APRACA FinPower Program

COMPLETION REPORT:

FinPower National Forum

Creating a Conducive Microfinance Policy Environment and Regulatory Framework

Facilitator: Benedicto S. Bayaua
Documentor: Sudhir Kumar Roy

An APRACA FinPower Publication with the Special Sponsorship of the International Fund for Agricultural Development (IFAD)

APRACA FinPower Publication: 2009/6

COMPLETION REPORT:

FinPower National Forum

Creating a Conducive Microfinance Policy Environment and Regulatory Framework

Facilitator: Benedicto S. Bayaua
Documentor: Sudhir Kumar Roy

An APRACA FinPower Publication with the Special Sponsorship of the International Fund for Agricultural Development (IFAD)

Published by:	Asia-Pacific Rural and Agricultural Credit Association (APRACA)
Printing by:	Erawan Printing Press
Distribution:	For copies write to: The Secretary General Asia-Pacific Rural and Agricultural Credit Association (APRACA) 39 Maliwan Mansion, Phra Atit Road Bangkok 10200, Thailand Tel: (66-2) 280-0195 Fax: (66-2) 280-1524 E-mail: apraca@apraca.org Website: www.apraca.org
Editing:	Benedicto S. Bayaua
Layout credit:	Sofia Champanand
E-copies:	E-copies in PDF file can also be downloaded from APRACA's website.

This book is published by APRACA under the auspices of the IFAD-supported APRACA FinPower Program.

The data gathered were based on primary and secondary data, interviews and information with key informants in selected APRACA represented countries. Opinions expressed by the author do not necessarily represent the official views of APRACA nor of IFAD.

This book is published during the incumbency of Mr. Pham Thanh Tan (APRACA Chairman), Mr. Abdurakhmat Boymuratov (APRACA Vice-Chairman) and Mr. Benedicto S. Bayaua (Secretary General).

Message

Greetings! APRACA has successfully established among its members machinery for systematic interchange of information on sustainable rural and agricultural financial services, encouraged inter-country studies and provided training, consultancy, research and publication services on matters of common interest in the field of rural finance and microfinance.

The national forum in Uzbekistan, together with the provision of technical support to key Uzbekistan rural and microfinance stakeholders, is a testimony of APRACA's strong commitment to pursue the promotion of efficient and effective rural financial systems and broadened access to rural financial services in order to help reduce rural poverty among countries in Asia and the Pacific.

The International Fund for Agricultural Development or IFAD has played the role of APRACA's strategic partner under the FinPower Program. APRACA and IFAD share that mutual desire to pursue and create conducive rural finance policy environment and regulatory framework. I wish therefore to acknowledge the IFAD support to APRACA.

May we therefore thank Dr. Thomas Elhaut, IFAD Asia Division Director, and Dr. Ganesh B. Thapa, IFAD Regional Economist, for the trust and confidence they have continuously bestowed on APRACA and for their commitment to help alleviate poverty and accelerate rural growth and development among countries in Asia and the Pacific.

We wish to thank Mr. Abdurakhmat Boymuratov, APRACA Vice-Chairman, for hosting the week-long program.

We sincerely wish that this report will continuously inspire policymakers, practitioners and other stakeholders in the Asia-Pacific region.

Pham Thanh Tan
APRACA Chairman

Acknowledgment

The IFAD-supported APRACA FinPower Program extends its gratitude to Mr. Abdurakhmat Boymuratov, AgroBank Chairman and concurrent APRACA Vice-Chairman, Mr. Djiyanov N.B., First Deputy Chairman, Mr. Rahim Mamadjonov, Head of International Department and Mr. Bakhodir Gafurov, Deputy Head, for hosting the national forum and technical support events, sharing invaluable information and providing critical field-level assistance.

FinPower also conveys its sincere thanks to Mr. Botir Komilovich Zaripov, Deputy Chairman, and Mr. O'tbosarov Kamron, Head of Department on Credit Institutions, Central Bank of Uzbekistan, for their sharing on the Uzbekistan rural financial landscape.

FinPower acknowledges the support of the National Bank for Agriculture and Rural Development (NABARD) in the conduct of the FinPower National Forum on Creating Conducive Rural Finance Policy Environment and Regulatory Framework in Uzbekistan.

FinPower thanks the NABARD-deputed expert Sudhir Kumar Roy, Assistant General Manager, who presented a paper based on the experiences of India and who provided technical support to the Central Bank of Uzbekistan, the Open Joint Stock Commercial Bank "AgroBank" (AgroBank) of Uzbekistan and other financial institutions.

FinPower likewise extends its appreciation to Mr. Atthasit Surakul, Vice-President, Customer and Rural Development Department of the Bank for Agriculture and Agricultural Cooperatives (BAAC), for sharing his bank's rural financial innovations and marketing linkages.

Finally, FinPower acknowledges the significant support received from Mr. Mukim, a progressive Chinoz District farmer, who provided important inputs and insights on the rural scenario of Uzbekistan and to Mr. Akhror Askarov, who made an easier understanding of the proceedings by reducing the language constraint through excellent and crisp Uzbek-English translations.

Benedicto S. Bayaua
Secretary General

Table of Contents

Page

Message iii

Acknowledgment iv

Acronyms vii

1. Introduction 1

1.1 Background 1

1.2 Objectives 1

1.3 Methodology 2

1.4 Forum Opening Ceremony 2

2. Sharing of Experience and Expertise 3

2.1 Uzbekistan 3

2.2 India 7

2.3 Thailand 13

3. Conclusions and Recommendations 16

Acronyms

ADB	Asian Development Bank
AgroBank	Open Joint Stock Commercial Bank “AgroBank”
AMC	Agricultural Marketing Cooperative
APRACA	Asia-Pacific Rural and Agricultural Credit Association
BAAC	Bank for Agriculture and Agricultural Cooperatives
GTZ	German Agency for Technical Cooperation
HDI	Human Development Index
IFAD	International Fund for Agricultural Development
JLG	Joint Liability Group
MFI	Microfinance Institution
MFO	Microfinance Organization
NABARD	National Bank for Agriculture and Rural Development
NGO	Non-Governmental Organization
PACS	Primary Agricultural Credit Societies
RBI	Reserve Bank of India
SHG	Self-Help Groups
SME	Small and Medium Enterprise
TABCO	Thai Agri-Business Company, Limited

1. INTRODUCTION

1.1 Background

The rural financial markets of developing countries in Asia and the Pacific are in various stages of development and experience. While some countries already have a policy regime that is fully liberalized and deregulated, there are still a number of countries with a policy environment characterized by credit subsidies, credit allocations and loan targeting and some countries that are partially liberalized and deregulated because interest rate subsidies and loan targeting continue to be imposed for the benefit of certain sectors particularly the poor or the marginalized.

