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IFAD Rural Finance Policy

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**University of Cologne
Development Research Center
Universität zu Köln
Arbeitsstelle für Entwicklungsländerforschung**

IFAD RURAL FINANCE POLICY

by

Hans Dieter Seibel

May 2000

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ABBREVIATIONS AND ACRONYMS

AgDB	Agricultural Development Bank
AFRACA	African Regional Agricultural Credit Association
BAAC	Bank for Agriculture and Agricultural Cooperatives
BRI	Bank Rakyat Indonesia
CARD	Centre for Agriculture and Rural Development
CGAP	the Consultative Group to Assist the Poorest
FSA	Financial Service Association
MFI	Microfinance Institution
NGO	Non-Governmental Organization
PCFC	People's Credit and Finance Corporation, The Philippines
P4K	Proyek Pembinaan Peningkatan Pendapatan Petani-Nelayan Kecil (Income Generating Project for Small Farmers and Landless)
RACA	Regional Agricultural Credit Association
RoSCA	Rotating Savings and Credit Association
SACCO	Savings and Credit Cooperative

IFAD RURAL FINANCE POLICY

I. RATIONALE¹

1. **Rural finance is a vital tool in poverty reduction and rural development.** Two thirds of the Fund's current projects have a rural finance component; about 21% of the Fund's resources are dedicated to rural finance.² Most of IFAD's target group are small producers engaged in agricultural and non-agricultural activities in areas of widely varying potential. Direct access to financial services affects the small producers' productivity, asset formation, income and food security. This policy paper is designed to provide an overall framework for the Fund's work in rural finance. On that basis, operational guidelines and regional strategies will be prepared in due course for the use of staff, consultants and partner institutions, with scope both for innovations and for consolidation of successful existing practices.

2. **Rural finance is not a panacea.** It is but one of several important areas for investment in poverty reduction, and its impact is fully felt only when conducive policies are in place, markets are functioning, and non-financial services are available. The very poor, i.e. those without income, may be more effectively reached through direct microenterprise promotion, income transfers, safety nets and improved infrastructure. Through its rural finance policy, IFAD confirms its commitment to continue its search for better ways of providing support to the rural finance sector in order to benefit the rural poor. It is understood that a policy does not cover all fields of intervention and cannot be mechanically applied. It needs to be adapted to the socio-economic setting of each area and leave room for financial innovations beyond the scope of this policy paper.

3. **Defining rural finance.** Given IFAD's special concern for women and the very poor, major but not exclusive-emphasis is placed on rural microfinance, which is beyond the purview of conventional banking. Rural microfinance comprises formal and informal financial institutions, small and large, that provide small-size financial services to the rural poor, as well as larger-size financial services to agro-processing and other small and medium rural enterprises. It covers a wide array of microfinance institutions (MFIs), ranging from indigenous rotating savings and credit associations (RoSCAs) and financial cooperatives to rural banks and agricultural development banks. IFAD recognizes that only a small number of MFIs have the status of a non-governmental organization (NGO) or have the support of donors. In the absence of efficient institutions, rural finance also flows through channels of interlinked transactions in cash or in kind, such as trader, processor and supplier credit.

4. **IFAD's history in supporting rural finance** started in most countries with subsidized credit as an agricultural input handled by project staff and covered by government guarantees. This was followed by credit channelling through agricultural development banks and their retail intermediaries. Early on, the Fund also contributed to institution building, most notably of the Grameen Bank. However, in

Box 1:

Transforming rural financial services in El Salvador

In El Salvador, as in other countries of the same region, agricultural development banks did not previously mobilize savings; instead, credit lines served as a source of funds for loans to IFAD target groups. A new generation of projects is now being initiated, geared to the development of rural financial markets with sustainable institutions offering deposit, credit and other financial services.

¹ A more detailed presentation of IFAD's rural finance policy is given in a background paper, *Challenges, Opportunities and Options for the Development of Rural Financial Institutions* (Rural Finance Working Paper No. A 2).

² IFAD has 236 ongoing and newly approved projects, with a volume of USD 2 981.8 million. Of these, 156 projects for a total of USD 630.5 million are involved in rural finance or have a rural finance component (December 1999). For a complete list of IFAD projects in rural finance, see Appendix I (Annex I).

a policy environment of financial repression and easy money, many programmes failed to cover their costs and recover their loans, which made them unsustainable. Rural financial markets were grossly distorted while outreach stagnated. IFAD support is now shifting to rural finance systems development, institutional diversity and sustainable access of the rural poor to financial services, as in the case of El Salvador (Box 1). This involves the strengthening of sustainable rural financial institutions, which is in turn related to the viability of the farm and non-farm enterprises of their clients.

