices.

The primary objective of this synthesis report is to examine high-impact good practices in providing finance to the rural sector in the project countries in the Asia-Pacific region. Asia is a vast region composed of many heterogeneous countries that have employed a variety of products, services, policies, and programme since the 1970s to improve rural finance. To narrow the task to manageable proportions, five countries were selected by IFAD for the detailed study: China, India, Indonesia, Philippines, and Thailand. The overarching objectives of this synthesis report of the five country case studies undertaken during the first phase of the RuFBeP project are to enable country-level stakeholders to appreciate and scale up the good practices. The report is also envisioned to support the stakeholders to engage with local and national-level policy leaders to take well-informed decisions and action, to strengthen the rural finance delivery system at the country level. The report will also support the knowledge enrichment process in the region on this important development issue. This report is designed to assess the existing rural finance scenarios and the good practices being followed in each of the five countries, which may help policymakers and bilateral and multilateral development and donor agencies to identify the areas of intervention required and also carefully judge the lessons learned. This synthesis report pulls together the main takeaways from the already-published individual country reports and situates them in the context of nine key elements of sound rural finance good practices.

1.3 Methodology

The synthesis report methodology included the current rural finance institutions, delivery systems, products and services, innovations, and policy environment in the five countries selected. The country reports already published by the project are the primary sources of information for the report. Apart from that, all other relevant literature that could be identified for these five countries was assembled and a limited amount of primary data was also obtained. Cross-cutting lessons were also drawn from the case studies. Insights from this work shaped the recommendations for pilot testing of the good practices in three countries (China, Indonesia and Philippines) under the RuFBeP project and for the governments to increase the effectiveness of rural finance policies and their coordination.

1.4 Structure of the Document

With this backdrop, the rest of the chapters in this document are arranged as follows: Chapter 2 describes in detail the rural finance scenario in Asia. While providing a historical background, it provides the details of the main actors and providers involved and regional coverage of various operational schemes in these countries. An attempt is also made to highlight the regulatory framework and the enabling conditions while also summarizing the pitfalls of these. Chapter 3 is devoted to the individual best practice cases in the context of China, India, Indonesia, Philippines and Thailand. The emerging trends and patterns are presented in detail in Chapter 4, where, first, the innovations in product design and service delivery are described and the second part identifies the application of ICT and risk mitigation in rural finance. While concluding the report in Chapter 5, key implications and policy recommendations are presented in detail. Similarly, Annexure 1 presents a summary sheet for all the identified best practices in the country study reports, along with the inclusion criteria for each of the cases.

[5] The project used certain criteria as agreed during the project planning phase to identify the rural finance best practices in the countries of study.

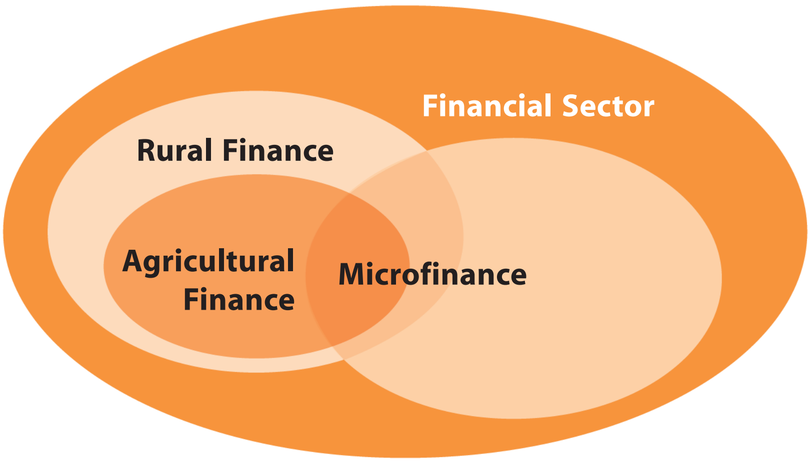
[6] The five country reports are available in the e-library of APRACA (www.apraca.org), IFAD Asia (www.asia.ifad.org), and the Rural Finance and Investment Learning Centre (www.ruralfinanceandinvestment.org).

CHAPTER 2
Rural Finance in Asia

2.1 Overview

A new paradigm in rural finance[7] began to emerge in the late 1980s and gained momentum during the mid-1990s in the Asia-Pacific region (Figure 1). The genesis was based on lessons from the old paradigm and the emerging microfinance[8] revolution took place to bridge the gap between demand and supply of financial services in the rural areas of the region. The new paradigm reflects a financial systems approach, using market principles to deliver financial services aimed at facilitating rural development that, in turn, promotes asset creation and poverty reduction in the rural areas. The new paradigm is based on the principle that a commercial, market-based approach is most likely to reach large numbers of clients on a sustained basis. It also recognizes that innovative financial products and services could demonstrate desired impact to rural socioeconomic situations. Financial institutions are constantly developing new products and services to cater to the rural population in their country context with some scale of success, which, however, is not being disseminated to the right audiences across the continent. It was also seen that the national government has a role to play in establishing a favorable policy environment, which also needs more engagement and knowledge sharing to facilitate the scaling up of good practices and innovative ideas.

Figure 1. Rural Finance in the Structure of Financial Sector



Source: Meagan, 2006.

The rural financial markets in Asia have been struck by several major events during the past few decades. The financial institutions catering to the rural population in collaboration with the central banks and national governments in the region have tried their best to meet economic and social objectives, first to support the Green Revolution and, more recently, to aid in pulling the people out of poverty. The approaches of the countries in the region were also different, ranging from massive inflow of subsidized funds (as in the case of India, Indonesia and Thailand) to a market-led interest regime

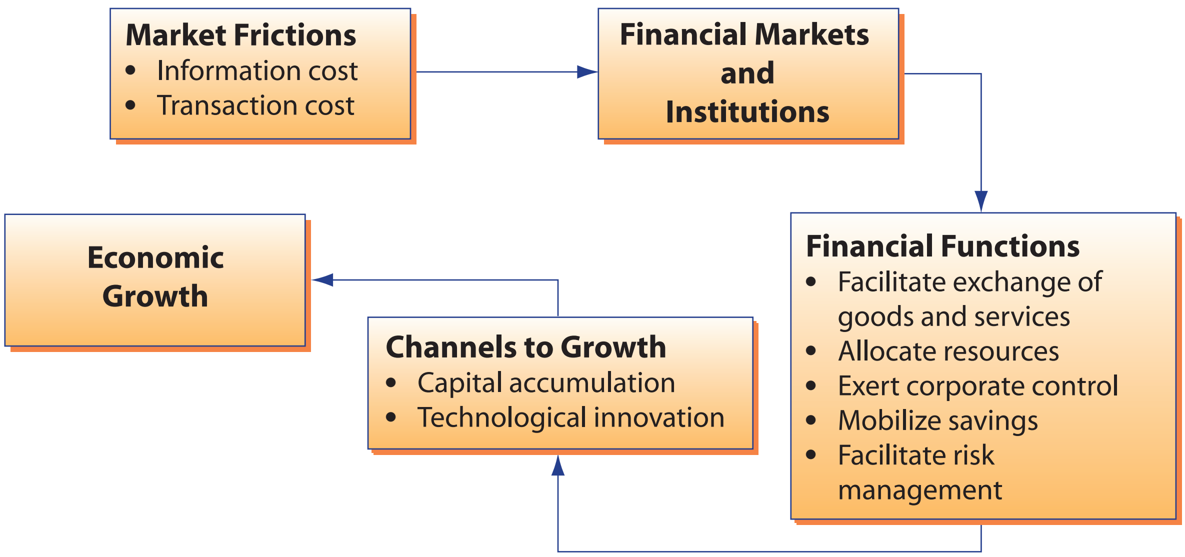
[7] Rural finance describes financial intermediation outside of urban areas, including deposits, loans, payment and money transfer systems, trade credit, and insurance, to rural households as well as to farm and non-farm enterprises.
[8] Microfinance refers to small transactions involving low-income households and micro-enterprises, using character-based methodologies. Microfinance tends to be short-term in nature and may not fully address the issues of agricultural and term finance that are important concerns of rural finance.

(in the case of the Philippines). New specialized development finance institutions (ADBC in China, NABARD in India, BAAC in Thailand, Land Bank in the Philippines, etc.) have emerged to deliver credit to targeted clients when commercial lenders have failed to serve rural clients adequately. There are instances when many of the institutions have failed, many have been recapitalized, and many of them became weak because of the accumulation of large non-performing portfolios. Out of the five countries studied, almost all of them[9] have strong, self-sustaining institutions with the capacity to serve large numbers of rural farm and non-farm clients, including the poorest members of the rural economy.

2.2 Historical Background

The countries in Asia have undergone fundamental economic transformations during the past decades across both rural and urban settings. Although economic growth has been high, particularly in East and Southeast Asia, nonetheless, notable development has also been recorded in other countries across the region. This growth has also resulted in a structural transformation of the rural economy, with the contribution of the agricultural sector to overall national income declining steadily over the years. On the other hand, phenomena such as the increased use of sophisticated capital inputs in agricultural production, greater specialization in production, diversification of income sources, growth of rural cities and towns, and the emergence of a heterogeneous rural nonfarm economy have been clearly witnessed in many countries. This transformation requires massive support from institutions and markets. Markets play an enabling role in a greater division of labor, through which producers specialize and trade with others with different specializations. Markets integrate these specialized producers and consumers, allowing them to engage in transactions involving an increasingly heterogeneous set of goods and services produced across space and time. With structural transformation, markets for land, labor, capital, and finance emerge, multiply in number, and become more complex in response to the greater variety of goods and services demanded (Meyer and Nagarajan, 2000). Figure 2 shows the overall process along with the substages involved. This is true for countries in the Asian region also and, as a response to the structural transformation during the last three to four decades, markets with varying degrees of efficiency have emerged.

Figure 2. Theoretical View of Finance and Growth



Source: Levine, 1997.

[9] There are some instances of heavy subsidy and recapitalization of financial institutions in India and China. Some institutions failed in Indonesia and the Philippines but are not significant in number.

In this context, it is important to note that the financial system plays the primary role of facilitating the allocation of resources across space and time. Levine (1997) mentions that this primary role of the financial system consists of five basic functions: (i) ameliorating risk, (ii) allocating resources, (iii) monitoring managers and exerting corporate control, (iv) mobilizing savings, and (v) facilitating the exchange of goods and services. When these functions are performed to a satisfactory extent, they contribute to economic growth through capital accumulation and technological innovation. In view of this, the emergence of financial systems and banking can be expected to influence the speed and pattern of capital accumulation and technological innovation in rural areas. The role of rural credit hence gains importance as policymakers have time and again questioned the ability of farmers to self-finance investments that would result in socially optimal growth. The perception was that the potential of the Green Revolution would not be realized unless farmers could access an elastic supply of funds at more reasonable interest rates than available from informal sources. In this context, ADB (1978) observes that during earlier times the development of credit programme reflected, first, the concern for accelerating agricultural (especially food) production; second, the growth potential of agriculture by widespread adoption of high-yielding varieties; and, third, recognition of the role of credit in the development of small-farm agriculture. These views provided the rationale and were responsible for the development of targeted and subsidized agricultural credit programme along with strong support for input and output marketing projects to encourage the adoption of Green Revolution technologies in many Asian countries.

2.2.1 Evolution in Policies and Approaches

Most Asian economies had followed up an approach of directed credit as a means of controlling finance, including rural finance, rather than relying on market mechanisms for generating savings and allocating resources. This was done with a view to speeding up specific policy objectives from time to time. The instruments used for intervention by state actors were in the form of lending requirements and quotas imposed on banks, refinance schemes, loans at preferential interest rates, credit guarantees, and lending by development finance institutions. The dominant idea during the 1950s and 1960s was that farmers lacked access to formal credit and informal lenders charged lofty interest rates and short-term high-cost informal loans were unsuitable for financing the productive investments considered essential for rapid technological change and sustainable rural development (Meyer and Nagarajan, 1996). As a response, supply-leading directed agricultural credit policies were viewed as instruments to overcome perceived financial market imperfections. In this scenario, a major role was assigned to financial institutions to address numerous economic and social issues; however, this was based on the false notion that rural poverty could be addressed through credit alone (Adams, 1998).

However, two major events (the 1972-73 Spring Review of Small Farmer Credit by USAID and the 1975 World Conference on Credit for Farmers in Developing Countries held at FAO) were instrumental in raising concerns about the directed credit paradigm used to rationalize agricultural credit projects in developing countries. The findings of these two events implicitly challenged the directed credit approach and the concerns were the following:

- Small-farmer credit projects are part of a larger rural financial market and tend to have greater access to informal sources.
- The major increases that occurred in formal finance have mainly gone to larger farmers.
- The introduction of special subsidized agricultural credit programme inhibits commercial lenders from expanding into rural areas, thereby perpetuating dualism in rural financial markets.
- Although low interest rates were observed to be a major factor determining the distorted patterns of credit allocation, preferential interest rates for small farmers were detrimental to improving access to formal loans, but were effective in transferring income to small farmers.
- It was also observed that, when interest and other subsidies are provided, they should be used to build up institutions rather than passed on to farmers in low-interest loans.

- Loan default rates are high and demand more attention, but crop and credit insurance and loan guarantees are not likely to be good solutions to the problem.
- The administrative costs of lending were high and required cost-reducing innovations such as partial-service bank branches, mobile banks, village bank agents, and the creation of rural banks.
- It also emerged from the deliberations that there was no single best type of institution to provide rural financial services. Commercial banks, agricultural development banks, and farm cooperatives have all experienced successes and failures in serving agriculture.
- A particular concern was that the benefits of small-farmer credit projects may not cover the costs. When the conditions for successful credit projects are not met, other programme may be capable of raising small-farmer welfare at lower costs.

In the following years, additional research was conducted on rural financial markets with the results tending to support the observations made in the Spring Review and FAO conference. The Asia-Pacific Rural and Agricultural Credit Association (APRACA) was established in October 1977. Again, through its auspices, studies were conducted in the region and training was conducted on agricultural credit policies and programme. Subsequently, the Colloquium on Rural Finance in Low-Income Countries sponsored by USAID and the World Bank was held during 1981 in Washington, D.C., and many of the conclusions reached at this meeting were similar to those of the USAID and FAO meetings held earlier. Additionally, it was demonstrated how subsidized credit programme were a part of a system of political patronage and how subsidized interest rates for farmers failed to compensate for other policies that discriminated against agriculture. Unfortunately, the insights presented in these research results and disseminated in these meetings did not make a major impact on Asian policymakers, so credit projects in the region often continued to be designed and implemented under the directed credit paradigm until the emergence of the microfinance revolution during the 1970s.

2.2.2 The Microfinance Boom

During the 1970s, a new financial development emerged in developing countries that contributed to the amended views regarding the appropriate strategy for developing rural financial markets. This was the emergence of microfinance, mostly the granting of small loans, which began as a series of small experiments and mushroomed into a development fad. Many institutions, especially NGOs, make small loans as part of their programme to create employment, raise the income of the poor, provide emergency relief following natural disasters and conflicts, and improve rural health, education, and nutrition. Microfinance experiences in Bangladesh and Indonesia made important contributions to the emergence of microfinance (Meyer and Nagarajan, 2000).

Microfinance organizations (MFOs) managed to develop important innovations that enabled them to expand the financial frontier in developing countries. For the first time, large numbers of poor borrowers had access to formal financial services because of these innovations, which reduced lending costs and risks, and permitted MFOs to serve poor clients successfully without the collateral normally required by banks. The unique features that contributed to their success include the following:

- Loan sizes: Small in size, and made for only a few weeks or months, to be used mostly for working capital purposes.
- Repeat loans: Incentives to maintain good repayment records. For some lenders, the size of the first and repeat loans is set according to a predetermined formula.
- Repayment schedules: Frequent payments are required, often weekly or monthly, to enable close monitoring.
- Loan collateral: MFOs use a lending technology involving peer group formation and peer monitoring as a substitute for conventional loan collateral to reduce transaction costs and risks.

- Decentralized lending procedures: The procedures for screening applicants and processing loans are simple, with considerable autonomy given to loan officers, who are required to maintain close contact with their clients.
- Loan delinquencies and losses: Lenders frequently report loan recoveries of 95 percent or more. Some organizations also offer interest rebates for on-time or early repayments, and others charge an interest penalty for late payments.

Although many developing countries continue to use the traditional directed credit approach toward agriculture, a significant shift in views has been occurring in some developing countries. The old paradigm of subsidized and targeted lending has been gradually replaced by the new paradigm oriented more toward financial market efficiency (Table 1) (Robinson, 1997; Vogel and Adams, 1997; Adams, 1998). The failure of most countries to develop a sustainable rural financial system using the old agricultural credit paradigm, coupled with the successes of a few MFOs, contributed to the emergence of a new paradigm. In Asia, the experiences of the Unit Desa system of BRI in Indonesia, of the Bank for Agriculture and Agricultural Cooperatives in Thailand, and of the Grameen Bank in Bangladesh made important contributions to the new views. There are few challanges in developing the financial sector in transition countries as given in Box 1.

Table 1. Summary Features for Old and New Paradigms

Features	Directed credit paradigm	Financial market paradigm
Problem definition	• Overcome market imperfections	• Lower risks and transaction costs
Role of financial markets	• Promote new technology • Stimulate production • Implement state plans • Help the poor	• Intermediate resources more efficiently targeted
View of users	• Borrowers as beneficiaries selected by targeting	• Borrowers and depositors as clients choosing products
Subsidies	• Large subsidies through interest rates and loan default • Create subsidy dependence	• Few subsidies create independent institutions
Sources of funds	• Governments and donors	• Mostly voluntary deposits
Associated information systems	• Designed for donors	• Designed for management
Sustainability and evaluations	• Largely ignored • Credit impact on beneficiaries	• A major concern • Performance of financial institutions

Sources: Adams (1998); Meyer and Nagarajan (2000).

BOX 1. Challenges in Developing the Financial Sector in Transition Countries

1. Strengthening the banking sector to improve efficiency
   - Reducing bureaucratic interference and overdues
   - Unclogging payment systems
   - Strengthening regulatory and supervisory systems and developing legal systems that can enforce contracts and inculcate financial responsibility
   - Reducing corruption and improving the skill level of staff to assess and manage risks
2. Reducing systemic problems in financial markets to increase competition
   - Reducing insider control of financial institutions and developing capital markets
   - Reducing the political hold on institutions
   - Reducing barter transactions and reducing barriers to entry for private banks and non-banks

Source: EBRD (1998).

2.3 Main Actors, Providers and Typology

The providers of financial services in China can be categorized into the following: (i) regulated financial institutions, mainly deposit-taking banking institutions regulated by the China Banking Regulatory Commission (CBRC); (ii) semi-regulated financial institutions, such as the lending-only microcredit companies (MCCs) and financial guarantee companies, supervised by the local government or government departments; and (iii) informal institutions such as P2P and some credit cooperatives that are not supervised by any government departments in any formal arrangements. NGO microfinance institutions could be categorized as semi-formal institutions as they are usually supervised by the county level of government or agencies of the county government. Again, the regulated rural banks can be classified under the following categories:

- Policy banks: the Agricultural Development Bank of China (ADBC)
- Commercial banks: the Agricultural Bank of China (ABC) and Postal Savings Bank of China (PSBC)
- Cooperative banks: the rural credit cooperative (RCC) system, including rural credit Postal Savings Bank of China cooperative unions (RCCUs), rural commercial banks (RCBs), and rural cooperative banks (RCOBs)
- New types of RFIs, which refer to those institutions, permitted entry by CBRC in 2008, which include village and township banks, loan companies, and rural fund cooperatives
- Insurance companies providing agricultural and rural insurance

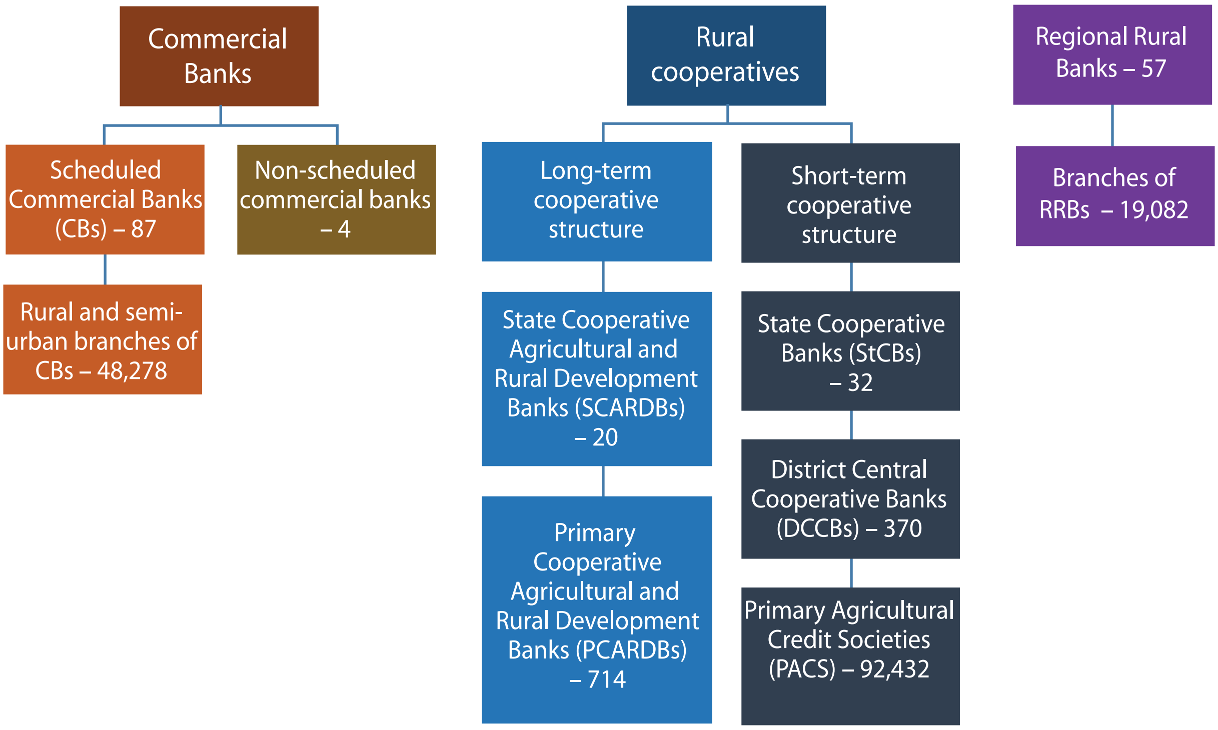
The rural financial infrastructure in India comprises a very wide variety of formal, semi-formal, and informal financial service providers, each with distinctive cultures and characteristics. They can be categorized as follows:

- Formal service providers: The formal players are made up of Apex development banks/DFIs, commercial banks, cooperative banks, regional rural banks, insurance companies, and post offices (Figure 3). In addition, India has public- and private-sector insurance companies and their branches and a large network of post offices spread across the country that offer financial services.
- Semi-formal service providers: The semi-formal players consist of the SHG-Bank Linkage Programme (SBLP) and the microfinance institutions that are described in Table 2.

Table 2. Semi-Formal Service Providers in India

Nature	Coverage
Self-Help Group Bank Linkage Programme (SBLP)	• The SBLP, pioneered by NABARD, has been described as the largest microfinance intervention in the world (APRACA, 2015a). • Today, there are more than 7.3 million savings-linked SHGs and 4.5 million credit-linked SHGs, covering approximately 97 million households. • Although the programme has expanded exponentially over the years, there is at present a high degree of concentration in the southern states, with just two states (Andhra Pradesh and Tamil Nadu) accounting for more than 66 percent of the SHGs receiving loans through bank linkage.
Microfinance institutions	• The country has more than 200 MFIs, of which about 50 are substantial in size. • The microfinance industry in India is growing very fast and has developed various products, delivery systems, and business models for the poor. • The MFI sector in India has gone through three broad phases – high growth (until 2010), volatility (2010-11), and consolidation (2011-13) – and is now entering a phase of relative stability. • With the RBI providing a strong regulatory regime from 2011, the sector entered a consolidation phase with the MFIs adjusting their business model to the new market and regulatory environment. • The current focus of the MFI sector is mainly on microcredit with other products still evolving, including thrift, insurance, and remittance.

Figure 3. Formal Rural Banking System in India



Source: APRACA, 2015a.

- Informal sector: Informal financiers include a range of actors – landlords, local shopkeepers, traders, professional moneylenders, etc. Survey data indicate that poor rural households rely heavily on informal finance to meet a range of financing needs: from consumption and emergency financing to investment loans. It is reported that the interest charged on informal loans averages 48 percent per annum. Not surprisingly, informal borrowing is very important for the poorest, who are the most deprived of formal finance. Informal financiers have the advantage of knowing their clients better than most formal institutions, such as banks. They are better able to enforce contracts and provide flexible products.

The rural financial service market in Indonesia is complex with different types of financial institutions operating to serve the rural poor with a variety of financial products (Table 3). Since the rural finance system includes both microfinance and agricultural finance, the main categories of rural and microfinancial institutions in Indonesia are as described in Table 3.