As pointed out in many policy studies, a country should have a conducive rural finance policy environment that would allow financial institutions to operate in areas where there is demand for their services and, in effect, enable them allocate their funds from surplus units (savers) to deficit units (borrowers) at a price that would make them recover their cost and generate sufficient yield to capital. An enabling policy environment, thus, implies deregulated interest rates, compliance to reasonable performance standards and regulations especially with respect to capital requirement, branching policy and risk management, among others. Within such a policy environment, therefore, banks and other financial institutions will be able to operate prudently while providing adequate, sustainable and timely credit and other financial services to the rural sector especially the small farmers and fishermen. Simply put, a conducive policy environment and regulatory framework could mean increased and sustained credit access for the rural households including the poor. Weak rural financial markets discourage rural growth.

However, despite policy reforms instituted, most countries continue to experience inaccessible credit for the rural poor. In fact, microfinance institutions (MFIs) still hesitate to lend to agriculture and fishery projects. Innovative approaches and practices have to be developed so that MFIs can be encouraged to lend to the rural poor in general and to the small farmers and fishermen, in particular. For most microfinance institutions, lending to the agriculture and fishery sector is deemed a risky and therefore, costly lending activity. Making microfinance work in agriculture is the biggest challenge that needs to be addressed.

The Asia-Pacific Rural and Agricultural Credit Association (APRACA), in partnership with the International Fund for Agricultural Development (IFAD), is currently implementing the IFAD-supported APRACA Regional Program of Accelerating the Financial Empowerment of Poor Rural Communities in Asia and the Pacific through Rural Finance Innovations or dubbed as the **FinPower** Program. The FinPower Program has three central components: a) participatory dialogue, policy forums and technical support, b) pilot programs, exposure visits and documentation and c) training and sharing of innovative practices.

1.2 Objectives

In consonance with the main goal of the FinPower Program, which is *to promote the financial empowerment of the rural poor in Asia-Pacific Countries through policy dialogue, innovative pilot programs and knowledge-sharing among actors in the rural finance sector,* FinPower provided technical support to key rural finance stakeholders in Uzbekistan on November 12-15, 2009. The event culminated in a national policy forum on rural finance and microfinance policy environment and regulatory framework held at the Bankers' Association of Uzbekistan Headquarters in Tashkent on November 16, 2009.

The technical support and national policy forum had the following specific objectives:

- To assess the current status of rural and microfinance policy environment and regulatory framework in Uzbekistan;
- To identify the issues, constraints or obstacles to the efficient and effective provision of rural financial services in Uzbekistan;
- To share the experiences of the National Bank for Agriculture and Rural Development (NABARD) in the creation of conducive rural and microfinance policy environment and regulatory framework and the Bank for Agriculture and Agricultural Cooperatives (BAAC) on credit-production-marketing linkages; and
- To formulate a number of recommendations on sound policies and regulatory framework towards further strengthening the rural financial markets in Uzbekistan.

1.3 Methodology

Two experts were commissioned by FinPower to provide technical support to key rural finance stakeholders: a) Mr. Sudhir Kumar Roy, NABARD Assistant General Manager, who focused on conducive rural finance and microfinance policy environment and regulatory framework and b) Mr. Atthasit Surakul, BAAC Vice President, who focused on credit-production-marketing linkages.

Mr. Roy provided technical support to the Central Bank of Uzbekistan, the Open Joint Stock Commercial Bank "AgroBank" of Uzbekistan and other selected institutions. At the Central Bank of Uzbekistan, Mr. Roy conducted dialogue with Central Bank of Uzbekistan officials headed by Deputy Chairman Zaripov, SME and Microfinance Department Head Sayfullaev Aktam and Department on Credit Institutions Head O'tbosarov Kamron. He likewise provided technical support to officials of AgroBank Uzbekistan, led by First Deputy Chairman Mr. Djiyanov, AgroBank International Cooperation Head Rahim Mamadjonov and Deputy Head, Mr. Bakhodir Gafurov.

Mr. Roy and Mr. Atthasit also shared their respective countries' experiences during the national forum. Mr. O'tbosarov Kamron likewise presented the Uzbekistan economic and financial landscape.

A total of 140 participants from the Central Bank, national policymakers, private and government banks, NGOs, cooperatives, and other representatives from government agencies and other relevant institutions participated in the national policy forum.

An open forum immediately followed each presentation. The results of the discussions of the technical support and the national forum discussion were synthesized and presented toward the end of the forum. Recommendations were formulated in order to outline the activities towards strengthening the rural financial policies and regulatory framework of the country venue as well as improving the delivery of microfinance services to the poor especially those in the rural areas.

In order to have a first-hand insight of the agriculture sector of Uzbekistan, AgroBank arranged a field visit to Chinoz Province. Interactions were held with Mr. Mukim, a dynamic farmer and a Presidential Medal awardee, who farms about 300 hectares of cotton, grains and some vegetables. He employs about 90 agricultural laborers. Visits were also arranged with small farmer-producers.

1.4 Forum Opening Ceremony

The main speakers at the forum opening ceremony were Honorable Shukhrat Khaydarov, Central Bank of Uzbekistan Deputy Chairman, Mr. Abdurakhmat Boymuratov, AgroBank Chairman and concurrent APRACA Vice-Chairman, Mr. Abdullaev, Uzbekistan Banking Association General Director and Mr. Benedicto S. Bayaua, APRACA Secretary General.

Mr. Khaydarov welcomed the participants and the APRACA FinPower experts. He thanked IFAD and APRACA for promoting microfinance innovations and initiatives and hoped that participants will have a lot to learn from the presentation made by the consultants. He stressed that financial institutions in Uzbekistan must take a clue from the presentations to likewise promote microfinance in the country.

Mr. Boymuratov highlighted the proactive role played by the Uzbekistan banking sector as a major contributor in the development of the country, especially towards the agricultural and small industries sector.

Mr. Abdullaev shared the experiences of the banking sector in providing financial services to the rural areas, particularly agricultural and SME clients.

Mr. Bayaua provided a background of the topic and an introduction to the forum. He thanked the Central Bank of Uzbekistan and AgroBank for hosting the twin events as well as the Uzbekistan Banking Association for its contribution to the dialogue.

2. SHARING OF EXPERIENCE AND EXPERTISE

2.1 Uzbekistan

Geographic landscape

Uzbekistan is a landlocked country stretching about 1,500 km west-to-east and about 1,000 km north-to-south, sharing borders with Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Afghanistan. The climate is continental and relatively dry, with low rainfall, long hot summers and mild winters. The country has significant reserves of natural resources including large deposits of gold, copper, lead, zinc, uranium, natural gas and oil. It has the largest population of the five Central Asian Republics, recorded at 25.5 million in 2003, of which 77.2 percent are Uzbek, with the remainder being Russians, Tajiks, Kazakhs, Karakalpaks and Tatars. Of the total population, more than 15 million live in the rural areas and more than 9 million in the urban areas.

Economic Landscape

The economy of Uzbekistan is influenced by its geography. The country is situated in the basin of two main rivers: the Amudarya, which runs from Tajikistan and provides the Uzbek borders with Afghanistan and Turkmenistan, and the Syrdarya, which flows through Kazakhstan. The agricultural sector is extremely important to the Uzbek economy. The country is one of the world's largest cotton producers, with cotton being one of its primary export earners. Other significant agricultural products include raw silk, fruits, vegetables, grapes, melons, of which significant quantities are exported to neighboring countries.