The rural financial system in the Philippines is dominated by both formal financial institutions and informal lenders. Formal institutions include banks that are regulated and supervised by Bangko Sentral ng Pilipinas (BSP). The formal sector is complemented by other formal institutions that offer financial services such as credit cooperatives, which operate under the cooperative law, and non-government organizations, which are registered organizations but not regulated or supervised by any government entity. The financial sector is dominated by banks, comprising 36 commercial and universal banks, 71 thrift banks, and 566 rural and cooperative banks as of the end of 2013. The combined number of bank branches and head offices totaled 9,935 during the same period. Rural banks make up 27 percent of this total number, with almost two-thirds of their branches being located in third-, fourth-, fifth-, and sixth-class municipalities that are mostly rural (APRACA, 2015d).

Table 3. Rural Financial Service Market in Indonesia

Type	Details
Commercial banks	• Some commercial banks serve the microfinance segment such as Bank Rakyat Indonesia (BRI), Regional Development Bank (BPD) at the provincial level, Unit Mikro Mandiri-Bank Mandiri, Danamon Simpan Pinjam, Bukopin Swamitra, BTPN, and other microfinance programme from commercial banks. • In July 2015, there were 118 commercial banks with 12 commercial sharia banks registered in the OJK (OJK, 2015). • The most prominent microfinance provider among the commercial banks is the public bank of BRI and its pervasive Unit Desa (village bank).
Specialized banking institutions	• Usually licensed for limited operations, activities, or services to differentiate those from full-service commercial banks such as rural banks-people credit banks (Bank Perkreditan Rakyat/BPR) and non-bank finance companies. • Specialized banking institutions by definition have a limited license for their operations, activities, or services to differentiate them from full-service commercial banks. • In July 2015, there were 1,644 rural banks/BPRs with 161 sharia rural banks registered in the OJK (OJK, 2015).
Membership-based cooperative financial institutions (CFIs)	• Examples of membership-based cooperatives in this study are Microfinance Institutions for Agribusiness (LKMA), Pincuran Bonjo (with a cooperative as its legal business entity), KJKS/BMT UGT Sidogiri, and KUD Mina Samudera.
Government programmes or agencies for rural finance, microfinance, or SME finance	• Kredit Ketahanan Pangan dan Energi (KKPE) – Credit for Food Security and Energy (KKPE) is a subsidized credit scheme launched in 2008 to replace a previous KKPE programme. The purpose of the programme is to support food security and energy. • Kredit Pengembangan Energi Nabati dan Revitalisasi Perkebunan (Credit for Agricultural-based Energy Development and Estate Revitalization) is a subsidized credit scheme to support the revitalization of estate crops and energy. The scheme intends to facilitate rehabilitation and development of plantations through the provision of concessionary loans directly to farmers (in the case of cocoa). • The Savings and Loan for Women's Group (SPP-Simpan Pinjam Perempuan) managed by the Activity Management Unit (UPK) under the Umbrella Programme Nasional Pemberdayaan Masyarakat Mandiri-Perdesaan PNPM (National Programme for Community Empowerment in Rural Areas) SPP is a revolving loan fund (RLF) for women's group savings and loans managed by UPK. Loans are made available to women's savings and loan groups from which the funds are disbursed to the individual group members. • The Warehouse Receipt Programme (Skema Sistem Resi Gudang; S-SRG): A Warehouse Receipt Scheme is a loan granted by the bank to farmers, farmers' groups, joint farmers' groups, and cooperatives with a Warehouse Receipt as a guarantee (off-farm).

The main players in rural areas are the rural and cooperative banks. The rural banking system yielded a net profit of PHP 1.97 billion as of the end of June 2014. Although net profits increased slightly in 2014 to PHP 1.97 billion from PHP 1.85 billion in 2013, the industry proved to be more efficient as the annualized cost-to-income ratio improved to 72.7 percent from 77.5 percent in the same period. The industry continued to grow as total assets reached PHP 206.9 billion as of the end of June 2014, 5.5 percent higher than the PHP 196.1 billion recorded a year earlier. Unlike more than two decades ago, rural banks have become self-reliant as they continue to rely on deposit generation to fund their operations. During the same period, deposit liabilities accounted for a 68.7 percent (PHP 141 billion) share of total resources, slightly higher than the 68.5 percent (PHP 135 billion) share a year earlier.

Among commercial banks, the Land Bank of the Philippines is particularly mandated by law to provide financial services to small farmers and fishers. It is by far the largest formal credit institution, servicing more than 5,000 cooperatives and farmer groups and about 500,000 small farmers and fishers. The bank provides credit to small farmers and fishers through cooperatives and rural financial institutions (rural banks and cooperative rural banks) to finance various livelihood projects, which include the production of agricultural crops, livestock/cattle raising, and the acquisition of pre- and postharvest facilities, among others. In 2013, the loans granted by the Land Bank of the Philippines (PHP 59.5 billion) increased by 16 percent from the PHP 52.1 billion in 2012.

Like the rural banking system, the cooperative sector has large potential to be a significant player in rural finance and microfinance because of its extensive network. However, there are too few financially strong cooperatives. Therefore, great efforts need to be exerted to build up the capacity of cooperatives to undertake sustainable rural finance and microfinance. As mentioned earlier, the Cooperative Development Authority (CDA) reported a total of 23,672 registered cooperatives as of 31 December 2013, of which 2,959 are credit cooperatives and 14,722 are multi-purpose cooperatives. The CDA estimates that 50 percent of registered cooperatives or 12,000 are functioning. Although credit cooperatives used to account for the majority of the total number of cooperatives, multi-purpose cooperatives now dominate with a share of about 60 percent. Thailand has more than 30,000 NGOs registered with the Securities and Exchange Commission as private non-profit foundations, although only a small number of these, say, 2,000 to 4,000, are developmental in the strict sense of the term. Table 4 describes the financial institutions and other actors in Thailand.

Table 4. Financial Institutions and other Players in Thailand

Type	Details
Financial institutions	• Depository corporations, for example, commercial banks, Specialized Financial Institutions (SFIs), savings corporative and credit unions, and money market mutual funds • Non-depository corporations, for example, mutual funds, insurance companies, provident funds, asset management companies, and securities companies
Bank for Agriculture and Agricultural Cooperatives (BAAC)	• The BAAC, an SFI, has been the key player in the rural financial space in Thailand for the last five decades. • It holds around 65 percent of total rural and agricultural credit in the country. • As of 31 March 2014, BAAC had established 1,257 branches throughout the country with staff strength of over 18,300.
Other players	• SFIs such as Government Savings Bank, Agricultural Cooperatives, Village Funds, and Community Financial Institutions • They provide around 25 percent of the total financial service delivery in rural areas. • Finance companies and agricultural cooperatives hold a small share of the rural financial markets, whereas agricultural cooperatives provide credit to members (usually with loan funds obtained from BAAC for on-lending to their members).
Informal financial market	• The informal financial market is estimated to cater to one-fifth of the total rural credit demand in recent years, compared with about 40 percent three decades ago. • However, the informal segment is still a significant player in the financial spectrum.
Non-bank financial institutions	• Non-bank financial institutions (NBFIs) also play a significant role in the rural economy for the provision of loans and advances. • The Bank of Thailand (BOT) has licensed 28 NBFIs, the Ministry of Commerce has registered approximately 1,000 finance companies, and an unknown number of NBFIs are not registered.

2.4 Regional Coverage

The best cases selected for inclusion in the present study cover all of China, focusing on China's poor western regions. Chongqing RCB operates basically in China's southwest. CFPA MFI extends its operations to 141 counties in 16 provinces throughout China, mainly in China's state-designated poor counties. The 12 banks under the CDB microfinance downscaling pilot have also conducted their MSE financing operations throughout China. Similarly with regard to India, even though the country as a whole was considered for conducting the study, it was decided to conduct field studies in the states of Bihar, Uttar Pradesh, Maharashtra, Kerala, and Karnataka to document the best practices being adopted in these states, which actually represent all parts of the country. In the context of Indonesia, the scoping and mapping study is expected to cover all key players and stakeholders of rural finance products, last-mile service delivery, business models, and the enabling environment prevailing in Indonesia. While it captures the innovations at the community and rural financial institutional level in order to evaluate the most relevant issues, it also looks at previous studies. Hence, the geographic coverage of the report is representative of the country by selecting regional clusters. For the Philippines, the study focuses only on evidence regarding sustainable pro-poor rural financial services throughout the country. For Thailand, the study covers an innovative financial product of BAAC named Thaweesook Deposit scheme, which was implemented nationwide. The remaining products covered include four farmer organization funds (community financial institutions) in four diverse provinces of Thailand because of their robust and successful performance and recognition as a success case of sustainable operations.

2.5 Regulatory Framework and Policy Environment

Mushosho (2008) mentions that the regulatory framework includes laws, regulations, guidelines, rules, and codes that entities are required to comply with and the institution or structure for enforcing compliance. Regulatory structure is an institutional form that carries out supervision of the regulated entities. The aim of a supportive regulatory framework is to build strong regulated and unregulated institutions of all types (IMF, 2005):

- to provide services on a sustainable basis under uniform, common, shared performance standards; and
- to encourage the regulatory authority to develop appropriate prudential regulations and staff capacity that are tailored to the institutions' operational and risk profiles.

Sustained economic growth and integrated development in the urban and rural areas of China have led to significant changes in the objectives of rural finance policy, in market demand, and in types of institutions. Against such changes, China's central government launched a round of rural financial reforms in 2002 and 2003, aimed at building a multi-layered, inclusive, and sustainable rural financial system. As far as changes in market demand are concerned, demand for microcredit from rural households for farm production, particularly for seeds and fertilizers in traditional agriculture, has been on the decline. In contrast, demand for larger loans for rural structural adjustment, such as loans for large-scale livestock production, cash crops, and agricultural processing, is on the rise (PBC Zhangjiajie Branch 2005), and so is demand for loans from large-scale agricultural producers and from new economic entities, such as agricultural cooperatives and agricultural companies. With regard to changes in types of financial institutions, the most noticeable has been the entry into the market of new RFIs, such as village and township banks (VTBs). In addition, some existing RFIs have been permitted to engage in cross-regional operations. All these changes call for innovations in financial regulation and supervision.

On the other hand, India has a diversified financial sector comprising commercial banks, insurance companies, non-banking financial companies, cooperatives, pension funds, mutual funds, and other entities. The financial sector is dominated by banks where commercial banks account for more than

60 percent of the total assets of the system, followed by insurance. Many non-bank finance companies operate in specialized segments such as leasing, microfinance, and infrastructure finance. The Indian financial system's regulatory architecture is complex – in terms of both the number of regulatory, quasi-regulatory, and non-regulatory-but-still-regulating bodies and because of their overlapping, ambiguously defined spheres of concern and influence. The details of the regulatory structure are presented in Table 5.

Table 5. Regulatory Structure of Financial Institutions in India

Regulatory agencies	Details
Reserve Bank of India (RBI)	• RBI is the country's central banking authority involved in the regulation and supervision of commercial banks, NBFCs, and development finance institutions. • Most of the banking sector in the country is governed by the Banking Regulation Act, 1949. • For cooperative banks, there is dual control in that, while incorporation, management, and winding up of primary cooperative banks are regulated by the authorities under the State Cooperative Societies Act, the banking functions of cooperative banks are supervised by RBI and those of rural cooperatives by NABARD.
Securities and Exchange Board of India (SEBI)	• SEBI regulates Indian security markets, merchant banks, mutual funds, stockbrokers, registrars, FII, and credit rating agencies.
Pension Fund Regulatory and Development Authority (PFRDA)	• PFRDA regulates the National Pension System for government employees as well as other citizens of India through its registered intermediaries.
Forward Markets Commission (FMC)	• FMC regulates the commodity derivative markets.
Quasi-regulatory agencies	• These include the National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), and National Housing Bank (NHB). • NABARD supervises regional rural banks as well as state and district cooperative banks. NHB regulates housing finance companies and SIDBI regulates state finance corporations.
Central government ministries	• The Ministry of Finance (MoF) is most prominently involved, through its representatives on the boards of SEBI, IRDA, and RBI.
State governments	• Through the registrar of cooperatives that are typically under the departments of agriculture and cooperation, the state governments regulate cooperative banking institutions in their respective states.

India is also one of the first countries in the world to have introduced micro-insurance regulation. It provides for an intermediary called a micro-insurance agent with at least 3 years of experience in working with low-income groups. The responsibility for selecting micro-insurance agents with a good track record and building their capacity has been given to the insurance company. The micro-insurance agent can be an NGO, MFI, or other community organization such as SHGs and can distribute only micro-insurance products. The regulations have capped the commissions between 10 percent and 20 percent of premiums per year. The regulations permit bundling of life and non-life elements in a single product provided there is a clear separation of premium and risk at the insurer's level. The regulations also restrict an MI agent to working with only one life and/or one general insurer, respectively.

Furthermore, around 15 percent of the total population in the country uses the Internet and this number is growing rapidly, thus offering a huge potential for Internet banking. Banks are actively using the Internet as a means of providing service as this has a fraction of the cost of conventional methods. The RBI has issued detailed guidelines to all banks for Internet banking in India. Only such banks that are licensed and supervised in India and have a physical presence are permitted to offer Internet banking products to residents. The products are restricted to account holders and include only local currency products. In addition to this, banks are required to develop outsourcing guidelines to manage risks arising out of third-party service providers and set up "Inter-Bank Payment Gateways" for the settlement of e-commerce transactions using a leased-line network and appropriate data encryption standards.

Likewise, the remittance market in India comprises commercial banks, non-bank Money Transfer Operators (MTOs), foreign exchange bureaus, cooperative banks, and post offices. Banks are estimated to have the highest share at 80 percent, followed by the MTOs. Payment systems such as Real-Time Gross Settlement (RTGS) and National Electronic Funds Transfer (NEFT) have helped greatly in reducing the processing time for remittances. MTOs such as Western Union and MoneyGram are the other widely used remittance channels in India and they operate through alliances, partnerships, and sub-agencies. In 2000, India Post also started offering remittance services and it tied up with Western Union to support the transfer of funds. India Post has its own remittance products such as money orders and postal orders that are used for remittance services using the network of 160,000 post offices. Authorized dealers and full-fledged money changers are also allowed to offer foreign exchange-related services with a ceiling after obtaining clearance from RBI.

In Indonesia, the latest law on rural microfinance institutions is the Law on Microfinance Institution No. 1 year 2013, enacted in January 2013. Two types of MFI legal business entities recognized by the law are the cooperative and limited liability company (PT). The law also requires all microfinance institutions to have a legal business license as a "microfinance institution." Therefore, "un-registered microfinance institutions" must obtain a business license as a microfinance institution from the Financial Services Authority (FSA/OJK) at the latest on 8 January 2016. Table 6 describes the regulatory setup for rural microfinance institutions in Indonesia.

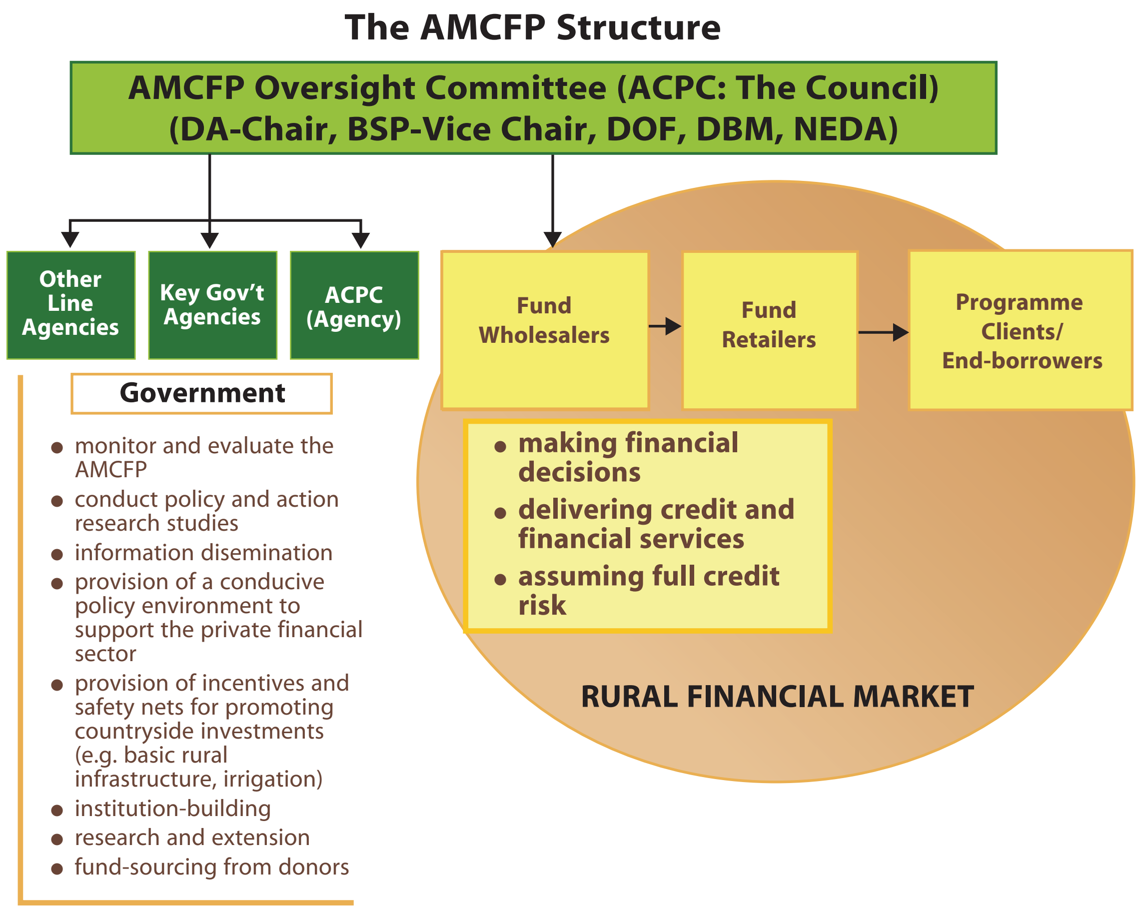
Table 6. Coverage of Regulatory Agencies in Indonesia

Regulatory agencies	Coverage
Financial Services Authority (FSA/OJK)	• Commercial banks (both conventional and under the sharia system) • MFI service unit • Bank Perkreditan Rakyat (BPR)/rural banks • Badan Kredit Desa village banks and paddy banks
Ministry of Cooperative and Micro Small and Medium Enterprise	• Sharia formal cooperative • Savings and loan unit of village cooperative • KSP savings and loan cooperative • Agribusiness microfinance institutions (LKMA) • Credit union
Ministry of Finance	• Pawnshop and financial institution – multifinance • Joint venture • Badan Kredit Desa village banks and paddy banks
Sub-district and district/city government	• Village-owned business-Badan Usaha Milik Desa (BUMDes) • Unit Ekonomi Desa – Pinjam (UED-SP)
Provincial government	• Lembaga Dana Kredit Pedesaan (LDKP) – Village Rural Fund and Credit Institutions
Ministry of Economic Affairs	• Government Programme on Microcredit (for example, KUR coordinating banks and Microcredit Ministry for Guarantee Programme)

The rural financial system in Philippines has three major players: (i) policymakers and regulators; (ii) wholesale financial institutions, mainly government financial institutions; and (iii) retail lending institutions composed of commercial banks, rural banks, thrift banks, and cooperatives. The main players in this system are the following:

- Agricultural Credit Policy Council (ACPC): The ACPC is an agency attached to the Department of Agriculture tasked to oversee the country's rural financial system moving toward an efficient, effective, and sustainable delivery of financial services in rural areas. Executive Order 113 (issued in 1986) mandated ACPC to provide policy directions on agricultural credit. It is also the agency tasked to administer the implementation of the Agro-Industry Modernization Credit and Financing Programme (AMCFP), as provided for under the Agriculture and Fishery Modernization Act of 1997 (Figure 4 and Box 2). Under another law, the Magna Carta for Small Farmers, the ACPC is also mandated to provide capacity-building support to farmers and fishers to increase their creditworthiness, and to cooperatives and farmer organizations to improve their effectiveness and efficiency in credit delivery.

Figure 4. Agro-Industry Modernization Credit and Financing Programme (AMCFP) Structure in Philippines



Source: APRACA, 2015d.

- National Credit Council (NCC): Administrative Order No. 86 established the NCC, a unit of the Department of Finance, on 8 October 1993, to rationalize government credit and guarantee programme. Under the leadership of the NCC, several policy dialogues and consultations resulted in the crafting of the National Strategy for Microfinance. Together with the ACPC, the NCC works with legislators and the government on the enactment or amendment of laws and the issuance of policy statements and regulations to support rural finance/microfinance.

BOX 2. AMCFP Lending Facilities

- Sikat Saka Programme. Credit support programme of the Department of Agriculture's Food Staples Sufficiency Programme; loans at a lower interest rate (maximum of 15 percent per annum) to small palay farmers through irrigators' associations.
- Cooperative Bank Agri-Lending Programme. Stable, low-cost funding support to eligible cooperative banks that lend to small farmers and fishers at full credit risk.
- Agri-Microfinance Programme. Microfinance facility for agriculture that extends short-term loans for income-generating livelihood activities (farm, off-farm, or non-farm) of small farming and fishing households.
- Agri-Fishery Financing Programme. Credit facility implemented through PCFC and LandBank to finance priority agricultural commodities and fisheries.

- Bangko Sentral ng Pilipinas (BSP): The BSP or Central Bank of the Philippines is the regulator, supervisor, and examiner of all banks as well as non-bank financial institutions in the Philippines. It oversees the country's monetary, banking, and exchange rate policies.
- Cooperative Development Authority (CDA): The CDA is the government agency tasked to register, monitor, develop, and supervise all cooperatives in the Philippines. As provided for in Section 15, Article XII of the Constitution, the CDA is mandated to promote the viability and growth of cooperatives as instruments of equity, social justice, and economic development.
- Securities and Exchange Commission (SEC): The SEC registers and gives legal personality to for-profit and non-profit companies, including NGOs. Although the SEC does not monitor or supervise NGOs, it requires all NGOs providing microfinance loans to categorically state in their respective charters and by-laws that microfinance is part of the services provided by these NGOs (APRACA, 2015a).
- Insurance Commission: The Insurance Commission is a government agency under the Department of Finance. It supervises and regulates life and non-life companies, mutual benefit associations, and trusts for charitable uses, including the provision of micro-insurance products. It issues licenses to insurance agents, general agents, resident agents, underwriters, brokers, adjusters, and actuaries. It also has the authority to suspend or revoke such licenses.

Thailand has a well-developed regulatory system governing rural financial services. Potential providers of small-scale financial services must cope with regulatory norms designed to protect clients and safeguard the financial system. Most obvious is the general interest rate cap of 15 percent under the Civil and Commercial Code, which applies to both commercial banks and SFIs, as well as community-based financial institutions that include village funds, cooperatives, pawnshops, and SGPs. One of the major policy decisions made by the government of Thailand is the establishment of SFIs such as the BAAC, which is a dedicated arm of the government to extend financial services to the rural areas of the country. Apart from establishing the BAAC, the government responded to the need of the farming community and created Agricultural Marketing Cooperatives (AMCs).

The origins of community banking in Thailand are derived from the grass-roots funds of rural areas and communities in 1977 arising out of the difficulty in accessing financial institutions by rural people. Group members were managed primarily by a trust that did not require collateral. The network expanded rapidly beyond the Community Development Department, which was supported by the interior ministry. Currently, rural/microfinance organizations are classified as (i) a semi-formal financial system, which contributes to the establishment of a law and as a legal entity, such as credit unions, savings and credit cooperatives (1,227 locations), village funds (78,013 locations), and savings groups for production; and (ii) self-help groups such as general savings groups that initiated joint savings, for example, credit unions. In 2001, the government set the rules for these community financial institutions (CFIs) (Figure 5) and donated THB 1 million to each village based on its corporate finance linkages and self-dependency.

Figure 5. The Structure of CFIs in Thailand

Source: APRACA, 2016.

2.6 Pitfalls of Rural Finance in Asia

Despite the great efforts made by financial regulators and the progress achieved after the reforms in 2005 and 2006, China's RFIs remain slow in penetrating rural financial markets (RFMs). Overall, the loanable funds have been channeled from rural to urban areas and from the poor western regions to the richer coastal regions by the formal financial system in China. On the whole, the financial markets in China are dual: large and medium-size enterprises have access to cheap credit from formal banks whereas the privately owned small and micro-enterprises and farmers either have very limited access to formal credit or have access to formal credit at a much higher cost.

For India, the important challenges in rural finance stem from the dependence of agricultural production on natural vagaries, high elasticity of the prices of produce, a lack of marketable collateral, high transaction costs resulting from low amount and scale of credit, weakness of the legal framework, a lack of credit information, a lack of suitable products, distance from banking outlets, and also little financial relation with the formal financial sector. This makes the development of suitable financial products and practices a difficult task. Informal financiers have the advantage of knowing their clients better than most formal institutions such as banks. They are better able to enforce contracts and provide flexible products. It is reported that around 44 percent of the households have borrowed from informal lenders at least once in the preceding 12 months, but the interest charged on informal loans averages 48 percent per annum.

For Indonesia, although the potential benefits obtained from successful RFS are enormous, the development of RFS needs extra efforts. Some scholars have identified major obstacles to developing RFS (DFID, 2004; Zeller and Sharma, 1998, Nuryartono, 2005, Nuryartono et al., 2012; IFAD, 2009): (i) information asymmetries between market participants, (ii) lack of suitable collateral, (iii) high transaction costs, (iv) high risk, (v) contract enforcement problems, (vi) high operating costs, (vii) formal banking procedures and physical access difficulties, (viii) weak institutional capacity, (ix) lack of enabling policy environment, and (x) remote areas (mountainous and scattered geography) making service delivery expensive.