The east of the country contains the fertile region of the Ferghana Valley, which is densely populated. The Ferghana Valley region contains much of the country's industrial base, both developed during the central planning era and during the period of independence. The valley, having a long history of irrigated agriculture, produces a significant proportion of agricultural output. To the south, Surkhandarya and Kashkadarya are significant agricultural regions, though the latter is getting known for its gas production. The regions in the west are mainly industrial (mining, chemicals and oil refinery) with tourist centers of world-wide importance such as Bukhara and Samarkand. Large but sparsely populated Karakalpakstan to the northwest of the country is arid with little industrial activity. Both industry and agriculture in Karakalpakstan are negatively affected by the Aral Sea disaster.

Uzbekistan possesses a significant potential for development as it has political stability and is a dynamically developing economy. The country is rich in mineral resources, developed infrastructure, convenient transport corridors and a population with 100 percent literacy.

The country offers tremendous potential of growth in the agriculture sector especially in cotton and of processing of agricultural products being one of the largest producers of raisin and dried fruits in the world, one of the top-five producers of tomato paste in the world and is capable of producing more than 10 million tons of fruit-and-vegetable products per annum.

Since independence, the Uzbek Government's economic policies were largely protectionist, including non-convertibility of the Uzbek Soum (though this has changed to some extent in October 2003 after the introduction of convertibility) and the reliance on cotton as a major foreign exchange earner.

Economic reforms in Uzbekistan were gradual. This step-by-step approach was intended to achieve economic independence by way of:

- curtailing imports through their replacement and self-sufficiency with energy resources and food products;
- re-orienting the economy from raw materials production towards creating a competitive industrial structure;
- expanding export potential and increasing its gold and hard currency reserves to ensure stability of the national currency; and
- creating new opportunities and improving living standards.

To this day, the role of the State in the economy is sizable although it continues to decline. The share of the non-State sector in the nation's GDP in 2001 was 74.1 percent; however this figure varies from sector to sector. The State still exercises a fair degree of control on the non-State sector. For example, the major part of agricultural production still depends directly on Government targets for cotton and grain.

With all the achievements in maintaining political and economic stability, a number of problems emerged during the transition period, including the decline of living standards, growing unemployment and an increasing gap between the poor and the rich.

With a human development index (HDI) of 0.694 in 2003, Uzbekistan ranks 111 out of 177 countries, according to the Human Development Report 2005. The country's HDI scores and overall rating have remained stable over the years since independence. Disparities between regions and rural-urban areas have become more apparent, with the strongest indicator of vulnerability to poverty being the region of residence. About 63 percent of the population live in rural areas, where approximately 35 percent are likely to be poor.

Job creation has been slow (2.1 percent over 2000-2004), compared with the average annual growth in working-age population of 3.2 percent, with the public sector, especially education and health services, accounting for the largest share of new jobs. Employment in agriculture contracted by 0.2 percent per annum; in industry, it grew by 1.4 percent, and in services, by 2.5 percent. As in other developing countries, the service sector is highly diverse. The significant informal sector is engaged in less productive activities, suggesting that there are bottlenecks in labor absorption.

There are three major categories of farms in Uzbekistan:

- Big – agricultural cooperatives
- Medium – farm enterprises
- Small – peasant enterprises

Land is owned by the State and is leased out to farmers for cultivation. There is good Government support for buying back crops. Irrigation is mostly done through canals and water charges are to be paid. A large number of the rural population work as agriculture laborers.

Farmers are treated with respect and agriculture as a profession is traditionally followed in the family. At least one of the children of Mr. Mukim, the farmer visited, will eventually join him in farming.

Financial Landscape

Uzbekistan has a two-tier banking system consisting of the Central Bank and the commercial banks and other financial institutions such as credit unions and microfinance institutions.

The Central Bank implements monetary policy, manages the financial system and monitors the commercial banks' activities. The distinguishing feature of the Uzbek banking system is the relatively small number of banks in comparison with other Central Asian states. One of the main reasons for this is the tough position of the Central Bank regarding the issue of licensing. Effective and moderately rigid monetary and fiscal policies in the last 4 yrs had allowed to support inflation rate at a rather low level.

Uzbek legislation divides banks into the following categories:

- State-owned bank: the state directly owns more than 50 percent of equity (generally held or managed by the State Property Committee or the Ministry of Finance)
- private bank: individuals own at least 50 percent of equity; no State ownership
- bank with participation of foreign capital: foreign shareholders own at least 30 percent of equity
- joint-stock commercial bank: banks in which the State's share is less than 50 percent, the private sector share is less than 50 percent and the foreign-owned share is less than 30 percent.

The minimum charter capital for banks was increased at 5 million Euro for commercial banks and 2.5 million Euro for private banks starting from 1 January 2008.

A sufficient number of laws and regulatory acts have been adopted in Uzbekistan relating to banking liberalization, development of and financial support to small and medium enterprises (SME) and focusing on guarantees for liberty of entrepreneurial activity, farmer enterprises, microcredit organizations, microcredit and investment activities. Likewise, there were the State President's decrees and resolutions on arrangements for further liberalization and reformation of the banking system, arrangements for further improvement of legal protection system of entrepreneurship and additional measures for stimulating of development of micro-firms and small enterprises, and on peasant households.

The currently main priority-driven issue in Uzbekistan is a deepening of market reforms and further liberalization of the economy. Stable economic growth is ensured by structural changes of economy, modernization of its most important branches, further technological renewal, development of production and social infrastructure, especially in rural areas, and, particularly, with the support of producers, small business and private entrepreneurs.

Banks hold special position on financial support of business subjects, especially of small business in market economy.

In a short period, the national banking system was established in Uzbekistan. Today it includes the Central Bank of Uzbekistan, 30 commercial banks with more than 800 branches, and a network of mini-banks in each district of the country. The system creates a base for real competitive environment in banking.

AgroBank is one of biggest banks in Uzbekistan. Its network includes 13 Regional branches in each administrative centers of Republic, 185 district branches, 730 mini-banks, and 184 special cash outlets. AgroBank provides complex banking services to more than 219,000 legal entities and to more than 260,000 individuals.

AgroBank undertakes great actions to fulfill the decrees of the President and directives of the Government for reforming agriculture, improving rural population welfare, supplying population with cheap food products and creating new jobs in rural areas.

Microfinancing in Uzbekistan

The focus of the government has been towards the promotion of entrepreneurial endeavors especially in the rural context. This thrust therefore calls for suitable investments being mobilized in rural areas that support creation of enterprises and concurrent market development processes. Thus microfinance holds a strong portfolio in the overall development scenario of the country. The purpose is to explore suitable model that aligns with the existing systemic mechanisms of governance and financing.

The country's microcredit program was initiated in 1998 with two UNDP pilot projects in Kashkadarya and Karakalpakstan. The projects have supported the establishment of three NGO-MFOs and their implementation laid the foundation for national legislation adopted in August 2002 (Resolution No. 309 of the Cabinet of Ministers). Principal outcomes of the pilot projects included a tangible increase in low-income people's access to financial resources which enabled them to participate in trade and small scale production and manage household assets based upon microbusinesses and livestock tending.