These factors are often compounded by limitations on women's role, which is justified by religious customs and traditions. Many communities observe strict Islamic prohibitions against interest-based lending, thus making activity in the region difficult for the formal banking sector, and the solution is introducing an Islamic microfinance (IFAD, 2009). Other obstacles are related to the peculiar borrowing behavior of farmers. Since most of the farmers derive their income from agriculture, they all tend to borrow at the same time, and to save immediately after the harvest. This makes it difficult for the financial institutions to diversify their portfolios (Zeller and Sharma, 1998). Besides the identified obstacles, rural finance services face a number of other challenges. These challenges reinforce and compound one another, and are not only faced by the community but also by the institutions. These challenges can be divided into external, client, and provider/government related.

A big challenge among rural finance/microfinance institutions in the Philippines is good governance. Board members of family-owned rural banks are expected to protect their investments, and thus practice good governance. However, the Philippine experience with rural banks also indicates that failures and eventual closure of many of those banks can be explained by bad or faulty management. Another challenge is the development of products and processes and improvement of skills of rural financial institutions. They have to take a more positive and pro-active outlook on clients as customers waiting to be satisfied with quality and timely financial services. There is also the challenge of building the capacity of RFIs to lend to more clients, especially in so-called hard-to-reach areas. Those rural financial institutions in search of customers/clients would have to expand their operations to areas with a high magnitude of poor households and where access to microfinance is limited. In deepening outreach among the poor households and micro-enterprises, RFIs face the costs and risks peculiar to those areas. They will need to discover the proper mixture of capital, human resources, professional expertise, and technology and grit in serving the excluded segment of the population.

There is the outstanding issue of the regulation of NGOs engaged in microfinance in the Philippines. All NGOs, including those engaged in microfinance, are required to register with the Securities and Exchange Commission as non-stock, non-profit organizations. Although microfinance NGOs are required to file annual audited financial statements and general information sheets with the SEC, they are not subject to prudential regulation and supervision by any government regulatory authority. Those microfinance NGOs are imbued with a non-profit-oriented mission and they perform a vital function for society in making scaled-down financial services (small and medium-size loans and capital buildup opportunities) available to the excluded segment of the population. Government and regulators have to tread carefully on the issue of regulation of NGOs. The challenge is to find an appropriate balance between the goal of ensuring financial viability of those NGOs and, at the same time, providing some degree of flexibility in NGO efforts to innovate and reach the poorer, even the poorest, strata of society.

The FinScope study for Thailand reported that more than 1.7 million Thais (7.4 percent of borrowers) are currently borrowing from informal money lenders and a further 335,000 or more from unlicensed NBFIs despite their high interest rates (up to 3 percent per day charged by moneylenders for short-term loans). A significant proportion of informal lending is for productive purposes while the remaining is for consumption purposes or emergencies. Although the qualitative demand-side research revealed that Thais are very price sensitive when it comes to formal credit, they do accept high interest rates from the informal sector. A substantial percentage of Thai households carry a high debt burden, which causes them to draw upon multiple sources of credit. Much of this credit is at higher interest rates than those charged by regulated financial institutions. This means that the lowest income groups (those earning below THB 3,000) carry a higher debt burden than the higher income segments. The ratio of total debt to annual income for individuals earning below THB 3,000 is estimated at 4.6. The same ratio for persons earning THB 42,000 is estimated at 1. This level of indebtedness suggests that past initiatives to deal with the high amounts of household debt (such as programme by SFIs to purchase informal debt) have not only been unsuccessful but have actually accelerated the problem. A renewed strategy and approach is therefore desirable to establish a sustainable way forward in the rural financial sector.

There remains an unusual risk appreciation among the Thai population. Normally, low-income clients are most concerned about health risks, the death of a breadwinner, or funeral expenses. However, none of these risks featured in the top ten risks identified by respondents. In fact, the top four risks were related to fears of rising prices for goods, fuel, electricity, and fertilizer. This could stem from a combination of (i) traditional risks being covered by the government and community-based organizations and (ii) high levels of debt for which even small changes in prices can eliminate any residual monthly savings. Risks currently not covered by the government and community-based mechanisms include loss of assets and personal accident. It is therefore no surprise that the 2.1 million insurance policies underwritten by private insurers are primarily personal accident and property-related.

CHAPTER 3
Good Practice Case Examples from Asian countries

The rural economy of Asia is huge, is heterogeneous, and defies easy categorization and analysis. On the one hand, Asia is home to some of the most dynamic and successful agribusinesses in the world that satisfy domestic food demand and penetrate competitive foreign markets. On the other hand, it is home to millions of poor people who are only slightly better off than their ancestors. Prior to the financial and economic crisis that began in 1997, the region had some of the fastest-growing economies in the world but also some with poor economic performance. The rural financial markets in a few countries are served by strong financial institutions that provide sophisticated services on market terms, while others are dominated by weak and subsidized institutions and NGOs that are dependent on donors and whose sole function is to dispense credit. An analysis of rural financial markets in Asia must attempt to account for this heterogeneity. Each of the five countries selected represents a particular kind of scenario. Given the background of rural finance scenarios in Asian countries, this chapter documents case examples of good practices observed in China, India, Indonesia, the Philippines and Thailand, respectively.[10]

3.1 China

The Chinese government has used several policy instruments to promote rural finance and microfinance. These initiatives include measures such as inclusion of the provision of agricultural on-lending to the RCCs, tax concessions and subsidies for regulated RFIs for rural and micro-lending, and partial liberalization of the lending rate of interest for rural and micro-lending. Subsequently, the government also permitted the entry of new types of RFIs to strengthen competition in China's rural financial markets. The inclusion criteria for the selection of these case studies are (i) outreach to rural communities, (ii) operational sustainability, and (iii) innovations in financial products and services. Based on these observable indicators, three good practice cases are identified for the country and described in the subsequent paragraphs. In doing so, specific emphasis is given to outlining the innovations carried out in either products or service delivery in each of these cases and then linking them with implications for outreach, impacts, and banking operations. For examples of good practices, three cases are presented that satisfy the inclusion criteria described above: (i) the mobile phone product by Chongqing Rural Commercial Bank (CRCB); (ii) the case of CFPA Microfinance Pty. Ltd. (CFPA MF), which is a semi-formal RFI unregulated by the China Banking Regulatory Commission (CBRC); and (iii) the microfinance downscaling by city and rural commercial banks in China.

3.1.1 The Chongqing Rural Commercial Bank (CRCB)

Chongqing is a provincial-level municipality directly under the central government and it has 38 districts and counties, of which nine districts are located in the metropolitan area. Different from other large municipalities such as Beijing, Shanghai, and Tianjin, Chongqing has a higher percentage of rural and poor population. The municipality has more than 8,400 rural villages and more than 10 million rural people out of a total population of 34 million while also containing 14 poverty-stricken counties. As the largest RCB in China, Chongqing Rural Commercial Bank was created in 2008 by merging all the RCC county unions in Chongqing, a provincial-level mega-city. CRCB went public on the Hong Kong Stock Exchange in 2010 and became the first listed RCB on the market. In the same year (2010), the bank also set up three village banks in Jiangsu, Sichuan, and Yunnan provinces. In 2015, the bank opened a branch

[10] The summary sheet for all the identified best practices in the country study reports, along with the inclusion criteria, is presented in Annexure 1.

in Qujing District of Yunnan, and set up more village banks outside Chongqing. At the end of 2014, CRCB had one division bank, 15 branches, and 1,775 sub-branches, with a workforce of more than 16,000. By the end of September 2014, the bank's total assets exceeded RMB 600 billion, with its total deposits standing at more than RMB 400 billion and loans outstanding at RMB 530 billion. The non-performing loan ratio was maintained at within 1 percent. The bank was awarded "China's best rural financial institution" by the U.S. Global Finance Magazine in 2013. CRCB has made efforts to support agriculture and the rural economy in Chongqing and its 1,775 branches and offices are more than all the big five have added together in Chongqing. Chongqing is a mountainous region, and transaction costs are high for both the banks and their rural clients.

(a) Innovations in Products and Services

CRCB launched its mobile banking product "Jiangsu Mobile bank card" in June 2011. The mobile phone product of CRCB is mainly a technological innovation focusing on product delivery. It aims at reaching out to a large number of clients, especially rural clients, and facilitates account balance inquiry, account transfers, remittance (inter-bank to all banks in China), account payments, and credit card repayments for the beneficiaries. CRCB has actively promoted mobile phone products since 2011 with bank staff traveling to regions such as Guangdong and Guangxi in southern China and Inner Mongolia Autonomous Region in northern China to promote the new product to the migrant workers from Chongqing. The bank has also actively promoted it in Chongqing, using festival times when migrant workers visit their families and relatives. The primary advantages to consumers through this platform are the following:

- Access and outreach to rural communities: Using the communication system of mobile phone messages, the product can operate without an Internet connection, so it can reach a vast region and cover a large rural population, especially in the remote and mountainous regions of Chongqing. It is also very cost effective as even the very basic mobile phones in China have message functions and mobile service providers usually do not charge, or charge a meager amount, for mobile messages.
- Safety: The product is physically separated from the mobile phone parts and the Internet, so it is immune to cyber-attack and virus infections.
- User-friendliness: A farmer with an advanced primary school or middle school education (6-9 years of school) generally has no difficulties in using the product. A client can select the menu, similar to the messages, and can learn to use the product quickly.
- Quick instalment: A bank staff member can install the membrane into a mobile phone in 1-5 minutes over the bank counter.

(b) Implications for Outreach and Impacts

Mobile banking was mainly responsible for the jump in bank transaction volume: from 2010 to 2014, the share of cross-bank money transfers grew from 18 percent to 33.8 percent by volume and from 55.1 percent to 46.8 percent by value, mainly at the expense of money transfers within the CRCB. The overall bank volume of transactions soared from 2011 to 2014. They more than doubled in 2011 (5,055) and 2013, and grew by more than 40 percent by November 2014 (and are expected to grow by more than 50 percent for 2014). By transaction items, the fastest growth was achieved by cross-bank money transfers, which more than doubled in 2012 and tripled in 2013 and had increased by a massive 90 percent by November 2014. The growth in fee payments tripled in 2012 but has decelerated since then. Similarly, up to 2013, the value per mobile transaction was about one-quarter of that for all bank transactions for money transfers and cross-bank money transfers, the two major bank transactions of CRCB. In 2014, the ratio jumped to 45 percent for money transfers and remained at 58 percent for cross-bank money transfers. For fee payments, the disparity between the two has been very minor. It is important to note that about 90 percent of fee payments have been made through mobile banking. The low value per mobile transaction indicates that the mobile product has targeted small rural clients.

According to CRCB at the district branches and township sub-branches, migrant workers have used mobile phones mainly for remitting their money home and for shifting money from their demand deposits to time deposits for higher returns. Many rural households have benefited by remitting money to their children at universities and high schools. Rural households and the poor have also benefited from paying mobile fees and other service fees through their mobile phones.

CRCB has also provided more support to its rural clients, including migrant workers and poor farmers, from the perspective of corporate responsibility. Likewise, CRCB has exempted all fees for mobile transactions that have targeted mainly its rural clients, including cross-bank remittances. Hence, the calculated savings by CRCB for its clients in cross-bank money transfers (for cross-bank remittances only, the clients of CRCB, mainly migrant workers and their families) amounted to more than RMB 18 million in 2013 and subsequently more than RMB 39 million in the first 11 months of 2014. Similarly, the use of mobile banking services has saved costs for bank clients, mainly its rural clients, for doing bank transactions over the counter. Based on a conservative estimator of the unit cost per bank transaction, the cost savings by CRCB clients, mainly rural clients, by using mobile phone services in terms of transportation costs, meals, and time spent on travel and over-the-counter banking transactions jumped from RMB 175 million in 2012 to RMB 355 million in 2013, and further to RMB 493 million in the first 11 months of 2014. Finally, the indirect benefits to the clients of CRCB also accrue from a subsidy provided by CRCB on cross-bank money transfers.

(c) Implications for Sustainability

The benefits of using mobile banking outweigh the costs. CRCB has benefited from the introduction of the mobile banking product despite the high costs for introducing it initially. First, the launching of the mobile product helped the bank to increase its deposits, especially savings deposits from rural households and migrant workers. Second, the costs of using the mobile phone product to the bank have declined over time. Although the annual investment in mobile banking by CRCB has gone up over time, the unit cost per mobile transaction dropped from RMB 7.03 in 2011 to RMB 0.79 in 2014. Moreover, based on the estimation by CRCB, the bank saved RMB 18 million in 2013 and RMB 35 million in 2014 through mobile phone over-the-counter transactions, with the same volume of bank transactions. Third, the use of mobile banking has prepared CRCB for its progress with Internet banking, which is expanding rapidly in China under the pressure of the new third-party payment system (*zhifubao* or Ali-pay in English, the world's largest third-party payment system, which can be used to pay for water, power, gas, traffic fines, cable TV fees, train tickets, etc.). Furthermore, CRCB has achieved other cost savings by promoting mobile banking, such as savings in the use of paper, energy, and transportation equipment, thus making the bank's operation greener.

3.1.2 Sustainable Micro loans to Small Farmers – The Case of CFPA MF

CFPA MF grew out of a pilot microcredit programme under a World Bank-funded anti-poverty project in the Qingba mountainous area started in 1996. CFPA MF has developed in the following three main phases: (i) pilot stage (1996-2004), (ii) innovation stage (2005-09), and (iii) transformation stage (after 2009). At the end of 2008, CFPA's microfinance department split from the China Foundation for Poverty Reduction and the CFPA Microfinance Management Co. was born.

(a) Innovations in Services and Products

Prior to 2005, CFPA had adopted a cooperative model for its microfinance programme by cooperating with the county-level MFIs. CFPA contributed funding and technical and management services. But, as the county MFIs were controlled by the county government, CFPA found it difficult to manage and supervise the programme and to standardize the microcredit products of the county MFIs. Loan quality declined in some counties and financial problems resulted. In 2005, CFPA launched an overall reform of its microcredit programme, whose highlights are described in the points below:

- A single line of command was established between CFPA headquarters and the county MFIs (branches), thereby giving the programme unambiguous property rights and clear responsibilities, and allowing more efficient management.
- The programme expanded its geographic scope from four counties in 2005 to 17 by the end of 2008 and was institutionalized following the creation of the CFPA Microfinance Management Co.
- With investment funds from the International Finance Corporation (IFC) and Sequoia Capital, CFPA Microfinance became a joint-venture company in January 2011.
- For the county branches, besides clarifying property rights and responsibilities, the reform measures increased loan funds from the head office to the service branches, improved wages and benefits, and raised loan interest rates.
- After the reforms in 2005, the head office became responsible for product development, fund use planning and allocation, credit management, and the recruitment, technical training, and supervision and monitoring of staff. The branches, on the other hand, disburse and collect loans according to rules issued by the head office.

CFPA Microfinance has three standard loan products: group (joint liability) loans, usually below RMB 12,000; individual loans, usually below RMB 50,000; and micro-enterprise loans, from RMB 50,000 to RMB 200,000. Group loans are the most important product of the three.

- Group loans: These loans are used mainly for farm and off-farm income generation activities, such as rural microcredit loans in other developing countries. The loan period ranges from 6 months to 1 year. One-year loans (with a 2-month grace period and repaid in 10 monthly instalments) are the most common. No collateral and no other guarantors, apart from the loan group, are needed. Before 2010, the nominal interest rate on the loans was 12 percent and the actual rate was around 18 percent. Now, the interest rate is 13.5 percent nominal and the effective rate surpasses 20 percent. Once the last instalment is paid, clients can apply for another loan after a week. Some old clients qualify for a new loan after 3 days.
- Individual loans: The individual loans and micro-enterprise loans of CFPA MF are based on cash flow analysis, which is similar to the individual loans disbursed by city and rural commercial banks in China.

(b) Implications for Outreach and Impacts

CFPA Microfinance is by far the largest not-for-profit microfinance institution in China. It provides microcredit services to vulnerable populations in underdeveloped areas. By the end of 2014, CFPA MF had 141 branches and subsidiaries across 16 provinces of China. Since 1996, it had disbursed a total of RMB 8.437 billion in 938,006 micro-loans to rural clients, with an average loan size at RMB 8,996. The loan portfolio at the end of 2014 was RMB 1.879 billion, with 237,817 active clients. Statistics show that 89 percent of CFPA MF clients were previously unable to borrow from traditional financial institutions; among these, more than 93 percent are females. Recently, CFPA Microfinance has made an effort to raise its capital to serve more rural people and the poor. In January 2015, CFPA MF raised about RMB 500 million from China's Shenzhen Exchange through its loan assets securitization. The rapid growth of CFPA MF as a poverty reduction microfinance institution, at a time when many other NGO MFIs experienced setbacks, can be attributed to its insistence on targeting small farmers in China's poor counties while promoting commercial microfinance operations.

(c) Implications for Sustainability

The company successfully improved rural group (joint liability) loans as its main product, efficiently controlling credit risk. At the same time, it pushed into individual lending to meet market demand. Now, individual loans account for 25 percent of loan disbursements and 10 percent of all loans issued by the company, and have boosted its profitability. CFPA Microfinance has accessed wholesale loans from a number of Chinese and foreign banks, including CDB, ABC, and standard and chartered banks. Outside financing has helped the company grow and enabled it to expand its operations. The company has also raised funds by asset securitization and P2P.

A common problem of non-profit MFIs in China is low salaries for workers and frequent changes in management by the county government. But, operating costs are not necessarily low. After the reform, CFPA MF was able to pay the county staff higher salaries while keeping operating costs low on the strength of rising interest rates and more efficient microfinance operations. The support of government agencies in the success of CFPA MF has been crucial. It is under the umbrella of the Leading Group Office for Poverty Reduction (LGOPR) in China and it has support from the LGOP system throughout China. As an unregulated microfinance institution, CFPA has a semi-legal status to undertake microfinance operations in China. With a permit for microfinance pilot programme from the State Council's LGOP and PBC, CFPA MF has access to the credit bureau service of the PBC.

3.1.3 Microfinance Downscaling by City and Rural Commercial Banks in China

Around 2005, under the guidance of CBRC, China introduced the IPC model of microfinance based on cash flow analysis into China's small and medium banks, mainly city and rural commercial banks, to increase the access of MSEs (micro and small enterprises) to formal credit. By the end of 2014, it was estimated that more than 100 Chinese banks had adopted the model based on their own choices. The introduction of the model and its application in China have had a profound effect on China's banking system and on MSE lending in China. The IPC model is based on evaluating the capacity and willingness of clients to repay loans. The procedure for assessing loan repayment capacity includes field visits by a credit officer to understand the client's production, marketing, and fund flows, and to prepare financial statements for the client to harden soft data. During the field visits, the loan officer collects information on the purposes of the loan and on the client's assets and liabilities, income, profit and loss, cash flows, and sources of funds for loan repayments, according to IPC procedures. With respect to willingness to repay loans, the IPC model uses soft data, such as personal reputation and credit history, to make judgments.

The city and rural commercial banks in China have conducted a number of institutional and management reforms to apply the model in China. First, many banks have set up special branches or departments responsible for piloting MSE lending. Second, the banks have usually created new incentive systems for recruiting and managing microfinance managers and loan officers. Finally, many of the innovations made in applying the model have been replicated to the overall management and operation of these banks, hence raising overall banking efficiency in serving MSEs and rural people.

(a) Innovations in Services and Products

The China Development Bank Microfinance Project consisted of two closely linked components:

(i) A credit facility for on-lending to eligible partner financial institutions (PFIs) and
(ii) A technical assistance facility to support the capacity building of the CDB and the PFIs.

After slow progress at the start, the pilot project grew quickly, and the model has since been tested and proven by at least ten CCBs serving urban or peri-urban MSEs with an average loan size of RMB 100,000 (range RMB 20,000-500,000) and non-performing loans below 1 percent of the loan portfolio (generally below 0.5 percent), and reaching the breakeven point in 12-24 months. The technology is spreading to rural areas. The project supported 12 Chinese banks (PFIs) in conducting MSE lending, including Maanshan Rural Commercial Bank. With consulting input from IPC, CDB provided on-lending and on-site TA support to the PFIs from December 2005 to 30 June 2008. The MSE loan disbursement and portfolios of PFIs increased over time.

(b) Implications for Outreach and Impacts

The quality of MSE loans disbursed by the PFIs was consistently excellent. The percentage of loans overdue for more than 30 days was less than 0.3 percent of the total loan portfolio, and well below the 3 percent level set in the project appraisal document. The project also put the average size of MSE loans under some control. The average loan size for the 12 PFIs was RMB 15,000 in 2005, RMB 52,857 in 2006, RMB 68,981 in 2007, and RMB 79,189 in 2008. For the six selected PFIs, the average loan size was RMB 110,561 in 2008-09 and RMB 118,370 in 2010. The increase in the average MSE loan size (in nominal terms) over time might partly explain the rapid increase in national incomes in China. The benefits from the project resulted in the PFIs (i) significantly increasing their MSE lending market share and profits from MSE lending (some PFIs from zero), thus helping to build a good foundation for increased bank competitiveness in local markets; (ii) gaining a diversified loan portfolio with reduced credit risk for the bank as a whole while achieving a good MSE client base, to which the PFIs provide not only MSE loans but also deposits and other financial services; and (iii) establishing their MSE lending reputation and brand in local markets, with local governments, and with bank regulators.

(c) Implications for Sustainability of Banking Operations

For the six selected PFIs, on average, the MSE lending operations were projected to reach the breakeven point by the 11th month but three of them reached the breakeven point by the sixth month. Again for the six PFIs, on average, MSE lending was projected to cover its costs within 2 years. The participating banks reached the breakeven point for their entire MSE operations within a year, a remarkable result. Jiujiang Bank, the slowest of the six to reach the two breakeven points, has set a profit target of RMB 500,000 for each MSE loan officer. The commercial viability and profitability of the PFIs can also be demonstrated by their lending rates and the cost of providing micro-loans. The average lending rate of PFIs is around 14.6 percent, whereas the average total cost of providing micro-loans is around 4.5 percent. The 10-percentage-point difference is due to the low funding costs, low loan-loss provision due to good loan quality, and low staff costs. By participating in the project, most PFIs established or strengthened at least five major assets for their bank: (i) well-trained and experienced loan officers and middle-level managers in MSE lending, (ii) a good micro-lending client base, (iii) a good-quality micro-lending portfolio, (iv) an established methodology and system for micro-lending and training, and (v) a good reputation in MSE lending.

In addition to the city and rural commercial banks, many MCCs and VTBs have received similar technical support in micro-lending. A number of project consultants have been employed as high-level or middle-level managers in charge of MSE lending operations by the banks. It is expected that more city and rural commercial banks and other MFIs will follow suit as the financial reforms deepen. Nationally, the project impact can be understood from the following two perspectives: (i) the implementation of the project among the 12 PFIs strongly indicates that micro-loans to urban and semi-rural micro-entrepreneurs and small enterprises in China can be provided in a commercially sustainable way and (ii) the universally accepted lending methodologies, such as the micro-lending methodology based on cash flow analysis that was introduced by IPC into China, can be applied elsewhere in the country, with certain modifications.

3.1.4 Summary

Mobile banking is a pilot undertaken by CRCB, one of the largest RCBs in China. The mobile phone product developed by CRCB has had a mass outreach to rural people, including migrant workers, and it has had a large impact on bank clients. CRCB itself has also benefited from the development of such a technological and product innovation, and the product is sustainable and replicable. In the mobile technology case, by appropriate pricing and marketing policies, rural low-income people can easily move to mobile phone-based services. This and the enlarged rural clientele serve as an excellent base for expanding the bank's services from money transfers and deposits to more advanced operations, which in China could immediately include IT-solution-supported rural loans and village agent-/shop-based cash services in remote rural areas.

CFPA MF is a semi-formal RFI unregulated by CBRC. Unlike its peers in China, CFPA MF has enjoyed significant growth in its assets, loans, and geographic coverage driven by the organizational reforms, and improved in its governance structure and promotion of new products and services. A key lesson behind the success of CFPA MF is its commercial operations while sticking to its focus on the rural market. A key conclusion worth emphasizing is that, in China and most other countries of the region, there is room in the rural market for these institutions, if they follow the "best practices" of microfinance management.

Microfinance downscaling by city and rural commercial banks in China provides a good case for the success factors behind the replication of a lending model in China. In the case of downscaling by the commercial banks to the SME sector, the key conclusions are already clearly stated in the draft report: (a) a key to success is the change in understanding of the overall nature of modern SME lending by middle-level managers and loan officers, (b) high-class capacity building is required to make this change happen, and (c) these two things are much more important than the provision of credit lines by the state or donors, as most city and rural commercial banks have adequate low-cost funds of their own. The leadership and commitment from the bank management, organizational adjustment, training, and the provision of incentives to loan managers and loan officers are noted to be crucial for the successful replication of best practices in rural finance. The downscaling pilot itself has also had a large impact on the provision of microfinance services to MSEs in China. These best practices are summarized in Table 7.