Microfinance funding in Uzbekistan is currently sourced from commercial banks, credit unions, non-government non-profit organizations as well as off-budget funds (e.g., Funds for Farmer Support, State Employment Fund) and credit lines of the international financial institutions. Banks have a leading role in microfinance; they account for more than 80 percent of the total amount of microcredit.

Credit unions and especially microfinance NGOs have greater outreach but have smaller asset sizes than commercial banks, indicating stratification by size in the microfinance market of Uzbekistan.

Beginning in 1998, substantial technical assistance from the Asian Development Bank (ADB) and the World Council of Credit Unions, financed by the United States Agency for International Development, supported the development of a sound legal and regulatory framework and capacity building for individual credit unions. A credit union law was enacted in mid-2002. The first credit unions were licensed in September 2002. From the outset, the focus on development support for credit unions was on training of credit union staff and members, the establishment of systems, and some limited grant support for equipment rather then providing liquidity support in the form of credit lines. By end-2005, 20 credit unions had been established and had performed well. Since then, the number of credit unions increased to 32 at end-2006 and 49 at end-2007. The number of members increased from 48,000 at end-2006 to 64,000 at end-2007. In parallel, the outstanding credit portfolio of credit unions has risen sharply. It exceeded the equivalent of US$10 million in late 2006 and has more then doubled since then. The average loan size of credit unions was US$1,400 at end-2006. Credit unions had about 9,000 loans outstanding at that juncture. Credit union activities are concentrated in urban centers, although about 10 percent of loans are extended for agricultural purposes.

These credit unions can act as special vehicles for the proliferation of microfinancing in Uzbekistan. Overall, microfinance in Uzbekistan consists mainly of microcredit. Microfinance institutions across the country cover only 9 percent of the demand. Therefore, a huge market exists for new microfinance institutions in Uzbekistan.

Although NGO-microfinance institutions demonstrated robust growth trends, these entities face big obstacles and have not been able to fulfill their full potential for the following reasons:

- First, lack of legislative and regulatory frameworks has caused problems. Donors will refrain from investing into the microfinance sector of Uzbekistan even if the funds were available until laws clarify the legal status and mandates of NGO-microfinance institutions.
- Second, taxation also plays a role. NGO-microfinance institutions were granted tax benefits until 2006, which facilitated their growth, particularly in rural areas, where they covered the most remote areas of Uzbekistan inaccessible to other financial institutions. The majority of NGO-microfinance institutions are operationally sustainable. However, if tax liabilities are introduced, they will not be able to accumulate essential funds needed for keeping the focus on socially-oriented targets.

2.2 India

The presentation and sharing by the FinPower-commissioned expert from NABARD delved on microfinancing in India, reflecting on the various aspects, challenges and future prospects of the Bank-Self-Help Groups (SHG) linkage program, a joint program designed in the mid-80s by the German Agency for Technical Cooperation (GTZ) and APRACA and subsequently launched by selected APRACA member institutions. NABARD launched its linkage banking program in 1992. The idea of SHGs as a viable credit delivery model for the poor is one of the path-breaking concepts which emerged in the last two decades as a workable instrument for *financial inclusion*, long before the term was coined by the financial experts.

The Bank-SHG Linkage Program is the flagship microfinance intervention of NABARD and can be considered as a landmark development among banking-with-the-poor schemes. The informal thrift and credit groups of the rural poor came to be eventually recognized. Following the program pilot phase, the Reserve Bank of India (RBI) set up in 1994 a Working Group on Non-Governmental Organizations (NGOs) and SHGs, under the Chairmanship of the then NABARD Managing Director. The working group came out with wide ranging recommendations to internalize the SHG concept as a potential intervention tool in the area of banking with the poor. The RBI accepted most of the major recommendations and extended the Bank-SHG Linkage Program beyond the pilot stage as part of the normal business activities of the banking sector. Banks could now show lending to SHGs as part of advances to the weaker sections.

The NABARD linkage banking program is acknowledged as the most cost-effective microfinance movement in the world based on its sheer outreach. One SHG savings or loan account services 14 persons on an average. As SHG members, the rural poor were able to access financial services, which were not possible in their individual capacity.

By March 2009, more than 4.2 million self-help groups had loan outstanding with the banking system. The banking system has mopped up low-cost deposits through 6.1 million SHG saving bank accounts. The linkage banking program has amply proven that banking with the poor is no longer an impractical and far-fetched idea. Banking with the poor is here to stay. So far, it has impacted the lives of nearly 80 million poor.

The NABARD microfinance program has made tremendous socio-economic impact on the empowerment of rural women as well as on the transformation of policies and practices of all key microfinance stakeholders in their approach to banking with poor. In the future, microinsurance, micropensions and microremittances are likely to be the areas for greater focus. The program has rightly set the stage for other microfinance initiatives to take root. The creation of self-help groups has enabled the banking system to expand their outreach and to build a quality credit portfolio with those segments of the rural population who were either non-bankable or have remained in the fringes of society.

The Government of India is now considering further suitable enhancing regulations of the sector to enable all round and orderly growth. Hopefully, a new environment ensuring responsible and responsive microfinancial services will prevail for the people at the bottom of the pyramid. Access to financial services forms a fundamental basis on which many of the other essential interventions depend. Moreover, improvements in health care, nutrition and education can only be sustained when household have increased earnings and command greater control over their own financial resources. Access to financial services therefore is one of the significant avenues to reducing poverty.

The social structure of India offers several options for forming and nurturing diverse kinds of community and grass roots initiatives to absorb financial services and ensure high-end repayments through their involvement in sustainable and viable economic activity. Some of these initiatives are:

- **Self-help groups**

Self-help groups are primarily community-owned institutions which evolve through a process of social mobilization wherein the poor are organized and their capacities built to tackle various issues that are critical for mitigating and ultimately overcoming poverty. SHGs provide an enabling platform for unleashing the innate abilities of the poor to overcome poverty by organizing themselves. Through collective strength, the poor gain knowledge, accumulate capital through their own savings, build their own social capital to improve their livelihoods and actively participate in all human development interventions.

In the long run, the SHGs are expected to evolve into self-reliant and self-sustainable community-owned institutions to effectively bring about perceptible change in the living conditions of their conditions on a larger and visible scale.

Self-help groups are small voluntary group structures for mutual aid and the accomplishment of a special purpose. They are usually formed by peers who have come together for mutual assistance in satisfying a common need, overcoming a common handicap or life-disrupting problem and bringing about desired social and/or personal change. The initiators of such groups emphasize face-to-face social interactions and the assumption of personal responsibility by members. They often provide material assistance and emotional support. They are frequently "cause"-oriented, and promulgate an ideology or values through which members may attain an enhanced sense of personal identity. Such groups are socio-economically homogenous and are bound together by the affinity of self-help and socio-economic progression. These groups could be especially helpful for rural poor women to access credit.