Table 7. Summary of Best Practices in China

Best practices	Thematic area	Key features
1. Mobile banking card	Savings, fee payment, money transfer	• Chongqing RCB introduced mobile phone banking to expand services to more clients for larger outreach • Sustainable and replicable • Provision for performing multiple banking operations from a single platform
2. China Poverty Alleviation Fund Microfinance Institution (NGO MFI)	Credit	• CPAF established NGO MFI for poor clients to expand credit service and achieve outreach in scale and depth • Improvement in governance structure • Exclusive focus on rural markets
3. Microfinance downscale of commercial banks	Lending	• Rural and urban commercial banks adopted advanced lending technology (German IPC) to downscale microfinance to lower-end clients on cash-flow basis to expand outreach • Coverage for various sectors

3.2 India

The financial environment has witnessed regular efforts and innovations on the part of the government of India, state governments, the Reserve Bank of India, IRDA, PFRDA, NABARD, SIDBI, and several NGOs to create different types of suitable rural financial practices and systems in India. Considering the predominance of informal credit, various types of products have emerged for microfinance. Starting from the subsidy-based credit programme IRDP in the 1980s, which could be considered as the largest microfinance programme of its time, the government of India introduced SHG-based SGSY in the late nineties and then the NRLM in 2011. The early nineties were a watershed regarding the development of microfinance, when NABARD/RBI introduced the SHG-Bank Linkage Programme on the one hand and also supported NGOs in experimenting with other microfinance products. Of the available rural financial products/services, the most representative ones based on the inclusion criteria under the dimensions of product, delivery system, business model, outreach, flexibility, adaptability, and enabling environment are (i) Self-Help Group-Bank Linkage Programme, (ii) Joint Liability Group (JLG) bank linkage product, and (iii) Kisan Credit Card (KCC). Other cases of best practices are documented in the Annexure.

3.2.1 Self-Help Group-Bank Linkage Programme (SHG-BLP)

The SHG-BLP is an innovation in the marriage of flexibility of the informal system with the strength and affordability of the formal system. Three radical innovations were introduced through the RBI/NABARD guidelines on the Self-Help Group-Bank Linkage Programme: (i) acceptance of informal groups as a client of banks – deposit and credit linkage, (ii) introduction of collateral-free lending, and (iii) permission to lend to a group without specification of purpose/activity/project. The basic features of SHGs as per the guidelines of RBI are as follows:

- Members are usually in the range of 10-20 with two to three office bearers such as president/secretary/treasurer elected by the members.
- Well-laid-down by-laws for running the group framed by the members and periodical meetings are held.
- Equal amount of uniform thrift/savings is collected from all members on fixed periodicity and savings bank account is opened in the name of the group and jointly operated by the office bearers.
- Internal loans are given to needy members out of savings corpus of the group for purposes such as emergency needs, social/consumption needs, productive activities, debt swapping, etc. Groups have flexibility to decide terms and conditions and their by-laws for smooth running.
- Books of accounts are maintained up-to-date and the bank provides credit support in certain multiples of savings corpus ranging from one to four times and even higher based on the maturity of the groups.
- Groups following Panch Sutras (five principles) as regular meeting, regular savings, regular internal lending, timely repayment, and proper bookkeeping are treated as well-functioning groups.

(a) Innovations in Services and Products

For a majority of SHG members, membership in the SHG is the first experience of savings. SHGs enable the participation of members in managing finance, making decisions on the use of funds, making investments in livelihoods available in the local area, and becoming empowered due to improved decision-making capacity. SHGs enable the poor to access financial services from formal financial institutions without procedural hassle and to use these financial services to diversify their livelihood, reduce vulnerability, and take a step toward escaping from poverty. Moreover, skill development and other livelihood support are also provided to the members. The recognition for self-help groups as a vehicle for purveying microcredit as a tool for poverty alleviation came in April 1999, when the government of India sponsored the Integrated Rural Development Programme (IRDP), the largest poverty alleviation programme in the world. It was amalgamated with other government programme such as DWACRA, SITRA, TRYSEM, and GKY to be rechristened as SGSY (Swarna Jayanti Gram Swarojgar Yojana), in which the group mode of financing was recognized.

SGSY was restructured in 2011 to form the National Rural Livelihood Mission (NRLM) to be implemented in a mission mode across the country. NRLM is an entirely group-centric, group-driven poverty alleviation programme. NRLM's components are formation, federation, and financing of women's SHGs; a livelihoods programme for rural women farmers and agricultural laborers; value addition in nontimber forest produce in tribal districts; gender rights issues; and various skill development programme. It aims to cover all the rural districts in the country intensively, in phases. The SHG model is also followed by several NGOs/MFIs/SHG federations for their lending operations. These MFIs take a bulk loan from banks for on-lending to SHGs promoted by them (the third model of SHG-BLP as per NABARD guidelines).

(b) Implications for Outreach and Impacts

The movement that started as a link between the un-bankable rural poor and the formal banking system to cater to the microcredit needs of the poor now boasts a group savings of a whopping INR 330,000 million (70 percent of which goes for internal lending and the balance to the SB accounts of the groups) and total bank credit outstanding of INR 429,275 million (besides nearly INR 230,000 million lent to members from groups' own savings). With more than 84 percent of these being all-women groups, the poor rural women in India now control a financial business with turnover of nearly INR 1,000 billion (inclusive of deposits and credit) – much more than most of the multi-national corporations in India. The financial inclusion achieved through SHG-BLP as of 31 March 2014 is astounding, with 7.43 million SHGs having savings linked to banks providing access to regular savings (through SHGs linked to banks) to about 97 million rural households. The share of exclusive women's SHGs in the total number of SHGs linked to banks now stands at 84 percent (up from 81 percent the year before).

(c) Implications for Sustainability of Banking Operations

The SHG-BLP model has proved to be one of the most cost-effective models of financial inclusion. To ensure the sustainability of SHGs post-exit of the GOs, NGOs, and other SHG-promoting agencies, federations of the SHGs have been formed by several agencies. However, most of the original proponents of SHG-BLP are afraid that the shift toward formalization of the process from a non-formal and flexible system to a rigid rule-based one may bring about political interference and the like in other developmental processes, and may provide a breeding ground for corrupt practices. The exponential growth of the SHG-BLP programme in India is self-proving of the replicability of the model.

3.2.2 Joint Liability Groups (JLGs)

Whereas SHGs provide a platform for financial inclusion providing savings as well as credit services and sometimes micro-insurance and micro-pension services also, JLGs (joint liability groups) are another group-based lending method usually adopted by MFIs. NABARD further innovated to introduce the method of JLG-bank linkage to ensure the provision of credit by banks to the mid-sector rural poor normally deprived of formal credit because of a lack of collateral. A JLG is a small group of four to ten poor persons and is formed by the members with assistance, guidance, and supervision of the NGO/bank. The members support each other socially and financially by guaranteeing the repayment of each of their loans. Peer pressure and close social ties ensure the timely repayment of loans. The members jointly stand liable for the repayment of a loan disbursed to any of them. Unlike in SHGs, regular savings by the JLG are purely voluntary. NABARD extends grant support for the formation and nurturing of JLGs to banks and other JLG-promoting agencies.

(a) Innovations in Services and Products

The success of the JLG concept depends mainly on the mutual trust within the group and peer pressure for the repayment of loans and the quality of group leadership is critically important for the sustainability of the group. Banks can finance JLGs by adopting either of the two models:

- Model A: Financing individuals in the group. The group would be eligible for accessing separate individual loans from the financing bank. All members would jointly execute one inter-se document (making each one jointly and severally liable for repayment of all loans taken out by all individuals in the group). The financing bank could assess the credit requirement of the individual as per the norm. However, there has to be mutual agreement and consensus among all members about the amount of individual debt liability that will be created.

- Model B: Financing the group. The JLG would be eligible for accessing one loan, which could be a combined credit requirement of all its members. All members would jointly execute the document and own the debt liability jointly and severally.

Although the mode of JLG-bank financing is basically to provide a system of collateral-free lending to the JLG, the loan needs to be appraised based on the strength of the activity undertaken. Banks are required to conduct a thorough credit appraisal to avoid under- or over-financing. Suitable assessment tools can be applied for the purpose of rating the JLGs. All other norms of financing, including rate of interest, margin on security, documentation, coverage under a crop insurance scheme, and personal accident insurance, etc., can be followed by the bank as per its regular norms. Additional features of the revised strategy for increasing JLG financing follow:

- Enabling JLGs within and outside SHGs: A few members of SHGs may graduate faster to start or expand economic activities requiring much higher amounts of loans than other SHG members. In such cases, a JLG could be created consisting of such members of one or more SHGs. The members of the JLG will continue to remain members of the SHG and continue to participate in SHG activities as earlier. Likewise, banks could encourage the creation of such enterprise-/livelihood-based JLGs within SHGs by financing these JLGs in addition to the loan/credit limit extended to the SHGs. Small farmers (SF)/marginal farmers (MF)/tenant farmers/oral lessees/sharecroppers/micro-entrepreneurs/artisans who have not yet been covered by SHGs could also be provided with adequate credit support by banks.
- Cluster approach in JLG promotion: Banks could undertake efforts to promote and finance JLGs on a cluster basis for agriculture as well as activities allied to agriculture and non-farm activities. This would not only help in training and improved monitoring of these groups, but would also enable these groups to aggregate into producers' groups at a later stage. Such an approach could help the JLGs to contribute positively to the agricultural value chain and enhance agricultural production and productivity by leveraging on economies of scale. This approach would be particularly effective in command areas of developed watersheds, tribal area schemes, and product-based clusters.

(b) Implications for Outreach and Impacts

The JLG scheme of financing has been accepted by banks and policymakers as one of the most viable approaches for financing the hitherto excluded small/marginal farmers, oral lessees, tenant farmers, sharecroppers, etc. JLGs promoted during 2013-14 were 0.21 million, making the cumulative number of JLGs promoted and financed by banks 0.67 million at the end of March 2014. Fresh loans to the extent of INR 22,201.6 million were disbursed to these groups during the year (INR 18,376.4 million during the previous year, an increase of 21 percent), taking the cumulative loans disbursed to JLGs to INR 67,757.2 million. After abolition of the ceiling interest rate for loans to weaker sections by the Reserve Bank of India in 2010, several private-sector banks began their programme for reaching out to individuals in the below poverty line group. HDFC Bank, under its SLI (Sustainable Livelihood Initiative) launched in 2010, had financed JLGs to the tune of INR 17.22 billion up to 31 July 2014. Other important private banks such as ICICI Bank, Axis Bank, and YES Bank are also now including JLG financing in their business goal. Acknowledging the initiatives of NABARD for financing of joint farming groups through JLGs, the Hon. Finance Minister announced the financing of 500,000 joint farming groups of Bhoomi Heen Kisan (landless farmers) during the year when presenting the Union Budget for 2014-15.

(c) Implications for Sustainability

The literature indicates that the JLG-BLP was to succeed since (a) social capital replaced physical capital, (b) peer selection was to address the problem of adverse client selection, and (c) peer pressure was to help in recovery. In addition, JLGs were to integrate the financial and real estate sectors. The sustainability and replicability of the JLG-bank linkage programme depend essentially on the quality of relationship built and nurtured between the target population and the bank. Basically, intensive support is necessary in the initial stages of sensitization and introduction of the concept to the target group to ensure good quality of the JLG and, while financing, adequate care to ensure the creditworthiness of borrowers and the project as well as an assessment of the required loan amount like any other loan proposal.

3.2.3 Kisan Credit Card (KCC) – Farmers' Credit Card

Subsequent to the announcement in the Union Budget (1998-99), the Kisan Credit Card (KCC) Scheme was introduced in 1998-99. A model Kisan (farmers') Credit Card Scheme was formulated by NABARD and was circulated among the banks in August 1998 for adoption. Since then, progress in the scheme has been good. The scheme has been facilitating growth in agricultural and allied activity GDP and the GDP of India. The KCC has emerged as an innovative credit delivery mechanism to meet the production credit requirements of farmers in a timely and hassle-free manner. The scheme is under implementation in the entire country by the vast institutional credit framework involving commercial banks, regional rural banks, and cooperative banks and has received wide acceptability among bankers and farmers. The scheme aims at providing adequate and timely credit support from the banking system under a single window to farmers for their cultivation and other needs such as the following:

- Short-term credit requirements for cultivation of crops, postharvest expenses, and produce marketing loans
- Consumption requirements of farmer households and working capital for maintenance of farm assets and activities allied to agriculture, such as dairy, inland fishery, poultry, etc.
- Investment credit requirement for agriculture and allied activities such as pump sets, sprayers, dairy animals, etc.

(a) Innovations in Services and Products

The KCC is available to all farmers – individuals/joint borrowers who are owner-cultivators or tenant farmers, oral lessees, and sharecroppers, or SHGs or JLGs of farmers, including tenant farmers, sharecroppers, etc. The KCC account is a savings-cum-credit account and the beneficiaries under the scheme are to be issued a smart card/debit card (compatible for use in ATMs/handheld swipe machines and capable of storing adequate information on the farmer's identity, assets, landholdings, credit profile, etc.). In addition, the banks having a call center/IVR may provide SMS-based mobile banking with a call-back facility from the bank for mobile PIN (MPIN) verification through IVR, thus making a secured SMS-based mobile banking facility available to card holders.

(b) Implications for Outreach and Impacts

The Kisan Credit Card is a pioneering credit delivery social innovation for providing adequate and timely credit to farmers under a single window, with a flexible and simplified procedure, adopting the whole-farm approach, including the short-term, medium-term, and long-term credit needs of borrowers for agricultural and allied activities and a reasonable component for consumption needs. The progress of the KCC in India has been spectacular since its launch as the annual compound growth rate of 22.02 percent for the number of cards issued and 33.08 percent for the amount sanctioned as credit under the scheme from 1998-99 to 2012-13 is commendable and shows the level of adoption of the scheme by both bankers and farmers. Regarding agency-wise progress, the share of cooperative banks in the number of cards issued decreased continuously from 70 percent in 1999-2000 to 16 percent in 2008-09, and then started rising, reaching 21 percent in 2012-13. Similarly, for the amount sanctioned, the share of the cooperative sector fell from 62 percent in 2001-02 to 9 percent in 2012-13. Further, the share of Regional Rural Banks in the number of cards issued increased gradually from 1 percent in 1998-99 to 18 percent in 2004-05, and then dropped to 16 percent in 2012-13. The share in amount sanctioned by RRBs increased from 0.1 percent in 1998-99 to 18 percent in 2005-06, and then dropped to 11 percent during 2012-13. The share of commercial banks has increased substantially. For the number of cards issued, their share increased from 27 percent in 1999-2000 to 63 percent in 2012-13 and their share in amount sanctioned also increased from 47 percent in 1999-2000 to 80 percent in 2012-13.

(c) Implications for Sustainability

Every year, a certain percentage of new farmers are being brought into the KCC fold as per the target prescribed by the controlling/head office of the banks. Quite a large number of new borrowers had been demanding a KCC every year because of its flexibility in usage and other utilities such as flexible withdrawal, flexible repayment patterns, coverage under the National Agricultural Insurance Scheme (NAIS) and Personal Accident Insurance Scheme (PAIS), minimum margin/security norms, etc. Further, the card is almost hassle-free in issue as well as in operation. Additional benefits such as the introduction of a weather-based crop insurance scheme with cyclical credit may go a long way in providing more relief to distressed farmers. There is no doubt that the KCC has emerged as the best financial gift to farmers in the country and it has been accepted by all stakeholders whole-heartedly. However, some issues in its proper use by farmers stem from a lack of financial literacy and also the reach of technology. Coverage of small and marginal farmers, sharecroppers, and landless farmers farming on a lease basis is still inadequate.

3.2.4 NABARD Financial Services Limited (NABFINS)

NABARD Financial Services Limited is a subsidiary of the National Bank for Agriculture and Rural Development (NABARD) with equity participation from NABARD, government of Karnataka, Canara Bank, Union Bank of India, Bank of Baroda, Dhanalakshmi Bank, and Federal Bank. It was originally registered with the name Karnataka Agri Development Finance Company Limited as a public limited company on 25 February 1997 with NABARD as the major shareholder. The board of directors of NABARD decided to rename the company NABARD Financial Services Limited (NABFINS) with an objective of developing the company as a model NBFC. For undertaking microfinance activities, it has adopted a Business and Development Correspondent (B&DC) model. NABFINS lends directly to SHGs, continuing the SHG-bank linkage model with the support of these B&DCs. The benefit of the lower transaction cost of the model is passed on to the client and the lending costs resulting are some of the lowest in the industry. The adoption of the SHG linkage model also results in a very low NPA (non-performing assets). The three principles followed by NABFINS are (i) need-based financing, (ii) adequate financing, and (iii) doorstep delivery with transparency.

(a) Innovations in Services and Products

NABFINS has adopted a B&DC model, which has attracted more than 205 B&DCs throughout the country. Since NABFINS is a non-deposit-taking NBFC, the B&DCs here are not involved in deposit mobilization or remittance activities. The B&DCs are involved mainly in lending activity of NABFINS. In the model adopted by banks, the BCs are like an extension of their branches. However, the NABFINS B&DCs are not an extension of its system but a partnership with independent institutions, besides the major activity of lending.

B&DCs are basically self-help group-promoting institutions (NGOs) and are working with such groups on a regular basis. B&DCs are required to perform the following functions:

- Aggregation of loan proposals for SHGs to be linked to NABFINS, documentation, disbursement of the loan to SHG members, and ensuring appropriate end use of the loan.
- Collection of interest and principal payable by SHGs to NABFINS as per the loan repayment schedule and at an annual rate mutually agreeable from time to time.
- Handling cash flows between NABFINS and SHGs in the form of disbursements and from SHGs to NABFINS in the form of recoveries.
- The B&DC will not collect a service charge in any form from SHGs toward meeting the expenses incurred in discharging its duties, and, while B&DCs render their services to NABFINS, they will not render similar services as a B&DC to any other person, bank, NBFC, or similar institution in the areas mutually agreed upon by the parties.

(b) Implications for Outreach and Impacts

The B&DCs were also building up the capacities of SHGs in areas such as group dynamics, conduct of meetings, rules, regulations and goal setting, documentation/bookkeeping, conflict resolution and leadership qualities, gender equity, linkage and credit management, etc. The members are able to use the loan amount for any purpose they deem fit, for which loans will not be normally available from banks/MFIs. There is also no difficulty in making repayment since the due date is known in advance. The groups are obtaining both disbursement and recovery services at their doorstep. They save on travel expenses besides not sacrificing their daily wages. Since the loan size is not linked to the savings of the groups, they receive a need-based higher quantum of loan than with bank linkage. The waiting period is very low, only 7-10 days, compared with that of bank linkage.

(c) Implications for Sustainability

B&DCs as SHG-promoting institutions had promoted and nurtured the groups over a period of time. The B&DCs are able to earn a commission of 2 percent on the loan/recovery amount in this model, which they would not have obtained otherwise. The SHGs do not face any hassles in either the first or subsequent credit linkages. The documentation and loan processes were shorter and more convenient than with banks, resulting in a higher quantum of loans. The model provides regular profit to NABFINS although the margins are relatively lower than those of most of the other NBFC-MFIs. Regarding the sustainability of B&DC partners, the commission available to B&DCs at 2 percent (1 percent on lending and 1 percent on recovery) is adequate considering support from the internal strength of the SHG model as they need not make very strong efforts in recovery and monitoring like in other MFI lending models. Most of the B&DCs are leveraging on their existing infrastructure for implementing the NABFINS project. The NABFINS model is the model example of an MFI working on both the SHG model and business correspondent model. It has proved that an MFI can provide quality credit at a very affordable rate of interest and ensure almost 100 percent recovery without resorting to coercive methods. This gives a good direction for the MFI sector. It is necessary that the SHG linkage with MFI be accepted for support from NRLM and other government-sponsored schemes such as the SHG-bank linkage to make the model further replicable throughout the country.

3.2.5 Summary

The best practices of rural finance in India discussed in the preceding sections cover the major aspects of rural finance: (a) microfinance (SHG-BLP, the NABFINS model), (b) collateral-free lending for livelihood (JLG, NABFINS), and (c) agricultural lending (electronic farmers' credit card). Table 8 summarizes the key features of the above-described schemes.

Table 8. Summary of Best Practices in India

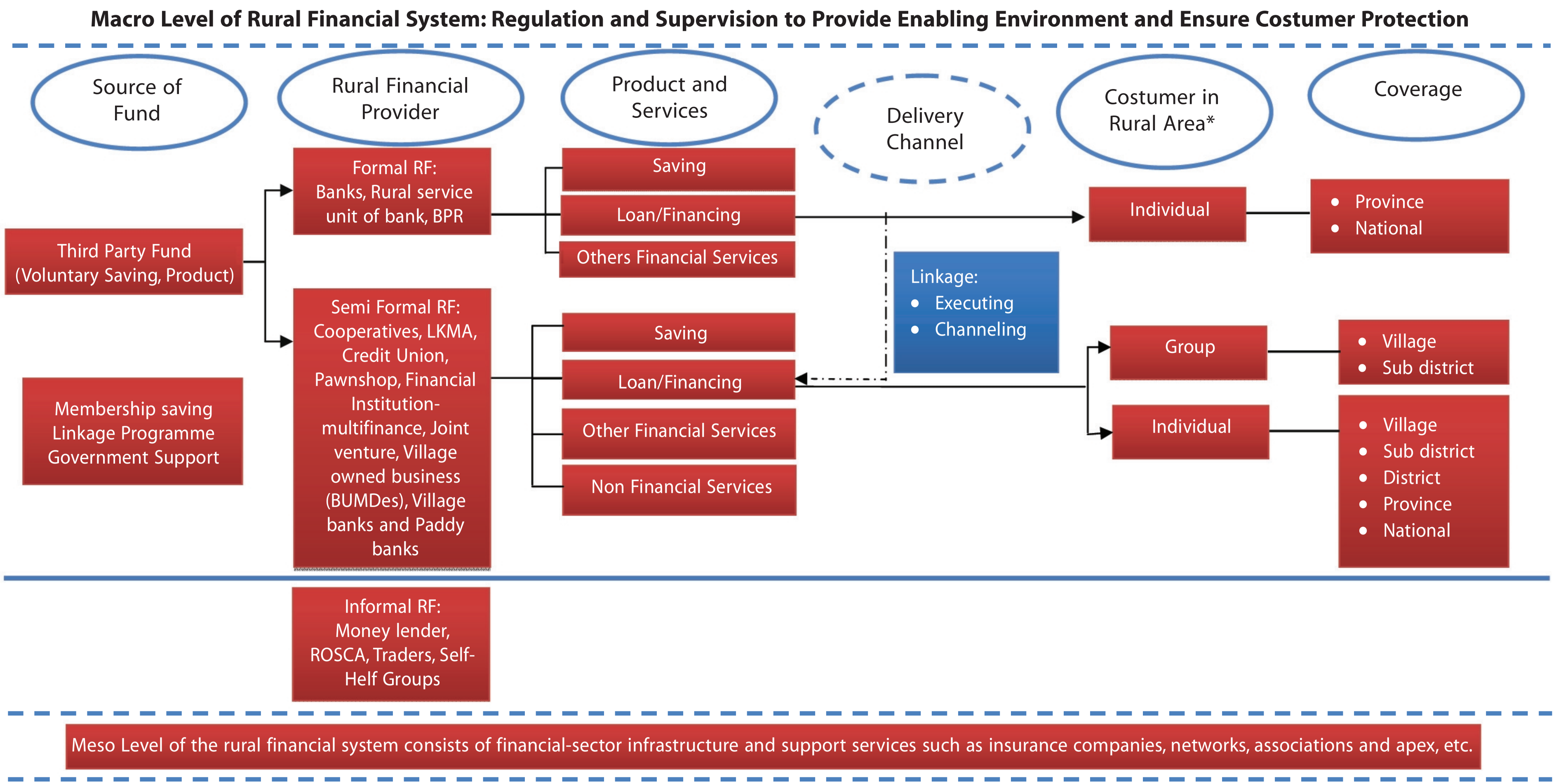
Best practices	Thematic area	Key features
1. SHG-Bank Linkage Programme	Savings and lending	• Allows SHGs to retail bank savings/credit to small clients • Accepted SHG as formal bank client; bank introduced collateral-free lending; allows lending to SHG without specific purposes • Flexibility and affordability
2. Joint liability groups	Savings and lending	• Groups formed to receive credit based on joint liability • Savings not compulsory; lending can aim for individual or group but both under joint liability • Support in occupational and social activities • Effective credit product for mid-segment clients having access to productive assets/ skills
3. Kisan Credit Card (KCC) – Farmers' Credit Card	Credit	• Debit card allows farmers to receive loan based on ICT available to minimize transaction cost • Adequate and timely credit support • Agriculture and other requirements
4. NABARD Financial Services Limited	Savings and lending, technology, delivery model	• Financial service company of national bank adopted business • Development agents to extend service to SHGs to facilitate the SHG-bank linkage • Accessibility (low interest)

3.3 Indonesia

Indonesia has been identified as the world's largest laboratory on rural financial market experiments with numerous institutional forms having been tested over the years. Valuable lessons have been derived from these and embedded in the ongoing programme that have resulted in a paradigm shift in terms of policy focus and approach: moving from microfinance toward inclusive finance. The main categories of rural and microfinance institutions in Indonesia are shown in Figure 6.

The study has identified and selected three rural financial services as best practices currently prevailing in Indonesia. It consists of two community-initiated and one government-initiated programme. In the following sections, key features of each of the services are outlined in detail.

Figure 6. Rural Finance Structure and Framework in Indonesia



Source: APRACA, 2015c).