This model proposes formation of a three-tier structure of self-help groups for promoting sustainable livelihoods. At the base are a large number of SHGs, which are federated at a cluster-level and upward into a larger representative body of SHGs as a block-level association. The following Table 1 shows data aggregates of the bank-self-help group linkage program, with State-wise position as on October 7, 2009.

Table 1. Management Information (Segment-wise Data Aggregates)

SHG Bank Linkage
State-wise position as on 7 October 2009

Name of State	During the Year				Cumulative since launching			
	No. of SHGs provided with Bank Loan	Of which Refinanced	Loan Disbursed (Rs. Lakh)	Refinance Disbursed (Rs. Lakh)	No. of SHGs provided with Bank Loan	Of which Refinanced	Loan Disbursed (Rs. Lakh)	Refinance Disbursed (Rs. Lakh)
Himachal Pradesh	0	0	0	0	31,899	0	13,893	3,583
Rajasthan	2,395	0	1,159	426	190,701	3,106	58,228	12,598
Haryana	26	0	13	0	12,860	719	11,042	1,946
Punjab	0	0	0	0	9,096	331	6,271	719
Jammu & Kashmir	0	0	5	0	3,529	0	2,037	0
New Delhi	277	0	196	0	820	0	796	0
Northern Region	**2,698**	**0**	**1,372**	**426**	**248,905**	**4,156**	**92,266**	**18,846**
Assarn	1,515	0	430	0	132,892	7,650	33,598	3,422
Meghalaya	0	0	0	0	1,211	0	336	33
Tripura	193	0	39	0	6,125	264	1,066	91
Sikkim	0	0	0	0	337	0	216	4
Manipur	0	0	0	0	2,683	0	1,127	249
Nagaland	0	0	0	0	517	0	221	8
Arunachal Pradesh	0	0	0	0	1,200	0	679	7
Mizoram	0	0	0	0	2,463	0	1,675	467
North-East	**1,708**	**0**	**468**	**0**	**147,428**	**7,914**	**38,919**	**4,282**
Orissa	0	0	0	0	307,591	22,884	119,483	24,962
Bihar	0	0	0	0	93,410	0	30,513	2,623
Jharkhand	0	0	0	0	42,605	0	19,307	2,143
West Bengal	0	0	0	0	228,395	5,614	67,514	11,202
A & B Islands	85	0	60	0	665	0	373	36
Eastern Region	**85**	**0**	**60**	**0**	**672,666**	**28,498**	**237,190**	**40,966**
Madhya Pradesh	0	0	0	0	83,570	482	30,503	3,960
Chhatisgarh	283	0	113	0	64,154	0	15,239	2,102
Uttar Pradesh	0	0	0	0	279,576	8,773	122,857	14,306
Uttarakhand	0	0	0	0	24,679	0	16,416	613
Central Region	**283**	**0**	**113**	**0**	**451,979**	**9,255**	**185,014**	**20,980**
Gujarat	0	0	0	0	46,526	0	22,965	4,007
Mahareashtra	2,944	0	3,588	0	353,994	38,711	126,470	17,257
Goa	0	0	0	0	1,645	3	1,816	155
Western Region	**2,944**	**0**	**3,588**	**0**	**402,165**	**38,714**	**151,250**	**21,418**
Andhra Pradesh	6,443	7,713	85,518	7,680	805,318	201,423	1,362,611	359,808
Karnataka	3,154	3,154	3,501	3,501	378,351	49,483	274,235	180,016
Kerala	0	0	0	0	146,984	0	100,274	15,444

- **Joint liability group**

A joint liability group (JLG) is an informal group composed of four to ten individuals coming together for the purpose of availing bank loans either singly or through the group mechanism against mutual guarantee. The JLG members would offer a joint undertaking to the bank that enables them to avail of loans. The JLG members are expected to engage in similar types of economic activities like crop production. The management of the JLG is to be kept simple with little or no financial administration within the group. JLGs can be formed primarily consisting of tenant farmers and small farmers cultivating land without possessing proper title of their land.

Other JLG features include the following:

- The group members reside in the same locality, with the same socio-economic status and conditions.
- The group members carry out similar farming activities
- The group members agree to function as a joint liability group.
- The groups are organized by like-minded farmers and on a voluntary basis, not imposed by the bank or other institutions.
- The members should know and trust each other well enough to take up joint liability for group individual loans.
- The group is formed for availing credit but with peer pioneering pressure responsibility.
- Each member accepts to take responsibility for repayment of every loan provided to remaining members.
- All members sign mutual agreement where the responsibility is assumed jointly.
- No two members of the group can be from the same family.
- Intangible social and human assets carry huge value for JLGs more than physical assets.
- The members are financed and not the project.
- Social capital is at the center of the group.

- **Farmers' club**

Farmers' clubs are grass roots-level informal forums. In India, such clubs are organized by rural branches of banks, NGOs and extension agencies with the support and financial assistance of NABARD for the benefit of the banks concerned and rural people.

Farmers' clubs coordinate with banks to ensure sustainable credit flow to its members and forge better bank-borrower relationship. They organize a minimum of one meeting per month and depending upon their needs, to increase this to two or three meetings per month. Non-members may also be invited to attend the meetings.

These clubs interface with subject matter specialists in the various fields of agriculture and allied activities, extension personnel of universities, concerned Government ministries and other related agencies for technical know-how updates. For guest lectures, experienced farmers who are non-members from the village or neighboring villages may be invited. They can also organize and facilitate joint activities like value addition, processing and collect farm products for the benefit of members. The clubs can liaise with input suppliers to purchase in bulk and market rural products on behalf of members. They can also sponsor and organize SHGs, undertake socio-economic developmental activities like community work, education, health, environment and natural resource management.

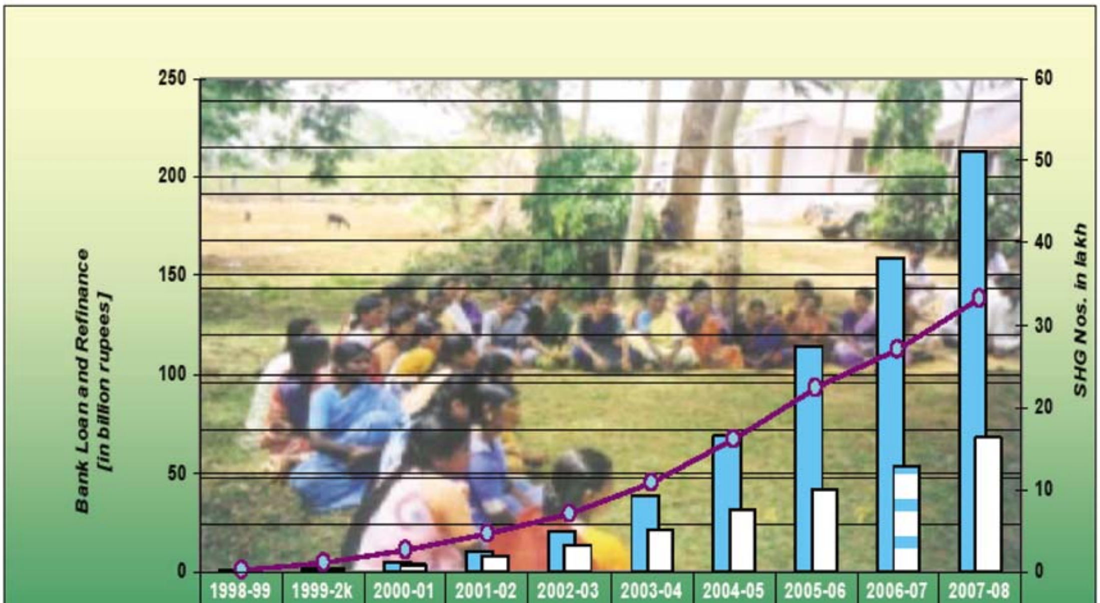
- **Common-interest groups**

A common-interest group consists of a minimum of five rural-based numbers, registered under the Partnership Act, with a common interest, e.g. dairy farming and banana cultivation. Initial amount is raised through equal participation among the members that build up the group capital. This could also be something like an artisan's guild, a producers' group or service providers' group. The prime motto is to bring together people with some skills so that thy can scale up their enterprises by coming together for providing services to larger audiences.

These groups need a lot on training, capacity building and institution building of various stakeholders to make any of the above models successful.

Concerns for sustainability in India

A furious pace of growth does bring in its wake a few concerns and also generates some misgivings in the minds of those who look at the large SHG numbers with considerable alarm. The question asked with increasing frequency is whether this mode of providing financial services to people of small means is sustainable. The question is whether microfinance in its present form is getting fatigued? Whether the program has been loaded with extraordinary expectations? Is it likely to suffer from a failure of the tall order expectations when the program shifts from access to small finance and onto enterprise finance? Figure 1 shows the progress under the bank-self-help group linkage program.



	1998-99	1999-2k	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Bank Loan	0.56	1.93	4.81	10.27	20.49	39.04	68.98	113.97	158.43	213.24
Refinance	0.52	1.50	4.01	7.96	14.19	21.24	30.92	41.60	53.61	68.03
SHGs	0.33	1.15	2.64	4.61	7.17	10.79	16.18	22.39	27.11	33.29

Figure 1. Progress under the SHG Bank-Linkage Program

Concerns have now shifted to growth management issues such as skilled human resources, flexible product design, reducing transaction costs, ensuring adequate management information systems, standard credit information, better use of advances in technology, accessing alternative financing, expanding into under-served areas and dealing with additional regulatory hurdles and political risks. There is an urgent need for structured long-term financing to the sector to fully address these important issues and smoothly transition into a well functioning mature industry.

The program faces several challenges. Most critical is the issue of sustainability of the SHGs; many are dependent on the promoter organizations for even routine tasks such as maintenance of account books and conducting of meetings where transactions take place. Others operate at a low equilibrium of low savings and low credit that is unlikely to contribute significantly to improving the lives of SHG members. Most importantly, there has been a decline in numbers of SHG's availing repeat loans. Repeat loans are critical because it indicates that loans to SHGs are not one-time loans as in the case of traditional subsidized loans, but that the banks could be a dependable source of loans for the SHGs. It is only when the number of repeat loans become significant that SHG-based microfinance could be said to be on par with financial services provided by other well-performing microfinance organizations (MFOs). The program also continues to concentrate predominantly in South India. As of 2008, 65 percent of the total SHGs and 81 percent of the total amount lent were in the four states in South India and 53 percent of total SHGs and 51 percent of the amount lent in the State of Andhra Pradesh alone.

Policy environment and regulation in India

India seems to be a very peculiar case when it comes to microfinance regulation and supervision. It is not only its sheer size that makes it very different from all other countries. The involvement of formal public sector banks is also much stronger than anywhere else. This means that a relatively (and increasingly) large share of the microfinance sector is under the purview of the Reserve Bank of India.

India today has an extensive banking infrastructure composed of over 30,000 rural and semi-urban branches of commercial banks, over 14,000 branches of regional rural banks, around 12,000 branches of district cooperative credit banks and 112,000 primary agricultural credit societies (PACS) at the village level (around 66,000 PACS are stated to be functional; the remaining are dormant).

The Microfinance Sector Development and Regulation Bill of 2007 sought to promote the sector and regulate MFOs. The bill has two broad objectives: (a) to promote and regulate the microfinance sector; and (b) to permit MFOs to collect deposits from eligible clients. NABARD regulates the microfinance sector. Every MFO that accepts deposits needs to be registered with NABARD. Conditions for registration include (a) net owned funds of at least Rs 500,000; and (b) at least three years in existence as an MFO. All MFOs, whether registered or not, shall submit annual financial statements to NABARD. Every MFO that accepts deposits has to create a reserve fund by transferring a minimum of 15 percent of its net profit realized out of its thrift and microfinance services every year.

The major issues in the process of regulation are: (i) whether MFOs are the appropriate vehicles to address the credit needs of the poor (ii) or whether there are adequate safeguards to protect depositors' funds.

Efficiency of MFOs

Commercial banks in India have fixed costs per transaction. Therefore, the transaction cost as a percentage of a loan amount rises as the loan size decreases. This deters banks from lending small amounts. Typically, lending to small borrowers follows an indirect route. Banks lend to MFOs who then lend to various SHGs and JLGs. Individual borrowers get funds through SHGs and JLGs.

Proponents of this model claim that (a) it is characterized by low transaction costs and high repayment rates; (b) it provides access to credit to the under-served; and (c) it builds livelihood capacity and social capital among the poor. However, there is an opposing view which suggests that MFOs do not incur lower transaction costs but transfer the cost to donors through subsidized borrowings or to borrowers through higher interest rates.

Formation of reserve fund

MFOs are required to transfer 15 percent of the net profit to a reserve fund as a protection to depositors. However, if an MFO offering thrift services does not make any profit and thereby does not form the reserve fund, there is no safety net for the depositors.

In short, rural financing is going to see significant upsurge in near future as this also combines the national priority of financial inclusion. With the nearly urban centers getting saturated and urban audience operating in an array of options, the attention is going to move towards rural hubs. Growing urbanization is also going to influence this move towards rural centers. In such situations, more and more financing institutions are expected to evolve. Evolutionary systems also call for decentralization and openness along with systems established for ensuring accountability and transparency. Thus, this calls for a nationalized regulatory framework and management mechanisms for ensuring smooth operations of the financing institutions apart from also ensuring hassle-free delivery of financial services to the disadvantaged communities. There are national evidences in insurance and telecom sector that have already set precedence for the microfinance sector to travel and grow on similar tracks.

2.3 Thailand

The Bank for Agriculture and Agricultural Cooperatives, like other specialized financial institutions, was established by an Act of Parliament and is owned by the Royal Thai Government. It was originally established to achieve certain government policy objectives such as providing loans to farmers. However, the bank's activities have been expanded to cover commercial banking services, including taking deposits from the general public which make up the biggest source of BAAC operating funds. According to the enabling Act, BAAC's mission is to provide financial assistance to farmers, farmer associations and agricultural cooperatives. Under a new law amendment, BAAC can expand its services to individuals, group, entrepreneurs, village funds and community organizations, which are established to support farmers, communities and cooperatives for the following purposes:

- to undertake farm, farm related and non-farm activities;
- to undertake other activities to increase income;
- to develop agricultural knowledge to increase income or to improve quality of living of farmers or their families; and
- to invest in ventures intended to promote or support agricultural activities to increase income or improve quality of living.