3.3.1 LKMA Pincuran Bonjo, Payakumbuh, Sumatera Barat

This community-initiative-based rural financial service scheme operates in West Sumatra Province. The fund comes from the community and is supported by the government. The other unique feature that is different from other rural financial services is that the LKMA Pincuran Bonjo applies an integrated system of rural financial framework. It provides financial and non-financial services to the clients and the community. The establishment of LKMA Pincuran Bonjo was motivated by marketing problems for agricultural products, especially for rice and vegetables.

(a) Innovations in Services and Products

LKMA Pincuran Bonjo has both savings and credit products for its members. Credit is directly disbursed to the clients as individual lending. The unique feature of LKMA Pincuran Bonjo is the bundling of a loan with savings products such as compulsory savings, voluntary savings, and the loan. Since the legal entity of LKMA is as a cooperative, it should follow the regulations as a cooperative to have several types of savings as membership-based savings. Principal and compulsory savings are requirements for membership. Principal savings are paid once during registration to be a cooperative member. Compulsory savings are made on a regular basis as long as one is a cooperative member. The second type of savings is voluntary savings (bundled with the credit to facilitate repayment), education savings, *Iedul fitri* savings, *qurban* savings, (time) deposit savings, pawning savings, maternity savings, and marriage savings. Community savings can be withdrawn at any time but the compulsory savings can be withdrawn by the saver only after membership in the financial institution is terminated. Access to savings withdrawn is open for voluntary savings. The education savings can be withdrawn every 6 months (at school opening); *Iedul fitri* savings can be withdrawn two weeks before *Iedul fitri*; *qurban* savings can be withdrawn two weeks before *Iedul qurban*; pawning savings can be withdrawn until the savings amount is enough to repay the pawned asset; (time) deposit savings can be withdrawn depending on the time schedule agreement; and maternity savings can be withdrawn a week before the birth of a child.

The system also provides short-term credit with several schemes. The first loan is limited to IDR 3 million with a 12-month repayment period. There are several features of financing: (i) five months of credit with a maximum loan size of IDR 5 million, (ii) 10 months of credit with a loan size of more than IDR 5-20 million, (iii) 12 months of credit with a loan size of more than IDR 5-20 million, (iv) 24 months of credit with a loan size of more than IDR 5-20 million, and (v) an agriculture financing scheme by profit-sharing mechanism with percentages of 80: 20 and 50: 50, depending on what kind of input the institution shares for agricultural activities. This kind of financing is without any interest. Credit is also provided for farmers without any physical or asset collateral. Moreover, the LKMA also provides stock to its members. The ownership of stock could foster a sense of belonging. Another unique feature is marketing and agricultural input facilitation. The members of LKMA are mostly horticulture farmers who face problems of agricultural product marketing, especially for rice and vegetables. The group formed Sub Terminal Agribisnis (STA) to sell commodities at profitable prices.

(b) Implications for Outreach and Impacts

The number of customers in LKMA Pincuran Bonjo is growing positively. The number of customers was 425 in December 2012 and increased to 580 in December 2013 and to 675 by December 2014. The positive growth in the number of customers implies growing total savings accumulation. The voluntary savings doubled from 2012 to 2014. The NPL or bad debt rate of LKMA Pincuran Bonjo from 2012 to 2014 was 1-2 percent. The financial performance of LKMA Pincuran Bonjo is presented in Table 9.

Table 9. Financial Performance of LKMA Pincuran Bonjo

Savings	Dec 2012 (IDR)	Dec 2013 (IDR)	Dec 2014 (IDR)
Principal savings	21,980,000	28,780,000	32,800,000
Special compulsory savings (stock)	11,300,000	14,700,000	16,700,000
Compulsory savings	28,043,000	40,208,000	56,788,000
Voluntary savings	280,090,171	387,049,871	579,418,641
Total loans disbursed	865,720,000	903,684,000	896,400,000

Source: APRACA, 2015c.

(c) Implications for Sustainability

LKMA Pincuran Bonjo is an integrated financial institution that is community driven. In the beginning, even though this institution did not have any support or subsidy from the government or other institution, it could sustain itself. In order to improve or to replicate LKMA Pincuran Bonjo, the following challenges need to be addressed:

- The point of sale of LKMA Pincuran Bonjo is only one village. LKMA staff go to customers to collect savings every day. So, when the point of sale widens, it will be costly to collect savings. The system should be more efficiently adjusted.
- LKMA was established to meet local needs and is driven by the community. The management should include local people who really know the characteristics of the community and this could minimize moral hazards. However, the local management must be equipped with the ability to manage operations, including marketing skills.
- In LKMA, the local elder is the guarantor who facilitates instalment repayment. If the scheme is implemented in other places, there should be a community elder (or other similar position) to guarantee the financing, someone who is really respected by the community.
- The implementation scheme introduced from elsewhere must be adapted to the local culture because the communities' culture and characteristics are different and this could affect the implementation of the financing scheme. The scheme could also be adjusted to the communities' needs.
- Portfolio credit should be enlarged to reduce the seasonal risks because the revenue cycle of LKMA is highly affected by seasonal patterns of agricultural activities.

3.3.2 BMT UGT Sidogiri

BMT UGT Sidogiri is a financial institution based on the Islamic/sharia system. BMT UGT Sidogiri was established on 6 June 2000, and was approved by the Head Office of Cooperatives and Micro Small Enterprises in Jawa Timur Province. As an Islamic Financial Services Cooperative (Koperasi Jasa Keuangan Sharia/KJKS), BMT UGT is supervised by Cooperative Offices at the provincial and district levels. In general, the managerial and administrative structure of BMT UGT Sidogiri follows the rules/guidelines from the Ministry of Cooperatives about KJKS and it adopts some managerial and administrative structures based on internal needs.

Apart from being a profit institution (Baitul Tamwil), BMT UGT also serves social functions (Baitul Mal). As a general principle in Islamic finance, interest is prohibited. Therefore, BMT UGT Sidogiri uses an *aqad* or contract called sharia contract/agreement. There are various sharia contract agreements (based on trading, profit sharing, rental, charity systems, and others), which can be applied depending on clients' needs. Based on the *aqad*/sharia contract agreement, the returns can be in the form of trading margin, profit sharing, rental fee, guarantee fee, and others.

(a) Innovations in Services and Products

BMT UGT Sidogiri has two types of savings: voluntary savings for the public and membership-based savings (principal and compulsory savings). To improve the capital capacity of the BMT, there is an option for the members of BMT UGT to contribute more than membership-based savings (principal and compulsory savings). There is a special savings scheme (only for members), which is voluntary. Principal savings are paid once upon membership registration with an amount of IDR 1,000,000. Membership-based savings are paid annually in multiples of IDR 10,000. Membership savings (principal savings and membership-based savings) cannot be withdrawn as long as the clients are members of the BMT UGT. Additional deposits and withdrawals from special savings schemes of the membership savings can be made only at certain times. The minimum first/initial deposit is IDR 10,000 and the same for the next deposits. Tabungan Umum Syariah can be withdrawn at any time using the savings book or internal card. The administrative fee is IDR 2,000 per transaction. For the administrative fee, members pay IDR 5,000 when opening the account and there is no monthly administrative fee. Starting in 2014, BMT UGT has a partnership with BRI (co-branding with BRI), which launched a scheme to provide a card that can be used as an ATM and debit card. The withdrawal limit is IDR 1,000,000 per day. The administrative fee is IDR 7,000 per transaction. Savings in BMT UGT Sidogiri use the sharia system, which charges no interest.

There are two productive financing schemes, namely, UGT Modal Usaha Barakah (MUB) and UGT Multiguna Tanpa Agunan (UGT MTA), and both are covered by insurance. Both types of financing charge no interest (based on the sharia system). This financing is disbursed directly to individual/micro small business entities and sharia agreements are used for UGT MUB Sharia Agreement of Mudharabah/Musyarakah (based on the profit-sharing system) and Murabahah (based on trading/buy and sell system), and profit sharing and trade margin are agreed by both parties. The repayment of loans is gradual. For debtors in the market areas, deposit money for savings is collected every day and financing repayment can be deducted from their savings account or cash paid monthly to the Account Officer (AO). For debtors outside the market areas, there is a policy to do savings every day, but the Account Officer will collect their repayments monthly. BMT UGT Sidogiri has financing that is bundled with savings and credit insurance that is provided by the sharia national insurance company. This product has advantages for customer protection because the debtor is protected by financing insurance.

(b) Implications for Outreach and Impacts

BMT UGT Sidogiri also has branches in remote and very remote areas. The presence of branches allows BMT UGT Sidogiri to have products such as remittances whereas other cooperatives rarely have such products. Through remittance, a customer in one branch can send money to other customers in another branch. Before BMT UGT Sidogiri had an online service, internal management was done using mobile phone technology by SMS for the remittance services. The remittances use an internal mechanism for deposits across branches. BMT UGT Sidogiri has strong institutional capacity. As a cooperative, this institution is successful and has good performance. BMT had 228 branch offices and co-branch offices spread across 10 provinces in 2013. As an Islamic financial institution, BMT has a big opportunity to grow and attract many more customers. Aside from being a profit institution (Baitul Tamwil), BMT UGT also serves social objectives (Baitul Mal). Its growth in membership can also be observed. Its diversity of products provides an opportunity to increase savings accumulated, which allows BMT to develop further. Moreover, BMT UGT Sidogiri has a special scheme for membership savings. In this scheme, members can save their money up to the amount of IDR 2 billion. BMT UGT is an executing agency for sharia banks. BMT UGT also receives gold as collateral for sharia-pawning gold, and this gold is stored in a sharia bank. This gold can be used for refinancing schemes by the bank. Table 10 presents the financial performance of BMT UGT Sidogiri.

Table 10. Financial Performance of BMT UGT Sidogiri (in million IDR)

Year	Own capital	Savings of members	Number of debtors	Loans to members	Assets created	Return on equity (%)	Loans to deposit ratio (%)
2007	6,748	31,177	18,441	30,318	51,673	NA	NA
2008	12,035	62,603	24,092	59,019	89,380	38.15	88.26
2009	19,424	92,250	34,992	88,479	133,242	39.49	85.43
2010	33,576	150,947	54,593	148,034	226,320	34.50	82.79
2011	47,374	265,221	80,805	266,587	406,199	38.02	79.81
2012	85,353	450,194	76,212	433,699	622,771	38.15	91.39
2013	164,435	664,465	98,128	628,274	1,068,232	36.68	94.55

Source: APRACA, 2015c.

3.3.3 Grameen Pesisir in KUD Mina Samudera Tangerang

The Ministry of Marine Affairs and Fisheries formulated the Coastal Community Economic Empowerment Programme (PEMP). This programme aims to reduce poverty in coastal communities, particularly for fishing workers, to enhance their livelihood. To improve the welfare of the coastal communities, the programme focuses on the revolving fund by Productive Economic Funds (DEP/Dana Ekonomi Produktif). This fund is managed by the Institute of Coastal Economic Micro Mina Development Partners (LEPP-M3), which was established as a holding company of the coastal communities. Five stakeholders are involved in this programme: (i) the government institutions – marine and fisheries departments and provincial government agencies – that are responsible in the field of marine and fisheries; (ii) management consultants – county or city NGOs, universities, or consulting firms; (iii) village facilitators; (iv) cooperatives of LEPP-M3 or fisheries cooperatives as recipients of Productive Economic Funds as cooperative capital; and (v) the executing bank that distributes a DEP to LEPP-M3. Related to those government programmes, this study focuses on fisheries cooperatives of KUD Mina Samudera as recipients of DEP funding. KUD Mina Samudera has four business units:

- Loan and Savings Unit of Swamitra Mina Samudera (USP Swamitra Mina Samudera)
- Loan and Savings Unit of Grameen Pesisir (USP Grameen Pesisir)
- Solar Packed Dealer for Fishermen (SPDN)
- Kedai Pesisir Unit (Store for Fishermen)

(a) Innovations in Services and Products

USP Swamitra Mina Samudera collaborated with one commercial bank in its running. The operational fund comes from the KUD but the management uses a system developed by the bank. Swamitra as a business unit of the KUD is regulated under the Act of Cooperatives No. 25 in 1992 and Government Regulation No. 9 in 1995 for Savings and Loan Business. USP Swamitra Mina Samudera provides basic financial products such as savings and credit. These units also provide financial services such as payments for electricity, water, and phone. USP Swamitra Mina Samudera offers the following financial products:

- Swamitra savings: This product is a voluntary savings, open-access and unlimited so that customers can deposit and withdraw their money any time without limitation on the unit office, as long as the balance is sufficient, using their savings book. The interest rate on savings is 5 percent per annum. This savings product is also a requirement for obtaining a loan as a tool for auto-debit instalment payments.
- Loan-bearing interest rate of 1.75 percent per month or 21 percent per annum. This is the only loan provided by Swamitra Mina. This loan can be used for productive (investment and capital) and consumptive purposes. This product can be accessed not only by members but also by

non-members of the cooperative as long as they can fulfill the administrative requirement, collateral, and other requirements. The loan will be disbursed through their savings account. Some portion of the savings account cannot be withdrawn and the value is accounted for in the 5 percent administrative fee/charges at the time of the credit disbursement. These held/frozen savings will be returned after the debtors repay all their debt (interest and principal).

- The loan is only for the short term. It's only for 3, 6, 10, 12, 18, or 24 months with loan size generally from IDR 1,000,000 to IDR 50,000,000. However, in some cases, a larger loan can be approved up to IDR 150,000,000 and the loan payment period can be extended up to 36 months. This loan is provided not only to bankable people but also to un-bankable ones who have a feasible business. Swamitra Mina Samudera also collaborates with Jiwasraya Insurance (one of the national insurance companies) to provide credit insurance to protect borrowers and their families.
- Swamitra time deposit: This product is the same as the product of deposits in the bank with maturity of 1 month, 3 months, 6 months, and 12 months. The interest rate on savings is 8 percent per annum.
- SMS for electricity and telephone payment services.

USP Grameen Pesisir is a business unit of the cooperative and the managerial and administrative structure of Grameen generally follows the system developed by the Ministry of Marine Affairs and Fisheries. USP Grameen Pesisir in KUD Mina Samudera was formed in October 2013. Its products include loans and savings. The loan is through group lending so this loan can be given if the borrowers are included in the group. It is distributed among the members using the pattern of 2-2-1 or 3-2 (the poorest members have the first chance in receiving the loan and the leaders are the last ones to obtain the loan). This loan is only for a short term – 25 weeks (6 months) or 50 weeks (12 months). The first loan for each member is IDR 1 million or IDR 5 million for a group. If the members show good performance in repayment and obey the rules, they can apply for a second loan and the value can be doubled.

There are five phases and each phase has a different IDR 1 million of loan for every member and it cannot exceed the maximum limit for each phase. The total loans as of November 2014 were IDR 2,409 billion with a return rate of IDR 1,203 billion and bad debt ratio of 0 percent. This loan needs to be repaid gradually during the weekly meetings or at the center meeting to the cooperative staff. The loan target is poor families, especially women who have a potential business or will develop a business or need additional money to support their husband in running household business activities.

There is no physical collateral but each member has a responsibility to supervise other members in the group. So, if one member cannot make a repayment, the other members should cover it or it becomes a joint liability of the group members. This also allows the loan to be easily accessed by the poor. This business unit has two types of savings, compulsory savings (1 percent from the loan) and voluntary savings. Compulsory savings cannot be withdrawn at any time. They are a pre-requisite (bundling) for credit and these savings are mandatory as cooperative members. These savings earn no interest, but groups will obtain a share of the "cooperative's surplus" every year. This surplus will be given in the form of a door prize due to the small amount of compulsory savings accumulated. Then, in each group, this door prize will be given in rotation for each member or it can be sold and the money can be distributed among the members.

(b) Implications for Outreach and Impacts

Until November 2014, the number of members serviced by this unit was 1,910 women, coming from 78 centers and 383 groups, with one group consisting of 5 women. A majority of the groups are in one center located in the same area. The success of Grameen Pesisir was attributed to the following factors: (i) the concept of Grameen Pesisir was formulated by the government and implemented fully by the resources of KUD Mina Samudera; (ii) the common features of the implemented Grameen Pesisir programme are small loans and frequent repayment by weekly meeting, self-chosen income-generating activities by borrowers, incentives for good payers, an interest rate to cover operations, financing, and return; (iii) to protect the loan, micro-insurance is used; (v) linking savings (compulsory savings) with loan services; (vi) loan terms are short and can be selected as either 6 months or 12 months; and (vii) a group-lending mechanism is used to overcome collateral problems. Table 11 presents the performance of Savings Unit KUD Mina Samudera.

Table 11. Performance of Savings Unit KUD Mina Samudera

Indicator	USP Swamitra Mina		Grameen*	
	Dec 2013	Oct 2014		Nov 2014
Total savings (IDR)	6,725,385,955	7,125,061,993	Compulsory savings and voluntary savings	99,748,000 and 68,629,500
Savers	1,978	2,700	Groups and members	382 and 1,910
Total loans (IDR)	7,744,612,399	8,289,386,256	2,409,000,000	
Borrowers	652	666	Groups	382
NPL/BDR (%)		4	Members	1,910

Note: * Established in October 2013.
Source: APRACA, 2015c.

3.3.4 Summary

The three financial institutions identified were established by local initiative and resources. It has been proven that they are all sustained even without the government's technical and financial support. USP Grameen Pesisir has a group lending approach directed to serving the financial need of small unit businesses operated by women. Moreover, it appears that this scheme has shown strong growth of business and outreach. However, its operation is only one year old. It needs more time to prove its viability as a good and sustainable scheme. Its primary features are presented in Table 12.

Table 12. Summary of Best Practices in Indonesia

Best practices	Thematic area	Key features
1. BMT UGT Sidogiri	Savings, lending, and insurance	• Membership-based savings and lending • Institution adopting Islamic scheme with religious leader guarantee • Training in self-discipline in managing finance • Leading to self-financing of business
2. LKMA Pincuran Bonjo	Savings and credit	• Integrated system for rural finance • Membership-based savings and lending institution • Collateral-free, loan insurance • Marketing services also offered
3. Grameen Pesisir KUD Mina Samudera	Savings and lending	• Grameen model for women's group lending • Phased repayment • Loan insurance and savings mobilization

3.4 Philippines

The best practices documented for the Philippines were chosen based on three indicators: (i) accessibility for the poor, (ii) technical and financial feasibility, and (iii) cost effectiveness and profitability. The first case is about establishing Micro-Banking Offices (MBOs) and other banking offices (OBOs) and how this recent innovation in microfinance has enabled CARD Bank to significantly expand its outreach even in hard-to-reach areas. It is a best practice because putting up MBOs has enabled CARD Bank to bring microfinance products and services to the doorsteps of the excluded in a sustainable and profitable manner. The second case is how GM Bank, a rural bank, has used the government's loan guarantee scheme to lend to small farmers even without the benefit of collateral. Since the guarantee scheme is able to lower the risk and cost of lending to small farmers who are perceived as high-risk borrowers, the GM Bank has succeeded in expanding its small-farmer loan portfolio significantly and, in effect, increasing the access of small farmers to rural financial services even without collateral. The third case discusses how small onion farmers, a microfinance NGO, a government development corporation, a large private food company, a donor (Catholic Relief Services), and the local government have successfully collaborated in using value chain finance to provide small onion farmers with access to finance and a market for their produce.

3.4.1 Case Study of Micro-Banking Offices and Other Banking Offices: CARD Rural Bank

CARD Bank, the largest microfinance bank in the country, is a member of the CARD Mutually Reinforcing Institutions group of companies. On 31 December 2013, CARD Bank received from the Bangko Sentral ng Pilipinas (BSP) a Hall of Fame award on financial inclusion, a fitting recognition for CARD Bank's dedication to financial inclusion of the poor people, especially women who have been excluded from mainstream banking in the country. This case study chronicles the significant contribution of OBOs and MBOs in providing accessibility of financial services to an expanding client base. In short, it is an effective service delivery structure for a microfinance bank that has been established to provide microfinance services to those excluded from mainstream banking. The case study explains how OBOs and MBOs have helped CARD Bank to reach those excluded in a sustainable and profitable manner.

(a) Innovations in Services and Products

From 1997 to 2005, CARD Bank conducted all banking transactions in a regular branch, staffed by one branch manager, an assistant branch manager, a cashier, a bookkeeper, and two to three tellers. CARD Bank tried hard to reach those microfinance clients but at the cost of productivity and efficiency as the transaction costs were simply too high. Under the BSP implementing guidelines of 2005, provisions were made in the management of OBOs with the following being implemented and complied with:

- An OBO must be established to service microfinance clients only and must be located within two hours traveling time from the branch.
- An OBO must not maintain a complete set of books of accounts.
- To ensure that the OBO has no cash and records, all transactions and excess cash must be remitted daily and must be taken up directly in the head office or branch to which it is attached.

Again, on 14 October 2010, the BSP issued Circular 694, an Amendment of Regulations on the Establishment of Other Banking Offices and Notes to Microfinance. It expanded the functions of the OBOs and the OBOs were also recognized as "microfinance-oriented." A "microfinance-oriented BO (MF-OBO)/Micro-Banking Office" (MBO) shall refer to an OBO that primarily caters to the banking needs and services of microfinance clients and overseas Filipinos (OFs) and their beneficiaries with the following instructions:

- Accept micro-deposits, including initial deposit and service withdrawals, and thereof accept check deposits of microfinance clients for collection and credit to own-deposit accounts.
- Disburse/release proceeds of micro-loans and collect loan amortization payments and related charges.
- Present, market, sell, and service micro-insurance products in accordance with existing regulations.
- Receive/pay out funds in connection with authorized remittance transactions and other functions.

(b) Implications for Outreach and Impacts

Immediately after issuing the circular, CARD Bank established OBOs in different locations, within and outside the towns where the branches are located. This really brought micro-loans to the doorstep of microfinance clients. Thus, from June to December 2006, 26 OBOs were established. The immediate impact was a boost in the productivity and efficiency of CARD Bank. The bank complemented the OBOs by establishing micro-banking units (MBUs) inside the branch office. CARD Bank experienced a significant improvement in productivity and efficiency in terms of total clients, total loan portfolio, total savings balances, and managing portfolios-at-risk. Other factors have contributed to the expansion of the client base such as the transition of clients and purchase of their loan portfolio from CARD, Inc. (NGO) and others. However, according to the management of CARD Bank, the MBOs have really played a highly significant role in expanding its client base and loan portfolio.

(c) Implications for Sustainability

Proportionate regulation of the microfinance industry, which has been the hallmark of BSP's approach to regulate microfinance, has allowed the formation of MBOs/OBOs, essentially scaled-down branches. This novel approach has equipped microfinance-oriented banks such as CARD Bank to expand outreach and also to contribute to achieving the financial inclusion objectives of the BSP and the banking community in general. In particular, the establishment of OBOs/MBOs with supporting implementing guidelines has been a major factor in successfully expanding the capacity of CARD Bank to provide microfinance products and services to micro-enterprises and poor rural households in remote rural areas. Through OBOs/MBOs, CARD Bank was able to continuously motivate and create more awareness among the general public, especially micro-enterprises and rural households, to save in the bank. Moreover, those OBOs/MBOs have also become the channel for members/clients, including their dependents, to avail themselves of the benefits of micro-insurance. An important lesson is the importance of maintaining an open policy dialogue between the regulator and the regulated entity. CARD Bank would not have been able to develop an extensive service delivery structure without the BSP's regulatory framework that was balanced in providing support to microfinance while maintaining financial stability.

3.4.2 Case Study on Using the Agricultural Loan Guarantee: GM Bank

This case study describes the Philippine experience in implementing a credit guarantee programme for small farmers and fishers through an assessment of the performance of one of the outstanding accredited financial institutions, GM Bank – a rural bank. The case study shows how the Agricultural Guarantee Fund Pool (AGFP) credit guarantee has helped this rural bank to succeed in expanding its loans to small farmers. The credit guarantee seems to function as an effective instrument to mitigate credit risks, which has encouraged this rural financial institution to expand its small-farmer loan portfolio. However, there are areas for improvement of the AGFP guarantee to make it a truly effective credit enhancement instrument. This case study indicates how the guarantee scheme could be improved based on the findings of a recent evaluation study. GM Bank, Inc. is a consolidation of two of Nueva Ecija's most established rural banks, the Community Rural Bank Inc. (CRBI) and the Muñoz Rural

Bank Inc. (MRBI). GM Bank, Inc. was founded in 2004 and is based in Cabanatuan City, Philippines. It offers a range of financial services, such as savings accounts, checking accounts, automatic transfer accounts, time deposits, and money transfers. The bank provides various types of loans: micro-agriculture loans, commercial loans, industrial loans, and special financing such as countryside loans, vehicle loans, motorcycle loans, salary loans, and loans against peso deposits. It also offers ATM services.

(a) Innovations in Services and Products

The AGFP was established in May 2008 through an Executive Order to increase access of small farmers and fishers (SFF) to credit. It provides an 85 percent guarantee cover on agricultural food production loans granted by accredited lending institutions against all types of risks of non-repayment by farmer-borrowers except fraud. Both financial institutions (banks and cooperatives) and non-financial institutions (small and medium enterprises, large corporations, traders and input suppliers, NGOs, and farmer organizations) that lend to SFF are allowed to use this credit enhancement instrument. The innovation introduced by the Department of Agriculture (chair of the Programme Committee) is to allow the enumerated non-financial institutions to avail themselves of a guarantee cover for their loans to SFF borrowers. To be eligible for the guarantee, lending institutions must satisfy the following criteria: (i) sufficient experience (three years) in lending to small farmers and fishers, particularly for agricultural production; (ii) satisfactory standing with creditors; (iii) stable financial standing; and (iv) good moral character and satisfactory credentials of management, officers, and owners. The line is valid for one year and can be renewed based on the institution's use of the guarantee line.

(b) Implications for Outreach and Impacts

Before merging with the AGFP, the bank had a micro-agriculture loan portfolio of only PHP 12 million with around 1,000 farmer-borrowers. In 2011, the bank was accredited under the AGFP and was initially provided with a guarantee line of PHP 100 million. This was raised to PHP 200 million in 2012 and PHP 300 million in 2013. At present, PHP 192 million in loans are covered by an AGFP credit guarantee. The guarantee enabled the bank's micro-agriculture loan portfolio to increase from PHP 23 million in 2012 to PHP 250 million in 2013 and the number of farmers from 1,000 to 3,600. Areas covered include several municipalities of the provinces of Nueva Ecija, Pangasinan, Tarlac, Aurora, La Union, Bulacan, and Zambales. Those are new areas for GM Bank lending operations. Both potential borrowers and local officials were oriented on the bank's loan programme to benefit borrowers through the credit guarantee. This contributed to the increase in the number of borrowers and the volume of loans. The credit guarantee has motivated GM Bank to expand its micro-agriculture loans, which have been beneficial to SFF borrowers and the bank's bottom line. The expansion in its micro-agriculture portfolio was accompanied by the implementation of a loan collection strategy developed by the bank after a diligent study of the clientele and the rural economy. To ensure loan collection, the bank adopted the following measures:

- Hiring of an appropriate number of account officers (one account officer = 80 borrowers)
- Monthly monitoring of all borrowers and flexible loan repayment, for example, loan repayment could be extended if production is affected by calamities
- Extension of credit for another cycle to borrowers who did not pay on time to give them a chance to recover and repay the previous loan
- Reduction of the interest rate from 3 percent to 2 percent per month for borrowers who pay on time or before the due date in two consecutive cycles

On the demand side, key informant interviews with a few small onion producers who borrowed from GM Bank corroborate the claim that the guarantee has resulted in an increase in the number of new borrowers. The informants indicated that submission of (traditional) collateral was not a key requirement for a loan and that the bank used the AGFP guarantee to secure the loans. Farmer-borrowers also cited the following reasons for borrowing from the bank: low interest rates, easy access through account officers who approached them and helped them with the documentation requirements such as farm plan and budget, etc., and quick and timely release of the loans.

(c) Implications for Sustainability

The AGFP had guaranteed a total of PHP 14.1 billion in agricultural production loans from 607 lending institutions to 229,623 SFF borrowers as of 2012. A total of 854 lending institutions have been accredited and provided with guarantee lines under the AGFP, of which 71 percent or 607 lending institutions have used their guarantee lines at least once. These lending institutions that have used the AGFP comprise banks (13 percent) and non-banks (87 percent). It is noted that the use of the AGFP by lending institutions is currently still relatively low. This may be because lending institutions perceive SFF as risky borrowers, especially those not familiar or known to them (a case of asymmetric information). This is when an instrument such as the AGFP credit guarantee can play a critical role but it has to be properly marketed to potential lenders.

3.4.3 Case Study of Agricultural Value Chain Finance: Kalasag Cooperative

In the Philippines, limited access to financing hampers the competitiveness of smallholders. Typically, small farmers and fishers depend on traders or middlemen for inputs and marketing of their produce. Because of the risks of agricultural financing, formal financial institutions tend to shy away from those smallholders. This case study discusses how the value chain can help such smallholders to break the barriers to financing and markets. Lessons learned through the failures of interventions focusing on one link in the value chain alone directed efforts to address constraints in the entire chain from production to postharvest, to marketing, to distribution. Value chain financing offers tremendous potential for providing smallholders and other small-scale clients in the countryside with access to financial services and markets for their outputs.

In recent years, value chain financing has been recognized as an effective credit delivery mechanism not only for small producers but for all the actors in the value chain. The value chain reduces commercial risk by providing an assured market for the produce, making it easier for chain actors to obtain financing from banks and other formal sources. Efficient value chain financing is critical in smallholder agriculture and this case study shows how its impact on small onion producers can help other small-scale producers in accessing financing and markets for their outputs. In the case of the Kalasag Farmers Producers Cooperative (Kalasag), the viability of the value chain financing project is strengthened because of the presence of a "custom-fit" financing package and the availability of institutional markets that adapted to the farmers' situation. Organized by ordinary farmers, the Kalasag Multi-Purpose Cooperative (MPC) of San Agustin, San Jose City, Nueva Ecija, is now an accredited supplier of onions to the country's leading food chain company, the Jollibee Foods Corporation (JFC), a milestone for Kalasag in its six years of existence.

Kalasag has shared the results of its success with other sectors of the community. The cooperative has been providing livelihood opportunities to out-of-school youth and farmers' wives. After its almost six years of existence, Kalasag has now made a name for itself in agriculture and industry. From farmers with simple dreams to provide for the needs of their families, they are now gearing up to be the leading producer of onions in the country.

(a) Innovations in Services and Products

The pilot collaboration project of the NLDC, CRS, and JFC was successful in linking small farmers with JFC and other markets. This approach has become a local model in supporting farmers through sustainable agro-enterprise development. The NLDC programme involves a developmental capacity-building process in which the farmers acquire knowledge in basic marketing, awareness of alternative market chains for their crops, and a grasp of buyers' preferences as to quality, volume, and price. The MFI

(ASKI) under the project was able to pilot test and develop a financing product that is suitable to the requirements of onion farmers in the value chain. Each collaborating organization (public and private) used its relative competencies and contributed its own resources (technical, financial, etc.) to support the market linkage between Kalasag and JFC.

(b) Implications for Outreach and Impacts

Kalasag was able to deliver white onions to JFC with a very low percentage of rejection (0.17 percent). This record is considered excellent compared with the Jollibee standard of 5 percent to 10 percent rejection and is the lowest percentage of rejection in the history of JFC. Kalasag was also able to sell its produce at PHP 30 per kilo when the prevailing market price of white onion during March to April 2009 was only PHP 20 per kilo. The quality difference justified the premium price paid for Kalasag onions. Projections show that Kalasag could generate a net income of PHP 196,750 per crop cycle if it could sell buffer onions at PHP 27 per kilo to local traders. The profit from this transaction will be used as capital buildup for each beneficiary; alternatively, such profits can be plowed back as buying funds in succeeding planting seasons. The cooperative now has the capability to ask for the best possible price for its produce even during the peak season when supply gluts exist. This is because of the established marketing linkages of the cooperative with JFC and other companies. The leaders' and members' efforts, support from the government and the private sector, the right technology, and financial assistance made the cooperative successful in its venture. In 2012, Kalasag started supplying onions to another company, CDO Foodsphere, Inc., a leading Filipino food corporation in the meat processing industry, with 3 tons of onions required per week. Likewise, Kalasag has ventured into corn production to supply a feed company.

(c) Implications for Sustainability

The experience of Kalasag provides the main lesson that agricultural value chain financing can be viable if the market for agricultural produce is assured. This assurance is a risk-mitigation measure that counters the voluminous risks, specifically those brought about by natural disasters and infestations. The financing structure still needs to be aligned with the specific requirements of small farmers at a particular time and, thus, it is best described under a value chain financing approach. It can also be noted that corporate markets are accessible if the farmers know how to be competitive in terms of prices and be consistent in quality and quantity of produce. Table 13 summarizes these case studies with key features.

Table 13. Summary of Best Practices in Philippines

Best practices	Thematic area	Key features
1. Micro-Banking Offices (MBOs)	Operation and outreach structure	• With favorable regulatory environment, CARD bank expands MBOs to extend services to the doorstep of communities • Tremendous expansion in outreach
2. GM Bank loan guarantee	Product (guarantee)	• AGFP agricultural guarantee programme • Enabled loan providers to reach out to more small farmers and fishermen because of the loan guarantee
3. Kalasag value chain financing	Innovation (onion producers', financial institutions', and buyers' collaboration)	• Small producers organized into cooperatives and supply for a lead buyer • Financial institution provided collateral-free loan • Government provided initial loan through an FI, plus facilitation and other support services

3.5 Thailand

Rural finance in Thailand is being led by BAAC, which emerged as the most prominent state-owned specialized financial institution. In the course of its 50 years of serving the rural community of the nation, BAAC developed a number of best practices and supported the government programme to reach out to the country's rural community. As a first of its kind, the joint liability group (JLG) was launched in 1967. This lending mechanism allowed a large number of farmers to access BAAC credit without any physical collateral. It also helped BAAC to speed up its lending operations. It has been proven as one of the most effective and efficient tools in rural and agricultural lending. This has been constantly practiced ever since. In 1991, BAAC launched innovative savings products called Omsap Thaweesook ("Lucky Draw"). Any individual who saved a certain amount for a certain period of time would be entitled to the right to win prizes such as a car, motorcycle, gold, electrical appliances, etc., twice a year. This kind of savings promotion is popular in rural areas and it attracts millions of savers. Another innovative and popular savings promotion programme in urban areas is Omsap Thaweesin ("Lotto certificate"). This savings features high cash prizes up to THB 20 million. Additionally, there are many tailor-made savings products that are appropriate for different kinds of customers, for example, the Thaweesook Deposit scheme that was launched by BAAC in 2003 to attract the elderly from rural regions to reap the benefit of the country's economic growth. The inclusion criteria for Community Financial Institutions (CFI) have been based on the common indicators recommended by APRACA. Specifically, the following indicators were considered when choosing the cases: (i) product, (ii) delivery system, (iii) business model, (iv) technology, (v) outreach, (vi) flexibility and replicability, (vii) enabling environment, and (viii) special features.

3.5.1 Suk Samran Community Financial Institution

The Suk Samran Community Financial Institution is located in Suk Samran Village under sub district Rabror, Thasae District in Chumphon Province. The committee of Suk Samran Community Bank/Financial Institution (CB/CFI) has 16 members. Apart from the designated committee members, some hired professionals manage the day-to-day operational aspects of the CFI. According to the current regulations, the Suk Samran CFI has set the criteria for membership as individuals of age 20 to 65 years, being a member of the group for at least five years, and living in the same village. Only one member of a family is allowed to take out loans. Borrowers must form a group of at least five members who dwell in the same village.

(a) Innovations in Products and Services

Multiple categories of loans are offered by the CFI to suit the business requirement of the groups depending on their activity levels and domain of operation. The following are the types of loans generally sanctioned with definite conditions and terms of references:

- Working capital loan: for the purpose of working capital in agricultural activities or improved quality of life. The maximum loan amount is THB 50,000, the interest rate is 15 percent, and the loan is payable in 12 months or 18 months in extraordinary cases.
- Investment loan: This loan is generally used in running a business, entrepreneurship, trading, production, etc. The maximum loan amount is THB 250,000 at 15 percent interest, and the loan is payable in 12 months or 18 months in extraordinary cases.
- Refinancing non-formal debt loan: There is no limit to the loan amount. However, this must comply with the condition and policy of the CFI.
- Emergency loan: This is used in cases of emergency such as family hardships arising out of accident, illness, death, or some other unexpected event that required a quick payment of cash. The maximum loan amount is THB 150,000 and it is payable in 12 months at 15 percent interest.

Realizing the difficulty of its members as well as the business opportunity, the CFI started a new business on money transfer and account payment services such as electricity bills, telephone bills and telephone top-up credits, sale of input supply such as fertilizers, pesticides, milled rice, drinking water production, and the provision of life insurance in the form of funeral aid association (FAA), which aims at helping members arrange a funeral ceremony and pay off the debt.

(b) Implications for Outreach and Impacts

It is seen that all members are satisfied with the CB in terms of the services and support it provides. The specific sense of appreciation from the members falls in categories such as encouraging cooperation, collaboration, and commitment. The members do believe in the sound system of the CB, including the committees they elect. Any changes in the management and staff in the future will not undermine the operations of the CB.

(c) Implications for Sustainability

The best practice elements of Suk Samran CFI have been that it is community oriented and evolves a holistic welfare approach among its members. It is democratically managed and community participation is established in the management processes. It acts as a contingency source of finance for its members and caters to the exigencies of the local communities. It provides a wide range of financial products that enable the members to invest in new activities, meet working capital requirements, as well as refinance business loans. Further, it provides services such as input supplies for effective farm operations and saves the time of members by paying their service utility bills (telephone, electricity, etc.). It also provides financial support for funerals and engages in debt resolution through negotiation with other lenders with whom the members have affiliations. It works on the principles of cooperation, collaboration, and commitment to be replicated elsewhere.

3.5.2 Don Moo Community Financial Institution

Don Moo is a village in Tumbon Khampia of Trakarn-Peuchpol, Ubon Ratchathani Province. The CFI serves 170 households with 680 people. It is situated 18 km north of the district town. Most of its population is engaged in agriculture. The total cultivated land is 0.64 hectares, with paddy being the primary crop. As this is a rainfed area, only one crop of rice is cultivated in a year. The secondary livelihood is livestock. The villagers raise beef cows, buffaloes, and swine. They also earn additional income as agricultural wage laborers. In 1994, the villagers were encouraged to form various occupation groups such as a savings group for production, paddy bank, community forest group, etc. Following the economic crisis in 1997, many financial institutions collapsed, hundreds of businesses closed down, and millions of people were laid off. Many of them returned to their home town, keeping agriculture as an option for food security. In 2003, the government launched the Debt Suspension Scheme (DSS).

BAAC played a significant role in educating the farmer-borrowers who participated in the DSS. It ensured that farmers, upon the completion of the DSS, were in a position to repay their debts. BAAC encouraged the farmers to apply the philosophy of sufficiency economy involving moderation, reasonableness, and self-immunity. Farmers were educated on the three steps of SE economic development: self-dependence by reducing the cost of living and cost of production and expansion of opportunity for mutual-dependence. They were encouraged to arrange themselves into groups of various occupations such as rice mill group, swine group, farmer farm school group, beef-cow group, etc. A network of cooperation and business connection in trading and exchanging food, products, and expertise has been formed at all levels, going from the *tambol* (sub district) level to the district level and provincial level. Seventeen committee members manage the CB in accordance with its regulations.

(a) Innovations in Products and Services

Don Moo CFI provides its services to the entire area of Tambon Khampia. At present, most of the members dwell in Don Moo. A few members come from neighboring villages also based on the convenience of services. The CB mobilizes capital from shares, with initial shares of at least one share worth THB 50 (USD 1.60). The value of shares is deducted from the loans. Five percent of the loan amount is deducted toward the shares held by the borrower. All members are required to contribute THB 500 to the welfare fund. They are entitled to receive welfare in the form of a cash voucher for a new-born baby, compensation of THB 80 per day (with a maximum of five days per year in case of sickness and undergoing treatment in the hospital), and indemnity provided to the family in case a member passes away. There are two types of savings: (i) time-deposit-interest with an interest rate of 5 percent (minimum duration is one year and the maximum amount of savings per person is THB 5,000,000 or USD 165,000) and (ii) savings deposit with interest rate at 1 percent and the maximum amount of savings is not yet determined. The general public, youth, and various groups in the community are eligible to save. The lending services consist of (i) regular loans, (ii) special loans, (iii) quick cash, and (iv) loans for other businesses.

(b) Implications for Outreach and Impacts

After interviewing the committee and members of the CFI, the following benefits of the CFI are identified:

- Promotes savings of people in the community, including youth who have never saved because of the small amount of money available to them. Now, everyone can have a savings account irrespective of the size of deposits.
- Convenience: Instead of going a long way to the district town, now the CFI is open in close proximity (a few minutes' walk from home). It became very convenient for everyone in the community.
- Lower transportation cost: Villagers don't have to travel a long distance. They save some money and have more time to work.
- Community members benefit from dividend, higher savings interest, and community welfare.
- Value creation of agricultural produce such as rice.
- Informal debt resolution: Most of the villagers are normally exploited by money lenders who usually charge very high interest rates ranging from 5 percent to10 percent per month or 60-120 percent per year. The CFI helps eliminate informal debt substantially.
- Member satisfaction and recommendations: The study revealed that members are satisfied with the CFI and they are very proud to be part of the CFI. Other villages highly admire the CFI of Don Moo and its performance, with many awards being received. They also feel they are not a client of the CFI but they are the owner of the CFI.

(c) Implications for Sustainability

Don Moo CFI covers an entire province that is agriculture based. It supports heterogeneous groups in operational spaces such as the flood-prone and drought-prone areas for farming operations. It seeks to promote agriculture and agribusinesses in the province through sustainable and flexible financial products for the farmers and small agribusiness entrepreneurs. It has developed financial products that will pay off old debts as well as take forward farm processing activities in a better way. Accordingly, it has regular loans, special loans, and quick cash to ensure the liquidity of activity groups across the value chain. The CFI has also created activity groups to take advantage of scale of operations and has established market and trade linkage to gain competitiveness of the businesses. These groups include the rice mills group, beef-cow group, trade group, etc. This promotes small savings among the youth and provides them with equity-based financial service participation. It provides training and exposure to the different activity groups toward enabling their enhanced efficiency along with financial support. Given the high levels of networking of the CFI, it is low-cost financing and a fast opportunity for the users to be benefited.

3.5.3 Sarng Thor Noi Community Financial Institution

Sarng Thor Noi sub district has 13 villages under its administration. It is one of the eight sub districts of Hua Taparn District in Amnart Charoen Province. It covers an area of 57,500 rai[11] of which 25,000 rai in Dong Yai National Reserve Forest and 30,000 rai of the land are under rice farming, with the rest being used as orchards and living quarters. Five rivers flow through the sub district and four reservoirs serve 1,702 households comprising 8,042 persons, with most of them being farmers. The main objectives set for the bank are (i) to be the funding source for the community members, (ii) to be the savings bank, (iii) to help clear its members' debts, and (iv) to provide community welfare. The services follow the same pattern as those of BAAC. The bank's business was later registered as a community enterprise named Sarng Thor Noi Community Bank and Enterprise with the Hua Taparn District Agricultural Extension Office (DAEO).

(a) Innovations in Products and Services

The business pattern of Sarng Thor Noi Community Bank and Enterprise takes the form of a Community Financial Institution running its half bank-half welfare business to help its members. It has three types of service products. Savings to collect capital in the forms of share capital and deposits can be further divided into three different categories:

- Share capital: Shares are sold to raise capital at THB 100 per share. Each member can buy no more than 2,000 shares, and will receive a dividend at year end, which varies according to annual profit.
- Savings deposit: Members or the general public can deposit their money by opening an account with THB 100 as the minimum and will receive an interest rate of 2 percent per year.
- Satja (Oath) Savings Fund for the community bank members' welfare: The bank's members and the general public can deposit their money on a regular basis. The accumulated amount of money will be used to provide welfare for the fund's members in times of child birth, sickness, old age, and death.
- Credit services focus on releasing loans for spending on developing members' as well as the general public's occupation and living. Applications for loans can be made as individuals or groups. Six types of loans are available for customers with the service system: emergency loan, ordinary loan, short-term ordinary loan, special loan, and loans for buying fertilizer and agricultural machinery).

(b) Implications for Outreach and Impacts

At the time of initiating the Sarng Thor Noi CFI, it was estimated that the community as a whole earned a total amount of THB 22.74 million in a year whereas its expenditure was THB 39. 51 million, causing a net debt of THB 16.84 million with an annual interest burden of THB 3.54 million. This study led to organizing the social groups for occupation development, creating the community master plan, and organizing savings group at the sub district level. The CFI's performance has now been successful and well recognized. It has become one of Thailand's model community financial institutions. It now has its own office area consisting of three buildings covering one rai with well-equipped systems and public utilities, all bought with its own funds of THB 1.20 million. The CFI now provides financial and social welfare services with its current capital base of as high as THB 50.00 million and the its business is steadily rising.

[11] 1 ha= 6.25 rai

(c) Implications for Sustainability

CFI's business according the financial statements as on 31 December 2013 such as capital, profits, and reserve reached to THB 49.03 million, THB 2.66 million and THB 1.41 million, respectively. It recorded profit continuously except in 2009, when the reserve amount dropped significantly because its largest part was used in buying land and building the bank's new office. An analysis of the bank's financial liquidity based on its fiscal budget by using the liquidity ratio from 2009 to 2013 revealed that the bank had moderate liquidity with its average five-year current capital ratio being 1.77 and average five-year quick current capital ratio standing at 1.78. Based on the analysis of the bank's fiscal budget by using its profitability ratio from 2009 to 2013, it was found that the bank's average five-year net profit rate was 36.32 percent. This high profit rate led to an average five-year return-on-equity rate of 11.29 percent. In 2012, however, the bank made a lower rate of profit against the higher amount of its capital, which then resulted in a lower rate of return. In 2013, despite its capital increase compared to 2012, the bank was able to make a higher rate of profit, leading to a higher rate of return.

Every household in the operational area of the CFI is a member and hence the inclusion level is complete for the system. The community leaders are elected by the members from each of the villages based on their capacity, volunteer record, social respectability, and track record in public life. The CFI has established a wide network for exchange of information, knowledge, experience, capital, production practices, and market channels. It proposes an innovative social movement to renew the way of life of the community. It promotes alcohol-free funerals, motivates for enhanced community savings, and returns profits to the members. It sells shares to mobilize capital, receives deposits from the public, and it has *satja* savings funds. It provides loans of various sorts to the members to meet their needs such as emergency loans, ordinary loans, short-term loans, special loans, as well as loans for agricultural and agribusiness activities. It aims to improve rural capital formation by providing finance to purchase agricultural implements and machinery, which provides long-term productivity enhancement for the rural production networks. It multiplies the investment of members through a network of community groups, community enterprises, markets, and customers. Table 14 presents the financial status of the Sarng Thor Noi Community Financial Institution.

Table 14. Financial Status of Sarng Thor Noi Community Financial Institution

Year	Current capital (THB)	Income	Expenses	Profits	Reserve (THB)	Members (Nos.)	Shares (Nos.)	Share capital (THB)
2007	6,340,909	895,009	421,787	473,221	47,578	2,014	39,983	3,998,300
2008	19,517,969	4,621,654	3,014,515	1,607,138	559,872	2,147	71,564	7,156,400
2009	25,224,144	4,282,971	2,842,140	1,440,830	2,061	2,197	94,453	9,445,300
2010	37,013,555	5,265,463	3,368,438	1,897,025	766,865	2,246	134,277	13,427,700
2011	42,585,224	5,785,265	3,464,099	2,321,166	956,567	2,302	181,248	18,124,800
2012	52,582,445	6,335,281	4,216,539	2,118,742	1,188,684	2,376	189,802	18,980,200
2013	49,031,353	5,345,995	2,686,270	2,659,724	1,400,558	2,392	187,063	18,706,300

Source: APRACA, 2016.

3.5.4 Na Koh Sak Savings Community Financial Institution

Na Koh Sak Savings Community Enterprise is a farmer organization that was established more than 32 years ago. The outstanding achievement of the CFI is the formation of groups among its members to raise money and set up a fund. This acts as a means of encouraging savings as a reserve for their families and as a funding source for running their livelihood activities. Most farmers in Wawi sub district are poor and lack capital to run their business occupation. They are constrained by lack of accessibility to funding sources, convenient transportation, and public utilities. At first, they formed a *satja* savings service with THB 10 per month and a loan leasing service for investment in occupations and later, by using the loan applicants' and guarantors' amounts of money in their savings passbooks, the loan amount was released. Personal guaranty was also being used for the release of the loans.

(a) Innovations in Products and Services

The formation of a savings group was one more initiative to form a new savings group as the former group was not functioning well. They gathered 45 members and set up the "Na Koh Sak Savings Group for Production" on 1 February 1982 with the objectives to (i) promote savings, (ii) assist one another, (iii) create love and esprit de corps, and (iv) abide by five moral principles: honesty, sacrifice for the whole group, common responsibility, sympathy, and trust. Twenty members were chosen as the executive committee. The group's main activity was *satja* savings service. Each member had to deposit THB 10 per month on the first day of each month at the group's temporary office. The DAEO helps the members of the CFI to develop their skills in agricultural production systems and also encourages the group's registration as a community enterprise under the name Na Koh Sak Savings Community Enterprise.

(b) Implications for Outreach and Impacts

Na Koh Sak Savings Community Enterprise's performance has been widely recognized by society and public organizations as proved by its winning of numerous awards. Its enterprise grew with expanded activities alongside financial service as its main business. Its supplementary activities included a marketing demonstration center, rubber plantation, agricultural cooperative distribution center for BAAC customer marketing, development activities of Muslim housewife groups, etc. In addition, more interested people from other districts (e.g., Muang, Kantang, Palian, and Yaan Ta Khao District of Trang Province) applied for membership. By November 2013, its total membership was 666 persons, consisting of 21 groups of people from outside Wawi sub district, with a total deposit amount of THB 26 million, a total loan amount of THB 10 million, and a total current capital amount of THB 29 million.

(c) Implications for Sustainability

This is essentially a farmer-based community financial institution. The members raise funds through savings and the same are loaned for financing productive enterprises within the community system. It follows the self-sufficiency approach as well as Islamic teachings. The farmers in the local area joined together and formed the CFI with the *satja* approach to savings (THB 10 per month). The same savings have been loaned to the local community enterprise. It promoted agriculture through the creation of demonstration centers, market systems, and an input distribution network. Along with oath deposits, it promoted special deposits that are unlimited and have flexible withdrawal options. At the same time, it provided loan products to individual members with a timeline for repayment. It provides two types of common loans with different sorts of collateral requirements depending on the nature of the operation. Special loans are also provided to members on oath deposits and collateral. The CFI also has emergency lending for short durations. It invests in new businesses for enhancing its cash flows. Table 15 presents the membership and financial status of Na Koh Sak Savings Community Financial Institution.