From years of farm lending, BAAC learned that credit alone could not fulfill the need of farmer clients. BAAC found that the client farmers need to procure good quality farm supplies at reasonable prices. And above of all, farmers, who normally depend on the private local merchants, want to sell their farm products to different buyers to avoid situation where the rate of exploitation is high. For example, these merchants offer low prices, cheat in weighing the products and insist on unfair payment or delivery condition. In response to this, BAAC established agricultural marketing cooperatives (AMCs) to collectively buy farm supplies and sell farm products on behalf of their members. AMCs can work on behalf of its members in negotiating with buyers on prices, delivery and payment procedures.

The above mentioned establishment of AMCs follows this majesty the King's philosophy on Sufficiency Economy which consists of three development steps: 1) rural communities must be able to depend on themselves, which would result in self-protection at individual and family level, 2) rural communities must collaborate and participate in all kinds of economic activities that benefit all on the basis of non-exploitation and sharing, and 3) rural communities and other social networks must collaborate with other domestic organizations in transferring and exchanging wisdom, knowledge, technology, and experience in order to establish sufficiency-based social networks on the basis of non-exploitation and sharing. Figure 2 below shows the business volume of AMC movement from 1991-2008.

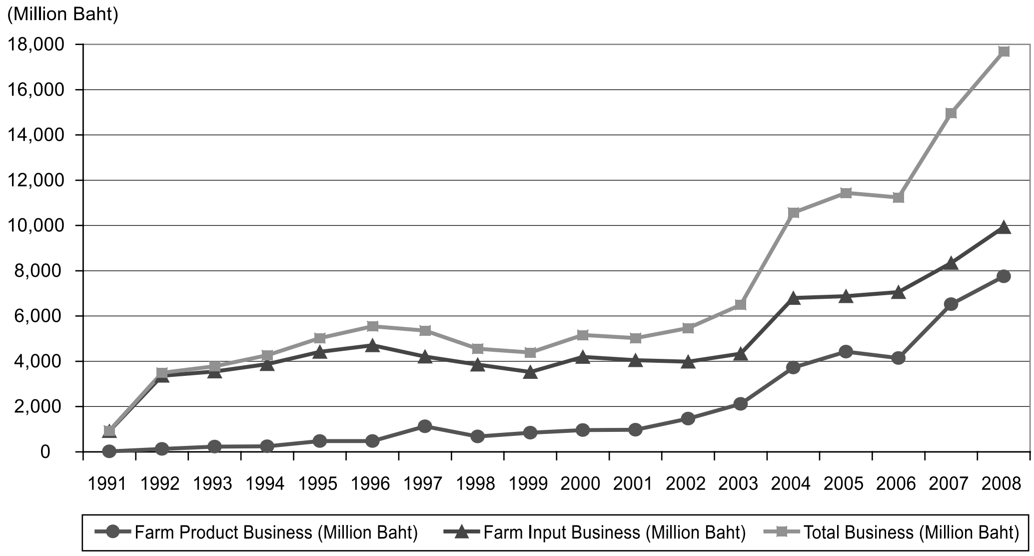


Figure 2. Business Volume of AMC Movement 1991-2008

The AMCs are BAAC's vehicle for poverty alleviation. They can act as intermediary to enhance individual farmer competitiveness and improvement as well as enhance collaboration among AMC members in their own communities. The strengthening of farmers' organizations will lead to the creation of market opportunities for both collective buying and selling of farm inputs and products. These activities could increase farm income and decrease production costs as well as household expenditures. Eventually, the income gap between rural and urban could be lessened. BAAC have been trying to support AMC movement by playing the role of a linking pin between finance, production and marketing.

One of the major objectives of AMC is to build the bargaining power of farmers in their buying and selling activities. In order to gain more power for the movement, there is a need for an organization at the national level to conduct business on behalf of AMCs over the country. Figure 3 shows the AMC business model.

The Thai Agri-Business Company Limited (TABCO) was established in 1992 as a joint venture company, wherein the AMCs hold 90 percent of the shares while BAAC holds 10 percent. TABCO plays an important role on behalf of AMC in two main businesses: bargaining with inputs manufacturer or importers to reduce the production cost of farmers and distribution of inputs to AMC over the country. For farm products marketing, TABCO sells AMC products to domestic market (manufacturers, supermarkets) and also to the international market.

BAAC expanded its role from providing savings and loan services to its clients to becoming a rural development bank, with more activities involved in the daily lives of farmers. As a rural development bank, it aims at building a strong financial base and using modern management tools to uplift the quality of life of small holders. To uplift the standards of living of farmers, BAAC must reduce production cost, increase farm and non-farm income and create opportunities for farmer. Hence, TABCO and AMCs have become important rural players, together with BAAC.

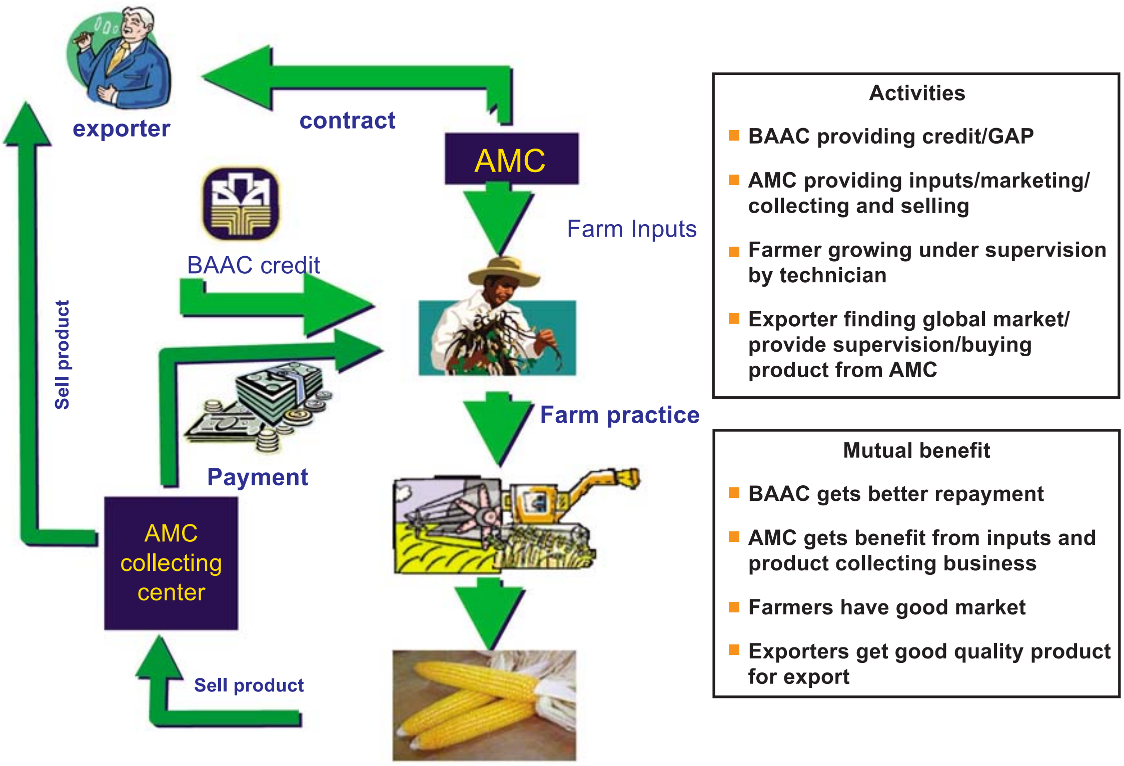


Figure 3. AMC Business Model

Value-added activities are being done with AMCs and TABCO, in tandem with government agencies and exporters so that additional income would redound to AMC members based on the cooperative principles. Figure 4 below shows the BAAC agricultural value chain.

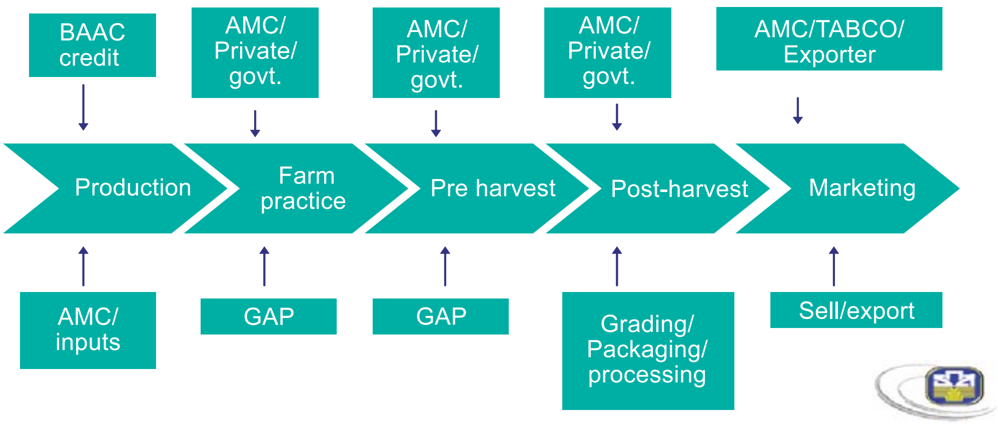


Figure 4. BAAC Agricultural Value chain

3. CONCLUSIONS AND RECOMMENDATIONS

The inclusion of the poorest in microfinance is often discussed in terms of trade-offs in social and financial performance. Of course, reaching the poorest with microfinance is more costly due to their lower borrowing ratio, greater risk factors, smaller loan size, and lower increments that they can usefully absorb. However, this is too narrow a perspective, which is unlikely to generate the kind of innovations we need to get the extreme poor out of chronic poverty. *Microfinance can be an important link in the mix of interventions that is needed to achieve this, but Governments need to be more imaginative with microfinance as well as to go beyond it. Effective packaging and sequencing of interventions that are likely to make microfinance work for the poorest will possibly have to address both demand- and supply-side constraints, including the process of delivery.*

How fast microfinance outreach will increase and what role different players will play in it, will largely depend on the creation of an enabling environment by regulatory authorities. Various policy level changes introduced by Reserve Bank of India and NABARD had facilitated the growth of SHGs as a potent tool for economic and social empowerment of rural poor.

Social and financial mobilization can be most effective when the grass roots groups are strong. For the poor women and men, their needs, their strengths and their achievements are central. Local organizations are the priority. All organizing at all levels should focus on strengthening the local primary organizations belonging to poor section of community. The poor people are unlikely to gain full economic, social, political and over all empowerment without belonging to (and controlling) their own local organization.

Membership in local organization offers poor access to resources in a variety of ways, including, pooling of assets, group collateral to access loans, joint marketing strategies, group mechanisms for delivering and accessing social discipline and responsibility. Membership in pro-poor local organizations increases women's individual power (by improving their fall-back position) as well as women's collective power (by increasing their solidarity).

Organizing the rural poor often promotes not just group solidarity and power but also individual confidence followed by the group's voice, visibility and visions. Organizing the rural poor are an important first step in collective bargaining for higher wages and prices and in lobbying and advocacy to change policies and legislation. Organizing rural the poor leads to multi-sectoral development of women by conversing the multi-issues based scheme into organizing women self-help groups.

Peer pressure of within the SHG works as a collateral and the very fact that the loan repayment rate by SHG to the banks is more than 95 percent is ample proof of strong repayment ethics followed by the rural poor. NABARD has strongly focused on intensive training and capacity building for various stakeholders.

There is a need for market research to develop popular and profitable microfinance products to discover customer opinions and expectations as well as process mapping to design procedures that are efficient and secure and for microfinance operations and proliferation. Pilot testing and roll-out to large-scale financial services are highly valued by the rural poor.

Considerable work and continuous efforts are needed to diversify the source of funding for microfinance, to attract more foreign investments for well established MFIs, to use all the possible channels to serve more rural and urban poor, to develop their staff to be more productive and professional and to make it more poverty-focused and profitable.

As the number of microfinance programs grows, it is expected that MFIs will remain competitive and innovative in serving the underserved and unserved throughout the world.

Recommendations

The key rural finance stakeholders, particularly the Central Bank of Uzbekistan and the Open Joint Stock Commercial Bank "AgroBank" of Uzbekistan, agreed to pursue the following recommendations to further enhance the policy environment and regulatory framework of Uzbekistan:

1. The key rural finance stakeholders shall look further into the design of client-friendly and conducive rural finance and microfinance policy environment and regulatory framework in Uzbekistan, based on the experiences of NABARD and other APRACA member institutions;
2. The Central Bank shall explore and look into the creation of sustainable rural microfinance institutions to augment the work of commercial banks in microfinance.
3. Following the Indian Microfinance Bill, the Central Bank of Uzbekistan shall determine the need for creating a regulatory authority to manage the prospective proliferation of microfinance institutions and organizations.
4. Key rural finance stakeholders, such as the AgroBank of Uzbekistan, shall support the design, pilot test and implementation of innovative rural and microfinancial approaches and delivery systems, including the linkage banking and the joint liability group schemes.
5. The Central Bank and AgroBank shall pursue the establishment of an institute to deliver professional training and technical support to microfinance institutions and their respective clients and to conduct further forums on policy and financial governance.
6. The Central Bank and AgroBank shall likewise explore the development of research and development units to look into key microfinance areas including financial products, services, financial and institutional linkage, marketing linkages and performance measurement.

Printed by

ASIA-PACIFIC RURAL AND AGRICULTURAL CREDIT ASSOCIATION (APRACA)
39 Maliwan Mansion, Phra Atit Road
Bangkok 10200, Thailand
Tel: (66-2) 280 0195
Fax: (66-2) 280 1524
E-mail: apraca@apraca.org
Website: www.apraca.org