Table 15. Membership and Financial Status of Na Koh Sak Savings Community Financial Institution

Year	Members	Financial status (expressed in THB)				
		Current capital	Income	Expenses	Profit	Reserve
2009	678	15,432,640	1,232,928	1,069,406	163,522	320,355
2010	710	20,498,109	1,232,928	1,148,476	84,452	404,807
2011	782	25,775,288	1,104,379	1,094,933	9,447	114,254
2012	776	26,479,135	1,275,846	1,159,685	116,161	319,053
2013	724	26,866,824	832,919	687,192	145,727	464,780

Source: APRACA, 2016.

3.5.5 Thaweesook Deposit Product

Thaweesook Deposit was created to enable farmers to be within the bank consortium and have reasonable savings. It began as one of the most important strategies of BAAC, a life protection plan for the farmers to secure their future well-being when they became old. Thaweesook Deposit is an innovative savings product for farmers with special interest rates (higher than the market rate). This also includes other special benefits such as loans, withdrawals, etc., to encourage farmers to save money to spend when they become old.

(a) Innovations in Products and Services

As a welfare enhancer for the people, Thaweesook Deposit follows certain norms and standards in its operations and procedures. The following are the requirements to become a member of the bank:

- Membership qualifications: a BAAC-registered client 20-55 years of age
- Savings plan: holds a Thaweesook Savings Account with three savings options:
  - Option 1: savings of THB 1,200 per year (approximately USD 40)
  - Option 2: savings of THB 6,000 per year (approximately USD 200)
  - Option 3: savings of THB 12,000 per year (approximately USD 400)

(b) Implications for Outreach and Impacts

The scheme was launched in April 2007 and has made steady progress since then. As per the available figures as of 31 March 2014, the number of clients participating in this scheme were 1.28 million and the total deposits surpassed THB 6,270 million. It is also very interesting to observe that, on average, 64 percent of the clients continue to maintain their accounts. As of 31 March 2014, the cumulative members among eligible clients reached 10,250 who received the benefits of compensation, a new child born, funeral aid, and medical expenses from this scheme for an amount of THB 75.62 million.

(c) Implications for Sustainability

This financial system caters to the aging population in the countryside who are mainly farmers and farming communities. Because no strong social security net prevails in the rural areas, this system establishes a savings and future well-being for the senior citizens. It links farmers with the bank consortium through savings. The CFI has a life protection plan to secure the future well-being of the farmers. It provides multiple savings options and plans with respective returns and dividends. As per the plans, the farmers have to continuously save as per the plan chosen by them up to the age of 65 and later they will receive regular returns to safeguard the rest of their life. The CFI supports the welfare funds of the existing communities by setting a special interest rate in accordance with the announced interest rate of Thaweesook Deposit to support the implementation of the Community Welfare Fund for a joint knowledge and development exchange. Table 16 summarizes the performance of Thaweesook Deposit Scheme during 2007 to 2014.

Table 16. Performance of Thaweesook Deposit Scheme during 2007 to 2014 (in million THB)

Parameter	2007	2008	2009	2010	2011	2012	2013	2014
No. of new clients	291,745	218,031	193,680	141,397	116,823	99,894	123,230	104,175
Deposits mobilized	462	618	708	804	826	1,090	920	1,124
Cumulative deposits	462	1,080	1,788	2,592	3,418	4,508	5,428	6,552
Clients continuing with the scheme (%)	NA	64.48	60.43	59.29	61.23	70.21	59.23	59.66

Source: APRACA, 2016.

3.6 Summary

The case studies analyzed and detailed above are indicative of the best elements of financial inclusion from various socioeconomic angles for their replication in wider contexts. The common best practices followed in all the cases have been that each of the financial services is target oriented and specific in focus and service delivery. For instance, the purpose and focus of the financial interventions vary from the enhancement of rural entrepreneurship and agricultural development through the empowerment of women to the provision of a social security net for the elderly population. The modes and the relations of operation across this community-managed financial system make it unique for adoption and replication in specific contexts and situations with suitable modifications and polishing.

One of the main characteristics of these community financial institutions is that they are all community driven and democratically managed. The members thereby play three roles in one – the owner of the institution, a client of the system, and also managing the institution. This makes the institutions effective in three different formats. First, there is an effective and constant interaction between the institutional representatives and the members for the welfare programme as well as the innovations in the delivery of service mechanisms. Because the members and administrative officials belong to the same locality, the interactions and communication channels are effective. Second, the members receive inputs for their livelihood enhancement activities from the community institution, which makes them determine the operational efficiency and the monitoring of the operations. Third, the members elect their representatives to run and manage the activities of the community financial institution.

Another significant feature of the cases analyzed above has been the state patronage and the support from national financial institutions. For instance, the role of BAAC in the cases explained above is quite significant in terms of providing the base capital and establishing systems in place and subsequently handholding the operations of the community financial institutions. This in a sense takes care of the government obligation of providing the needed livelihood support to rural communities. The best learning therefore is that strategic stakeholder partnerships are vital for community financial institutions to grow and sustain themselves. Table 17 summarizes the best practices in Thailand.

Table 17. Summary of Best Practices in Thailand

Best practices	Thematic area	Key features
1. Community Financial Institutions	Savings, lending, and activities for social security	• Government injected initial funds to create community banks • Savings, loans, transfer, insurance • Services to achieve outreach • Other value-added services
2. Thaweesook Deposit	Savings and credit	• Established community fund through pension savings for lending and other services to the members • Provision for a robust system of social safety net • Community welfare funds • Livelihood security during old age

It is important to mention that the demand-driven and market-based financing options proved to be more successful than the supply-side management of financing for development activities. The community financial institutions in this sense are the decentralized financing model whereby local needs and potentials are identified and accordingly demand is being generated for the financial institutions to establish their relevance, increase scope, and thereby have a sustainable demand-driven financing structure. The other qualitative supporting elements of the institutions are evident from the individual case analysis such as the honesty, commitment, and truthfulness of the leaders who take the community institutions forward. However, it can be seen from the case studies that, once the systems are in place, the above elements can find their roots for growth and sustainability of individuals and institutions.

CHAPTER 4
Emerging Trends and Approaches

In much of the developing world, enhancing the livelihoods of rural areas is still a task as it was several decades ago. This is simply because these areas are still home for the majority of their population and one of the country's major economic sectors. Further, agricultural patterns in rural areas are still a major source of employment and income for the majority of the population. Most of them are still under poverty even though development programme have been implemented in this sector for more than five decades – to depict their inefficiency or structural defects. The poverty that rural communities face has been closely linked with their lack of access to appropriate financial services. With the help of international donors and agencies, various financial service schemes have been designed and implemented to assist them in leaving poverty over the period of rural development programme implementation.

In this context, the development of an inclusive financial system has recently attracted much attention, being considered as a paradigm shift in terms of policy (from the earlier focus on microfinance). Financial inclusion has been viewed as a critical condition for the simultaneous achievement of both growth and equity (inclusive growth), which was previously considered impossible. Sarma and Pais (2011) have identified two potential positive effects of financial inclusion for the economy. First, it reduces the cost of using capital through its role in facilitating the allocation of efficient resources so that the economy can grow more rapidly. Second, it suppresses the growth of informal sources of credit such as money lenders who charge a high interest rate on loans whose borrowers are mostly poor households. This suppression would bring down the interest rate charged on informal loans so that poor borrowers could make better use of their informal borrowings to improve their income. In short, the development of financial inclusion will promote both economic growth and equity.

There has also been much emphasis on the importance of financial inclusion for poverty alleviation. Haughton and Khandker (2009) claim that the lack of capital is a key factor in causing poverty. Providing better access to financial markets by implementing inclusive financial policy would presumably allow the poor to escape the poverty that has held up their family's life. Meanwhile, Kelkar (2010) has made an even stronger point on the importance of developing an inclusive financial system to improve the life of poor people. With regard to poor Indian farmers, he points out that financial inclusion can drastically reduce the indebtedness of the farmers and that it could reduce farmers' suicide since indebtedness is one of the main causes of their suicide in this country. Financial inclusion involves not only the demand side of the credit market but also its supply side and hence resulted in numerous innovations in product and service designs being pilot tested in specific contexts, with the successful ones being taken for up-scaling across locations.

4.1 Innovations in Product Design

Innovative financial products create additional value and expand the frontier of finance if they allow groups previously without access to have access to the formal financial system or if they decrease the transaction cost of either the financial service provider or the clients or both (Buchenau, 2003). Innovative financial products are either newly developed products or an offshoot of other products. They cover rural finance, agricultural finance, and microfinance products. Product innovations include the introduction of new credit, deposit, insurance, leasing, hire purchase, and other financial products. Product innovations are introduced to respond better to changes in market demand or to improve the efficiency of the delivery of services.

Mobile banking is a pilot undertaken by CRCB, one of the largest RCBs in China. The mobile phone product developed by CRCB has had a mass outreach to rural people, including migrant workers, and it has had a large impact on bank clients. CRCB itself has also benefited from the development of such a technological and product innovation, and the product is sustainable and replicable. In the mobile technology case, by appropriate pricing and marketing policies, rural low-income people can easily move to mobile phone-based services. This and the enlarged rural clientele serve as an excellent base for expanding the bank's services from money transfers and deposits to more advanced operations, which in China could immediately include IT-solution-supported rural loans and village agent-/shop-based cash services in remote rural areas.

With regard to product innovations in the Indonesian case, all RFSs use bundling between loans and savings. None tries to link remittance to credit. Incentive for motivating customer discipline is provided by the BMT Sidogiri, LKMA Pincuran Bonjo, and Grameen Scheme of KUD Mina Samudera. Technical assistance for clients is provided by some RFSs, except for KUD Mina Samudera and the KUR microcredit programme. In addition, financial management reporting (although in a simple method) and governance are common practices in all the financial institutions.

The Agriculture and Fisheries Modernization Act of the Philippines terminated the subsidized credit programme of the government for agriculture and replaced them with the AMCFP as the umbrella credit programme of the Department of Agriculture. The following features make the AMCFP different from the past credit programme of the government: (i) it is demand-driven and not supply-led, (ii) it is not commodity-specific but finances a whole range of income-generating projects of farm households, (iii) the government is not involved in any credit decision-making as the programme is implemented as a two-step loan programme with government financial institutions as wholesalers and qualified private banks as retailers, and (iv) it adopts market-determined interest rates as opposed to the subsidized rates of the past.

Likewise, the Rural Household Business Financing (RHBF) Programme was one of the earliest attempts to replicate or adapt successful microfinance practices in agriculture. It was developed by the Agricultural Credit Policy Council (ACPC) and piloted by Land Bank of the Philippines in 2004. The RHBF provides short-term loans to finance non-agricultural livelihood projects of agricultural households to diversify income and risk. The loan amount and repayment scheme are based on the cash flow of the entire household and not merely on that of the farmer-borrower. On a similar note, the Agricultural Microfinance Programme (AMP) launched in April 2009 provides short-term loans for income-generating livelihood activities – whether farm, off-farm, or nonfarm – of small farming and fishing households. The AMP is implemented by ACPC in partnership with the PCFC, which was tasked to lend to small farming and fishing households through its network of microfinance institutions (MFIs) composed of cooperatives, cooperative banks, rural banks, NGOs, and people's organizations. Eligible projects for financing include (i) agricultural value chain activities (e.g., production, processing, marketing) and (ii) microfinance income-generating livelihood activities (e.g., farm, off-farm, and non-farm) of agricultural households. Interest rates on loans are market-determined and the repayment schedule is cash flow-based.

The Sikat-Saka Credit Programme for Rice and Food Staples is a joint programme of the DA, ACPC, and Land Bank of the Philippines. Sikat-Saka provides small farmers with direct access to credit for rice (*palay*) production through their respective irrigators' associations. CARD Bank Agri-Microfinance Programme also started to service smallholder agriculture through its Agri-Microfinance Programme, a loan programme designed to finance agriculture and agriculture-related businesses. The Livelihood Credit Assistance Programme of the National Livelihood Development Corporation (NLDC) provides credit support to livelihood and enterprise development projects of small farmers in agrarian reform communities and also of members of marginalized sectors. The Food Supply Chain Programme of Land Bank of the Philippines operates by linking all the economic units in the supply chain. In recent years, Philippine MFIs have become increasingly aware of the importance of micro-insurance as an instrument in reducing the risk of lending to small-scale clients. Through these insurance products, poor households are able to smoothen their consumption in times of crisis or emergency.

4.2 Innovations in Service Delivery

Microfinance downscaling by city and rural commercial banks in China provides a good case for the success factors behind the replication of the IPC micro-lending model in China. The IPC model is centered on evaluating the capacity and willingness of clients to repay loans. The procedure for assessing loan repayment capacity includes field visits by a credit officer to understand the client's production, marketing, and fund flows, and to prepare financial statements for the client to harden soft data. During the field visits, the loan officer collects information on the purposes of the loan and on the client's assets and liabilities, income, profit and loss, cash flows, and sources of funds for loan repayment, according to IPC procedures. As far as willingness to repay loans is concerned, the IPC model uses soft data, such as personal reputation and credit history, to make judgments. For instance, the banks collect non-financial information about the client, pertaining to honesty, family relations, and reputation, and cross-check the information. While the mobile phone product of the CRCB has focused on the innovations in savings and money transfer services for the rural community and households, the study on CFPA MF has focused on its effort to provide micro-loan services.

Most of the reforms in rural finance in India related to innovation in service delivery. The SHG-BLP, introduced in the early nineties, was an innovation in the marriage of flexibility of the informal system with the strength and affordability of the formal system. Currently, it is one of the largest microfinance programme in the world. Although SHGs can be considered as grass-roots institutions themselves, the bank linkage of SHGs has emerged as a product having the largest coverage of poor people in the country. The product has become the base of most of the inclusion models developed by the government of India and different state governments. Moreover, it is highly flexible and adaptable and has an adequate enabling environment. The JLG is another grass-roots institution. The JLG bank linkage product is based on the concept of joint liability and has emerged as an innovative solution for providing social collateral to bankers for their lending to mid-segment clients. The third unique credit product is the Kisan Credit Card, which has already covered half of the farm-holdings and has the potential to cover all farmers in the country through its adaptable and flexible methodology and the support of the enabling environment. The BC/BF has been recognized as a potent instrument for financial inclusion by RBI and RBI has provided detailed guidelines for the appointment and functioning of the BC/BF. Two new innovations aiming to correct the situation have proved that the BC/BF model can be successful and adaptable. Although these models are in the initial stages, their promise for expansion and as a good business model and delivery system has resulted in their selection as best practices. These are (a) an SHG member as a BC, being piloted in two RRBs, and (b) one MFI, SKDRDP, working as a BC with different banks in Karnataka State.

The most recognized best practice worldwide for rural financial services and operated in Indonesia is BRI Village Banking (Unit Desa). The BRI Village Banking approach is the best practice in financial services delivery by a government agricultural development bank (Yedra, 2007). The feature of BRI Village Banking is that the units operate as profit centers with deposit and loan services. It provides retail lending (individual lending), which is innovative with flexible loan terms adapted to local social, economic, and cultural circumstances. The targeted clients of BRI are low-income clients. Outstanding elements of BRI Village Banking are high outreach in savings mobilization and a high deposit-to-loan ratio. The BRI individual lending model is a success in Indonesia and a best practice for retail banking targeting low-income clients but it has not been widely replicated by other countries.

Microfinance Institution for Agribusiness (LKMA) is one of the innovative approaches in rural (micro) finance services. It is a combination between community-based organizations and government initiative. The Ministry of Agriculture promotes the establishment of LKMA through the establishment of farmer group associations. With support from the agricultural regional offices of Province Sumatera Barat, some

LKMAs in this province have innovated in their operations to reach the rural poor and make them sustainable. Another innovate practice in rural finance services is what is called "a mixed model." Most rural finance services use this mixed model as a mixture of features of two or more models under one approach.

Best practice in process innovation is showcased by the use of value financing to bridge financing and marketing gaps (the case of Kalasag cooperative). The pilot collaboration project of the NLDC, CRS, and JFC was successful in linking small farmers to JFC and other markets. This approach has become a local model in supporting farmers through sustainable agro-enterprise development (Box 3). The NLDC programme involves a developmental capacity-building process in which the farmers acquire knowledge in basic marketing, awareness of alternative market chains for their crops, and a grasp of buyers' preferences as to quality, volume, and price. The MFI (ASKI) under the project was able to pilot test and develop a financing product that is suitable to the requirements of onion farmers in the value chain. Each collaborating organization (public and private) used its relative competencies and contributed its own resources (technical, financial, etc.) to support the market linkage between Kalasag and JFC.

BOX 3. Innovations in an Integrated Framework Based on Rural Value Chains

1) Agricultural or Value Chain Finance (VCF):
   - VCF 1: Reducing third-party selling
   - VCF 2: Reducing production, price, and market risks
   - VCF 3: Improving fixed asset finance
   - VCF 4: Increasing returns through bulking and storing
   - VCF 5: Integrating poorer farmers
2) Non-farm Enterprise Finance (NFEF):
   - NFEF 1: More appropriate collateral requirements
   - NFEF 2: Determining capacity to borrow
   - NFEF 3: Improved design of NFE services
3) Household Finance (HF):
   - HF 1: Reducing households' vulnerability
   - HF 2: Expanding FI products to meet regular health, education, pension, and housing needs
   - HF 3: Improving FI marketing and outreach to rural audiences
   - HF 4: Improved financial education
4) Enabling Environment (EE):
   - EE 1: Overcoming infrastructural and cost barriers
   - EE 2: Creating a more enabling environment
   - EE 3: Improving MFI capacity and access to finance

The best practice in institutional innovation is seen in the use of MBOs and OBOs to develop extensive client outreach even in hard-to-reach areas (the case of CARD Bank) in the Philippines. In Thailand, two major types of players operate in the rural financial market and extend financial facilities that include savings, credit, insurance, and fund transfers. However, the specialized financial institutions (SFIs) such as the Bank for Agriculture and Agricultural Cooperatives (BAAC) and Government Savings Bank have been more active in rural finance for almost five decades. BAAC has been considered as a special-purpose vehicle to deliver low-cost credit to farmers and rural communities in the country. It has adopted the diverse demand of a market-driven, growing rural economy through a network of its branches. The most notable features of BAAC's success are its tremendous loan outreach to the rural poor and its impressive savings mobilization. Likewise, the Suk Samran Community Financial Institution, Don Moo CFI, Sarng Thor Noi Community Bank, and Na Koh Sak Savings Community Enterprise offer multiple categories of savings and loans to suit the business requirements of the groups depending on their activities and domain of operation.

4.3 Application of ICT

Rural finance innovations are observed among delivery channels and most tend to use ICT to bring banking services closer to the non-banking at a reasonable cost, especially in remote and rural areas. Many strategic partnerships among financial, ICT, and non-financial service providers are observed to achieve scale and scope economies to provide inclusive services in combination with essential non-financial services using various types of institutional arrangements (Nagarajan and Meyer, 2005). ICT is increasingly being used by AgDBs and other financial institutions in improving their internal business processes (e.g., loan appraisal, loan monitoring) and in reaching out to clients (e.g., use of SMS in payment services). The features of the information system include (Kurihara, 2005): (a) strengthening of business preparation and securing accurate credit evaluation by improving the data bank on client information and (b) automating the credit rating system of loan customers. Specific instances regarding the use of ICT in the present set of countries are summarized in the points below:

- CRCB (China) has actively promoted mobile phone products since 2011 with the bank staff traveling to regions such as Guangdong and Guangxi in southern China and Inner Mongolia Autonomous Region in northern China to promote the new product to the migrant workers from Chongqing.
- The Bank Sakhis (India) have taken ICT-based banking services to the doorstep of more than 18,500 households spread over 286 villages. The ICT-led financial services extended by the bank are basic savings accounts and other banking services. The bank is now offering fund transfer facilities on a real-time basis, real-time updating of transactions, and overdraft facilities. The number of transactions in the accounts was also improving gradually.
- For facilitating the implementation of KCC in India, the banks having a call center/IVR can provide SMS-based mobile banking with a call-back facility from the bank for mobile PIN (MPIN) verification through IVR, thus making a secured SMS-based mobile banking facility available to card holders.

4.4 Risk Mitigation in Rural Finance

Any financial institution can reduce its portfolio risk through geographic diversification, customer diversification, and product diversification. This also applies to institutions operational in the area of providing rural finance. However, the lack of risk markets and instruments to achieve risk reduction is an obstacle to rural financial market deepening. The rural economy is dependent on agriculture, which is a risky business, specifically in the context of Asian countries. The implied higher level of risk has two types of disincentive effects for rural financial institutions: (i) lending decisions and (ii) investing decisions.

The first effect is through the reduced willingness of these institutions to lend in rural areas. Financial markets are expected to play an important role in pooling risks of their borrowers to facilitate the flow of savings into productive investments. They manage these risks in a number of alternative ways such as diversifying their portfolios and issuing insurance. One of the major deterrents to financial intermediaries serving agriculture and rural areas has been the problem of how to effectively manage correlated risks. When underwriting the risks of an individual borrower, the lender is concerned about moral hazard and adverse selection problems (transaction risk). However, when the loans being granted are also correlated across borrowers, the risks tend to compound in the portfolio of the lender (covariant risk). When pooling correlated price and yield risks of borrowers, financial institutions need to develop sufficiently diversified portfolios of loans to adequately manage the risks. This may be particularly difficult to achieve in the case of small, local financial institutions. They also need to allocate sufficient capital to cover the expected level of loan losses given default. Although it remains at an early stage of development, the emphasis in best practice risk management has been on developing new market instruments to manage correlated risks, such as those found in agriculture, through global financial markets, and to share catastrophic risks (Skees, 2003).

The second effect of risk is through the reduced willingness of these institutions to invest in rural financial market infrastructure. Improvements in financial sector productivity and outreach to rural areas can occur through investment in cost-reducing technologies and in training personnel. Yet, investments that bring about greater productivity in rural financial markets are like other investments. High uncertainty tends to drive out productive investment and retard both financial sector development and economic growth. It is important to note here that the risks that deter investments by financial institutions may include not only the risks related to agriculture but also those related to uncertain government policies.

A host of risk reduction measures are being implemented across the five countries covered in this report. Linkages, partnerships, and alliances are being developed in which two or more institutions cooperate to provide financial services. It is expected that their natural complementarities will reduce costs and risks in ways that each would be unable to accomplish by itself. For instance, in Thailand, BAAC has been reducing risks by mobilizing savings and delivering and recovering cost-effective credit. Although BAAC is still receiving financial privileges from the government, its financial sustainability has steadily improved. Likewise, value chain financing has been gaining ground as an effective method for mitigating risks, reducing the costs of lending to agriculture, and eventually getting formal finance to flow to the sector. The value chain is defined as a series of activities that add value to a final product, beginning with production, continuing with processing or elaborating of the final product, and ending with the marketing and sale to the consumer or end-user. When credit or other financial services flow through actors along these chains, it is called value chain finance, and it may or may not include support from formal financial institutions. The value chain reduces commercial risk by providing an assured market for the produce, thus making it easier for chain actors to obtain financing from banks and other formal sources. Efficient value chain financing is critical in agriculture since it can enable small- to medium-scale farmers, traders, and processors along the chain to optimize financial investment, resource allocation, and capacity expansion. The three most common value chain financing products are (a) trader finance, (b) contract farming and out-grower schemes, and (c) warehouse receipts.

Other institutions have also adopted newer approaches and successfully increased outreach such as the case of Land Bank of the Philippines, which brought in a wholesaling approach. Additionally, micro-insurance has proved be a good case for risk reduction and other tools exist that aim to directly reduce the risk of lending to agriculture or the rural poor, thus benefiting both banks and farmers or producers and consequently encouraging investments in the agricultural sector. These are the index-based weather insurance and guarantee systems that are in existence at various levels and scales in different countries of Asia. Loan guarantee schemes, on the other hand, are analogous to insurance instruments that share the risk of lending among the lender, the guarantor, and the borrower. Proponents of loan guarantee programme indicate that the following conditions justify the use of this type of intervention: (i) when lenders place particular emphasis on the role of collateral in making their lending decisions and most small agricultural entrepreneurs do not have the traditional collateral to offer, (ii) when the high fixed cost of due diligence (relative to loan size) makes it uneconomical for lenders to extend small loans, and (iii) it is an excellent opportunity for partnership or collaboration between the public and private sector. Although not entirely new, the loan guarantee system has been reintroduced in some countries by adding new features to make it more attractive to banks and thus encourage these banks to adopt the scheme (APRACA, n.d.).

CHAPTER 5

Recommendation for Policy Measures and Sustainability

5.1 Key Lessons Learned on Sustainable Rural Finance

Financial exclusion has three specific dimensions. The first dimension relates to not having proximate physical access to a banking outlet: the supply side is not able to service the demand for financial service effectively. The second gap is psychological and may occur even if the banking outlet is in proximity. The formal system might look too daunting and uninviting for a poor person to access it. The system might be targeting a certain segment of the population such as higher net worth individuals, and its product ranges and attitude might be inappropriate for the poor. The third gap is of a person who not only has a proximate physical access and also has a relationship with the formal outlet, but that relationship is not deep enough to be meaningful. This is what we can call the exclusion of the included. Best practices related to microfinance attempt to bridge these three types of gaps.

The continuous income growth and urbanization in recent decades have resulted in dramatic changes in the demand for loans and other financial services in rural China. China's formal banking system has coped relatively well with the provision of savings, money transfers, and payment services to agriculture and rural communities and households in China. Marked progress has been achieved by the regulated RFIs in rural lending although more efforts are needed to deliver lending services to small rural households, especially poor households, and to micro-entrepreneurs in urban fringe areas for off-farm activities. Mobile banking is a pilot undertaken by CRCB, one of the largest RCBs in China. The mobile phone product developed by CRCB has had a mass outreach to rural people, including migrant workers, and it has had a large impact on bank clients. CRCB itself has also benefited from the development of such a technological and product innovation, and the product is sustainable and replicable. In the mobile technology case, by appropriate pricing and marketing policies, rural low-income people can easily move to mobile phone-based services. This and the enlarged rural clientele serve as an excellent base for expanding the bank's services from money transfers and deposits to more advanced operations, which in China could immediately include IT-solution-supported rural loans and village agent-/shop-based cash services in remote rural areas.

CFPA MF is a semi-formal RFI unregulated by CBRC. Unlike its peers in China, CFPA MF has enjoyed significant growth in its assets, loans, and geographic coverage driven by the organizational reforms, and improved in its governance structure and promotion of new products and services. A key lesson behind the success of CFPA MF is its commercial operation while sticking to its focus on the rural market. A key conclusion worth emphasizing is that, in China and most other countries of the region, there is room in the rural market for these institutions if they follow the "best practices" of microfinance management. Critically, if this is the case and the MFI's indicators show financial strength, the liquid commercial banks in Asia are happy to advance large wholesale loans to these institutions for on-lending, and in most cases on reasonable terms.

Microfinance downscaling by city and rural commercial banks in China provides a good case for the success factors behind the replication of a lending model in China. In the case of downscaling by the commercial banks to the SME sector, the key conclusions are already clearly stated in the draft report: (i) a key to success is the change in understanding of the overall nature of modern SME lending by the middle-level managers and loan officers, (ii) high-class capacity building is required to make this change happen, and (iii) these two things are much more important than the provision of credit lines by the state or donors, as most city and rural commercial banks have adequate low-cost funds of their own.

The leadership and commitment from the bank management, organizational adjustment, training, and the provision of incentives to loan managers and loan officers are noted to be crucial for the successful replication of best practices in rural finance. The downscaling pilot itself has also had a large impact on the provision of microfinance services to MSEs in China. The innovations in China's rural financial markets and services have been driven by a number of factors since the beginning of this century, chiefly among them a change in the demand for rural financial products and services following income growth and the process of urbanization; increased market competition for the provision of financial services in China's urban and rural areas; relaxation in rural financial regulations, mainly the liberalization of lending rates of interest; and technological progress in Internet and mobile phone uses.

For the Indonesian case, the following conclusions are drawn: (i) The study confirms that the rural poor need both small loans and other types of rural financial products, notably savings. Rural financial institutions have to design their products in line with these poor clients' needs if they want to see their operations grow sustainably. Their products are acceptable for poor clients only if they are made available to them on terms that suit their financial conditions. (ii) Rural financial institutions need to deliver these products in innovative ways. The high cost of transactions and the use of certified assets as collateral are the main stumbling blocks that prevent the rural poor from gaining access to the financial services offered by the commercial banking system. Rural financial institutions have to be innovative in overcoming these stumbling blocks if they want the poor to access their products. (iii) After the conduction of the field work, the Country Working Group (CWG) has agreed that only three out of the five identified best practices have good prospects for replication and up-scaling in other parts of Indonesia and in other countries. These selected schemes are (a) LKMA Pincuran Bonjo, (b) BMT UGT Sidogiri, and (c) Grameen Scheme of KUD Mina Samudera. The first and second financial institutions were all established by local initiative. The third was begun by the government for growing microfinance institutions to provide a group lending scheme but with funding basically from the microfinance institutions. They have been able to tailor their products to meet the needs of rural poor clients and to develop innovative ways to make these products accessible to the local poor. Although both BMT UGT Sidogiri and LKMA Pincuran Bonjo have been tested over time, the Grameen Scheme of KUD Mina Samudera has not yet been fully tested. This scheme has been in operation for only one year.

At the beginning of this study, it was noted that limited availability of credit and the lack of access to a range of financial services have hindered inclusive growth in many countries within the Asia-Pacific region, including the Philippines. This has serious repercussions on the development of national economies and also on efforts to lift the typical rural smallholder out of poverty. Providing smallholders (small-scale clients) with credit and other financial services has always challenged policymakers and financial institutions alike. For reasons already known, the problem of poor accessibility to financial services by smallholders has persisted.

However, it seems that this nagging problem is not insurmountable after all. The brief review of literature discussed the role of financial innovations in providing sustainable rural finance (services) and pointed out several successful and not-so-successful government interventions in the credit markets. The few case studies discussed in this report provide insights into a rich menu of best practices on rural finance in the Philippines and other countries. One important observation is the increasing emphasis on providing various types of financial services and not on credit provision alone. Rural financial institutions are concerned about outreach, an adequate fund base, cost recovery, and responsive financial products and services. The case studies indicate that attaining these objectives is highly feasible with the use of financial innovations, described as product, process, and institutional innovations. Best practice in product innovation is illustrated by the case studies on agricultural loan guarantee (the case of GM Bank) and micro-insurance. Best practice in process innovation is showcased by the use of value financing to bridge financing and marketing gaps (the case of Kalasag cooperative). Finally, best practice in institutional innovation is seen in the use of MBOs and OBOs to develop an extensive client outreach even in hard-to-reach areas (the case of CARD Bank).

The review of literature (from both published and unpublished sources) in Thailand has established the first level of evidence on the scope of financial innovations in providing sustainable rural finance (services). It pointed out several successful and not-so-successful government interventions in the credit markets and community-driven financial systems. A distinct lesson that came out of these experiences is the importance of community-driven systems and providing financial institutions with a greater role in rural financial markets. The government continues to play the role that it alone can effectively play, that of providing a policy and regulatory environment conducive to sector-wise participation in the market. This, however, did not prove to be sufficient to make a difference. Experience shows that financial institutions can lend and provide a variety of other financial services to areas or clients for which risk can be properly assessed and managed. Empowering the community and enabling the community to perform the roles of financiers can reduce risks significantly.

As the case studies indicated, community empowerment in financial management, the provision of credit in a joint liability framework, and credit enhancements through loan guarantee and risk protection schemes (such as micro-insurance) play a critical role in addressing financial access and its perceived risks simultaneously. The best practices in sustainable rural finance that are encapsulated in the case studies are really different types of financial innovations that have been instrumental in providing the excluded segment of the population with access to financial services. This establishes the scope of community financial institutions in catering to the various social segments to meet their financial requirements and creates a viable and responsible usage of such funds for enhancing welfare and improving standards of living. It further conveys the scope of such models in consumption smoothing, investment promotion, risk reduction, and protection of families and individuals from catastrophic losses. The handholding of government agencies improves the credibility of community institutions and leads to their expansion.

5.2 Implications for Policy Development

More efforts should be given to promoting agricultural value chain finance, which involves financing within the chain and from outside the chain but fit to the nature of the value chain and the actors involved. For financing outside the value chain, processing machines, inventory, and receivables, the important assets of agro-processing plants, should be accepted as collateral for loans, and purchase orders provided by the agro-processors or farmers could also be accepted as collateral for loans under certain conditions. For financing inside a value chain, first, RFIs can use value chains to reduce credit diversion by farmers so as to improve loan repayment rates. For example, a farmers' cooperative might purchase bulk farm inputs for its members with bank loans so the loans will not be diverted for other uses. Second, RFIs could accept the guarantee and collateral pledged by inter-linked enterprises for loans provided to individual farm households.

There has been an increasing policy thrust on financial inclusion by both the government of India and the RBI. The banking system has penetrated deeper with more branches being opened in rural and semi-urban areas. Further, the RBI has liberalized the business correspondent framework and involved mobile phone companies in certain types of transactions, particularly remittance, in order to encourage the banks to look at excluded customers and services. The recent impetus in financial inclusion has focused on strategies targeting the individual. Government policies that have pushed disbursal of benefits through bank accounts have further shifted the focus to the bank account of the individual. The outreach programme of the banks under a board-approved financial inclusion plan as well as the recent announcement of the Pradhan Mantri Jan Dhan Yojana (PMJDY) reinforce this trend. These efforts at financial inclusion are addressing first and second dimensions of financial exclusion by opening branches in the vicinity and opening accounts and providing access in a mission mode. However, the third dimension of exclusion needs much greater support and the use of different financial products.

For the case of Indonesia, the discussion on the observed best practices described in Chapter 3 indicates that they have no weaknesses. However, it is also not yet clear to what extent these institutions can be adapted to different socioeconomic environments. All these issues can be learned through a pilot project, which can be used as a means for learning about the measures required to (i) improve efficiency and outreach of the operational schemes, (ii) expand the functions of rural financial services, (iii) diversify in financial services, and (iv) increase the availability of supporting facilities for the effective working of rural financial institutions.

A distinct lesson coming from the Philippine experience is the importance of giving private financial institutions (private sector) a greater role in rural financial markets, and of the retreat of government into a role that it alone can effectively play, namely, that of providing a policy and regulatory environment conducive to private-sector participation in the markets. Philippine experience also shows that private financial institutions can lend and provide a variety of other financial services to areas or clients for which risks (e.g., loan default risk) can be properly assessed and managed. As the case studies indicated, credit enhancements such as loan guarantee and risk protection schemes such as micro-insurance play a critical role in addressing the perceived risks in smallholder lending. The best practices in sustainable rural finance that are encapsulated in the four case studies are really different types of financial innovations that have been instrumental in providing the excluded segment of the population with access to financial services. Consumption smoothing, investments and risk-taking, and protection of families and individuals from catastrophic losses were made possible by the accessibility to those financial services that have been designed by government or co-designed by government and the private sector.

The specific instances of the case studies discussed in this report provide insights into a rich menu of best practices in rural finance in Thailand, which are worthwhile and suitable for other countries to follow. One important observation in this regard has been the increasing emphasis on providing various types of financial services to the members and community by the system and not on credit provision alone. This makes the success pattern possible in an innovative framework of rural financing. Rural financial institutions are concerned about outreach, an adequate fund base, cost recovery, and responsive financial products and services. The case studies indicate that attaining these objectives is highly feasible with the use of financial innovations, described as product, process, and institutional innovations.

5.3 Implications for Capacity Building

Many success factors and key lessons from CFPA MF could be replicated by other NGOs and semi-formal rural and microfinance institutions, including the rural community funds sponsored by PADO and MoF in China. A formalized structure (or platform) could be created at the national level to monitor and supervise the operation of about 20,000 village community funds across China's poor areas, with a sound MIS. The platform could also provide technical support and wholesale finance to the village funds based on their performance. The downscaling of microfinance by city and rural commercial banks in China has provided us with valuable lessons for the replication of a best practice or a lending technique in a different environment. Such lessons are useful for the replication of the best practices under this project. The key lessons include the commitment from management, the necessary institutional arrangements for the pilot, and the incentives provided to the branches and loan officers for the pilot programme.

The other pilots that could be undertaken in China include a pilot on cash services for RFIs in remote villages, cash depositing and withdrawing, and a pilot on the development of cooperative finance at the grass-roots level (based on the village community, not beyond a township), with the priority given by the Chinese government to a comprehensive outreach of financial services to all rural areas in China, including the remote villages.

The next big change is in the technology platform. All commercial banks, including RRBs and even cooperative banks, are on a CBS (Core Banking Solution) Platform, providing seamless connectivity. The evolution of telecom infrastructure is playing a significant role in making the accounts of individuals "branchless" and "inter-operable through multiple channels," and the pressure on banking at the "counter" has declined significantly. Most of the technological interventions (except CBS) are not being developed exclusively for banking. Therefore, the banking channel need not bear the full cost of the evolving technology.

There is a need for innovation, adoption, and expansion of existing best practices to ensure meaningful and complete financial inclusion. Although access to a bank account for transaction banking is extremely important for all households, including poor households, on the lending side, the Indian experience shows that providing collateral-free loans works better through using social capital and group guarantees. In fact, such a model supported by non-financial services, for linkages to livelihoods and markets from NGOs/government departments, can have a meaningful impact on poverty. The growth of microfinance institutions in the past 15 years also shows the scope available to fill the unmet credit needs of the poor, not only in areas that do not have deep banking infrastructure and are backward but also in well-banked regions, including urban areas. Regarding MFIs, Bandhan FSPL shows how following the best practices can ensure that an MFI has wide outreach and can grow profitably without depending on any subsidy or external support. SKDRDP, working as a BC, is an innovative way for a not-for-profit NGO MFI to achieve its primary goal of reaching the poor and serving its clients without worrying about funding arrangements for its capital adequacy or on-lending to SHG members. NABFINS is adopting another innovative model of working through B&DCs and SHGs, which reduces its transaction cost sharply compared with other MFIs. However, the MFI cannot provide any support for savings accounts.

Experiences from Indonesia indicate that, to replicate or scale up rural finance best practices, they need some adjustment and adaptation to the local political/economic/social and environmental circumstances of the areas where they are introduced/replicated. Geographic and regional diversity with its unique cultural, social, and economic values should be considered in implementing the replicated schemes. This would provide key inputs with regard to (i) improved access of the rural community to financial services/increased outreach, (ii) enlarged functions of rural financial services, (iii) financial services diversification, and (iv) availability of supporting facilities for the effective working of rural financial institutions.

The case studies discussed in the context of the Philippines provide insights into a rich menu of best practices on rural finance in the country. One important observation is the increasing emphasis on providing various types of financial services and not on credit provision alone. Rural financial institutions are concerned about outreach, an adequate fund base, cost recovery, and responsive financial products and services. The case studies indicate that attaining these objectives is highly feasible with the use of financial innovations, described as product, process, and institutional innovations.

5.4 Recommendations and Way Forward

Developing countries strongly emphasize empowering their people, particularly the rural poor. Many efforts have been made in terms of financial and technical services to enhance their income and quality of life. However, the lack of access to formal financial services makes exploitation persist. The CFI is therefore considered as an alternative in empowering rural people by providing them with the opportunity to manage their own resources, using local wisdom supported by modern knowledge and technologies. It is therefore highly recommended that this be applied and replicated across countries in the region for improved and sustainable growth in human development. Moreover, these models have become the channel for members/clients and their dependents to avail of the benefits of micro-insurance. This strategy therefore calls for collaboration between regulators and the MFI. There is a view in this context that the regulators need to be open and encouraging to innovative measures in the rural sectors.

Further, it is established that great potential remains for the financing models explained in the case of specific countries to be expanded because agricultural value chain financing can be viable if the market for agricultural produce is assured. This involves linking small producers to lead actors in the value chain to enable them to secure technical, financial, and marketing assistance. More importantly, it highlights the crucial role of coordination and adherence to quality standards to sustain market access. Piloting experiences have shown that farmers can be linked to big urban/corporate markets for as long as farmers remain competitive in terms of cost of production and ensure a competitive price with consistent volumes and quality of produce. Linking the farmers to the supply chain of food corporations and local markets provides vast opportunities for sustaining farm income. The identified success factors as well as lessons learned show the way to replicate this highly successful scheme.

It is also established that the development of micro-insurance has been supported by the following pillars: (i) establishment of an appropriate policy and regulatory environment; (ii) strong coordination and collaboration by key government agencies to adopt reform measures in the insurance industry; (iii) active public-private sector participation in developing appropriate and affordable micro-insurance products; (iv) emphasis on education, awareness campaigns, and advocacy; and (v) efficient use of scarce donor resources (and technical assistance) in improving the regulatory framework for micro-insurance. These pillars are not silos but are integrated activities spearheaded and coordinated by national agencies with support from key government agencies. All the cases included in this document are piloted in different locations of the country and they have varying levels of outcome efficiency depending on the levels of relations and interaction efficiency of the qualitative and quantitative variables identified for the success of such modes. It is perhaps true that community financial institutions are comparatively more complex and require multi-tasking to establish and sustain their activities. The community enterprising experience showed that there is a simultaneous mobilization of savings on the one hand and productive investment promotion on the other hand. This creates a rural economic equilibrium for the long-run viability and sustainability thereof.

Microfinance systems are relatively less complicated and demand fewer innovations. This is because they are mainly deposit/savings mobilizers and they do not really engage in the enterprising mode. This, however, offers less return than an enterprising structure that is market linked and value adding in nature for higher returns to the members and the community. Establishing financial structures for the elderly is highly innovative. This is visionary in nature and provides for future planning. In countries that do not have a proper social security and safety net, this community institution model provides the much-needed social and economic support for the elderly population. This model is innovative in the sense that it does not incur any charity aspects but enables citizens to plan for their future and accordingly provides them with financial services and a sense of protection. It is observed that these products have not only provided for the security of the elderly but have also added much value to the next generation of the population in terms of wealth and lessons.

In essence, the piloting of the community financial services and products detailed in this report revealed the imperative of financial inclusion in social development. The empowerment of the people and the community has multiple advantages in ensuring desired outcomes. On the one hand, it enables the mobilization of resources and leadership for socially inclusive development programme. On the other hand, it enables the platform for growth-oriented investments for employment and income generation. This automatically leads to an improved standard of living of the people and the community to create socioeconomic mobility in a cohesive and sustainable manner. This will create a concrete relationship and brand (institution) loyalty among our customers. Overall, the following points highlight the thrust area as a part of policy initiatives:

- Focus on improving access of the rural community to financial services/increased outreach by enlarging the functions of rural financial services, diversifying financial services, and providing tailor-made savings products with added features.

- Promote agricultural chain credit as agricultural value chain finance involves financing inside and outside the value chain.
- For financing outside the value chain, processing machines, inventory, and receivables, the important assets of agro-processing plants, should be accepted as collateral for loans, and purchase orders provided by agro-processors or farmers could also be accepted as collateral for loans under certain conditions.
- For financing inside the value chain, value chain transactions can be used to reduce credit diversion by farmers so as to improve loan repayment rates.
- Establishing CFIs/MFIs in rural areas helps to reduce the burdens on the banking system to open brick-and-mortar branches.
- Intensify efforts to persuade commercial banks to participate in the agricultural lending programme by partnering with these institutions.
- The mature CFIs now need to develop more professionalism by using information technology and simplifying the loan processing system.
- As CFIs/MFIs have proven to be a very successful tool for streamlining rural finance, revival packages are necessary for the not-so-well-functioning ones and providing professional support.
- Again linking these with the mainstream banking system will help them to support the rural entrepreneurs who need larger loans to upgrade activities and implement innovations.
- Develop and implement a more strategic information/communication plan for financial institutions at the national level to maintain common standards for them.
- Capacity building of these institutions on various aspects of financial management, information technology, monitoring and evaluation, and other related aspects will build a strong system and reduce the probability of their failure to serve the rural population.

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Annexure 1. Summary sheet for good practices

Country	Inclusion criteria	Model	Strengths	Weaknesses
China	• Mass outreach • Operational sustainability • Innovations in financial products and services	CRCB	• Mass outreach • Low transaction cost • Financial inclusion • Sustainable and replicable	• Requires e-literacy • Appropriate pricing • Proper marketing policies
		CFPA	• Financial inclusion • Coverage for micro-borrowers • Risk reduction	• Requires organizational and governance reforms • Agency support • Requirement of low-cost funds
		Microfinance downscaling	• Potential outreach very high • Covers multiple credit requirements • Diversified loan portfolio	• Depends on capacity and willingness to repay • Marginally costlier to implement • High capacity-building requirement
India	• Accessible and favorable to the poor • Products and services should be cost-effective, profitable, and sustainable • Suitability of delivery system, business model, outreach, flexibility, replicability, adaptability, and enabling environments	SHG-BLP	• Coverage for informal groups • Financial exclusion for poor • Cost effective due to low transaction cost • Potential for social capital formation and livelihood diversification	• Variation in coverage role of IT not exploited to full extent • Financial intermediation and due diligence often neglected • Low literacy a problem
		SHG-BC	• Integration with community • Attain financial literacy and inclusion • Platform to mobilize other forms of savings • Convergence with govt. schemes (DBT for instance)	• Threshold of financial viability • Low remuneration • Delay in payments • Coverage of ICT in rural areas • Skill development of Bank Sakhis
		NBFC-MFI	• Strong grass-roots connection • Homogeneous and local staff • Strong monitoring structure • Decentralized audit and linked insurance	• Lack of market linkage and skill training • Costlier delivery model • Generating funds through equity still not achieved

Country	Inclusion criteria	Model	Strengths	Weaknesses
		SKDRDP	• Strong grass-roots linkage • Beneficial to all actors in the value chain • Potential for financial inclusion	• Physical reporting requirements • Time consuming • Delays in remuneration • Diversity of products • Familiarity of bank employees with local conditions and requirements
		JLG	• Social and financial inclusion • Low interest rates • Potential for the promotion of JLGs through matured SHGs • Creation of producer organizations through clustered approach	• Lack of financial literacy a problem • Huge capacity building required • Keeping an eye on NPAs • Lack of targets for JLGs • Guidelines for inclusion of riskier projects
		NABFINS	• No additional cost for establishment • Lower transaction cost • Transparency and timely delivery • Bringing in product diversity and linkage with different service providers	• Weak MIS and high attrition rate of staff • Inadequate risk and fund management system • No access to credit bureau data
		KCC	• Assurance, flexibility, and diversity in meeting requirements • Reduction in transaction cost • Simplification of procedure • Convergence with govt. schemes (DBT for instance)	• Operational arrangements • Demand and supply mismatch • No coverage of long-term loans • Coverage apart from agriculture not included
		PO	• Efficient delivery and supply of inputs • Sustainable market linkage and value addition	• Lack of diversity in products • Low capital base • Lack of awareness
		Kudumbashree	• Embedded in local self-governance • Wider definition of poverty • Highly participatory • Goes beyond economic empowerment	• No systemic change for poor • Micro-enterprises based on traditional occupation • Identification criteria need refinement

Country	Inclusion criteria	Model	Strengths	Weaknesses
		SERP	• Community based • Self-funded and flexible • Feasibility for usage with other microfinance products • Integration with other pension schemes	• Coverage and receipt amounts not adequate • Dependence on govt. budget • Requirement of corpus and budget support • Inflation
		SAMRUDDHI	• Options for exclusive banking • Commercial viability • Potential to be integrated with other schemes for entitlements	• Require adjustment in the MIS/ICT tool • Require overhaul of facilities at USB • Lack of connectivity and other ICT tools
Indonesia	• Savings/credit products and performance • Legal, managerial, and administrative structure • New innovation • Financial management and reporting • Islamic banking • Governance	LKMA	• Loan bundled with savings • Inculcates financial discipline • Integrated system of rural financial framework • Financial and non-financial services • No collateral requirement • Loan insurance, marketing services offered	• Limited capacity for outreach • More time consuming • Marginally costlier to implement • No group lending • Absence of long-term credit • No consumer protection
		BMT UGT	• Potential for financial inclusion • Agreement based on profit sharing • Repayment flexibility • Inculcates financial discipline • No collateral requirement • Loan insurance, marketing services offered	• Compulsory savings as a part of the loan • Focus only on small business units • Higher transaction cost • No group lending • Absence of long-term credit • No consumer protection
		USP Grameen Pesisir	• Group lending directed to serve financial need of small unit businesses operated by women • No collateral requirement in Grameen	• Limited outreach • Absence of long-term credit • Collateral required in USP • No consumer protection

Country	Inclusion criteria	Model	Strengths	Weaknesses
Philippines	• Accessible and favorable to the poor • Products and services should be cost-effective, profitable • Sustainable without support and subsidies	CARD	• Financial inclusion • Range of products and services • Mass outreach potential	• Extensive service delivery structure required • Coordination between regulators and service providers required constantly • No innovative products • Insurance literacy required
		GM	• Agricultural loan guarantee and micro-insurance • No collateral requirement • Low interest rates, easy access through account officers • Timely release of loans	• Requires more piloting for scaling up and replicability • Requires establishment of a formal institution to implement the loan guarantee scheme • All banks don't participate • More streamlining of the process required
		Kalasag	• Bridges financing and marketing gaps • Collateral-free loans • Futuristic design and has mass outreach potential • Risk reduction in agriculture and impetus on diversification	• Limited accessibility for small farmers • Requires in-depth knowledge of value chain • Identification of lead partner
Thailand	• Accessible and favorable to the poor • Products and services should be cost-effective, profitable • Sustainable without support over long term	CFI	• Wide range of financial products • Other value-added services • Activity groups to take advantage of scale operations • Market and trade linkage • Promotion of small savings • Improves rural capital formation	• More refinement in products required • Limited introduction of ICT • No linkage with mainstream banking • Still a need for capacity building in M&E • Structure slightly complex and hence requires handholding for success • Coordination required at national level
		Thaweesook	• Provision for a robust system of social safety net • Establishment of community welfare funds • Livelihood security during old age • Mass outreach and high potential for bringing in financial inclusion	• Requires strong commitment of the management and staff of BAAC • Limited introduction of ICT • Lack of entrepreneurship mode

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