5. IFAD has drawn lessons from various notable new developments in rural finance. In a number of countries, macroeconomic stability and deregulation have created a conducive policy environment, which has prepared the ground for reforming rural financial institutions, among them community banks, private rural banks, savings and credit cooperatives, agricultural development banks, Grameen-type banks and credit NGOs. New banking legislation has provided a legal framework for initiating regulated microfinance institutions on a commercial basis. This has also created opportunities for upgrading and mainstreaming informal financial institutions, which in many regions are based on ancient traditions of self-help (Box 2). As a result, increasing numbers of poor people now have access to financial services – not only as users but also as owners. However, in the majority of countries, there are still major shortcomings in rural finance that call for country-driven, coordinated interventions (Table 1).

Box 2: Financial service associations (FSAs), an equity-based financial innovation in Benin

In Benin and some other African countries, the rural poor have demonstrated that, with technical assistance, they can mobilize their own resources, operate a profitable lending business, and build up sustainable institutions. During the start-up phase of the FSAs, some people have made good use of credit lines to temporarily bridge a liquidity shortage. Women are actively involved as shareholders and borrowers.

**TABLE 1: RECENT DEVELOPMENTS AND CONTINUED SHORTCOMINGS
IN RURAL FINANCE AND MICROFINANCE**

Topic	Recent Developments in Some Countries	Continued Shortcomings in the Majority of Countries
Policy environment	Macroeconomic stability; interest rate deregulation; ease of setting up banks or branches; low minimum capital requirements for MFIs	Inadequate policy and legal environment; slow implementation of deregulation; inadequate property rights and judicial procedures
Microfinance institutions	New legal forms for commercially-operating MFIs; privately financed start-up; increasing numbers of self-sustaining MFIs.	Lack of appropriate legal forms; excessive capital requirements
Non-formal financial institutions	New legal framework provides opportunities for upgrading to formal levels and for financial market integration	The potential for upgrading millions of informal financial institutions remains largely untapped
NGOs	Innovative approaches to poverty lending in repressive environments; some successful conversions to formal intermediaries	NGOs are slow in mobilizing domestic resources and in striving for self-reliance; donors support unviable NGOs
Agricultural development banks	Incipient reforms towards autonomy, viability and self-reliance, with or without privatization	Political interference; lack of viability; failure to meet demand for credit and deposit services
MFI regulation and supervision	Controversial discussion on the need for effective regulation and supervision of MFIs	Financial authorities unable to supervise MFIs; agricultural development banks (AgDBs) escape supervision; lack of MFI self-regulation
Agricultural finance	Self-financing from profits and savings plus non-targeted commercial credit replaces preferential sources	Self-financing and commercial credit insufficient to meet the demand for short- and long-term finance; inadequate savings mobilization
Access of the poor to financial services	Outreach of viable MFIs (including rural and other banks) to the poor as users and owners drastically increased	Vast numbers of poor people, particularly in marginal areas, lack access to savings and credit services

6. The purpose of IFAD's rural finance policy is to render such interventions more effective, thereby alleviating poverty and making people, their institutions and their countries sustainably richer. It does not define where we stand, but where we go.

II. CHALLENGES IN RURAL FINANCE

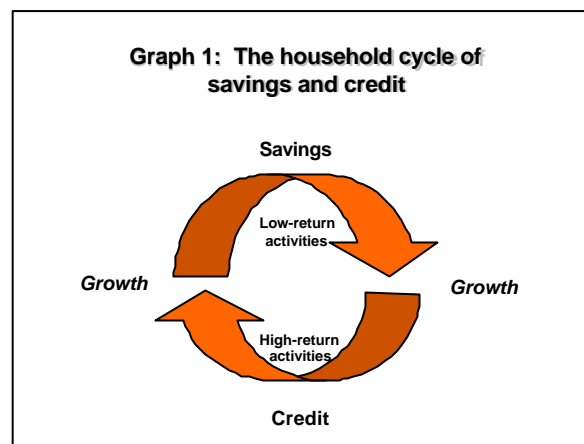
7. Based on the experience of the various stakeholders, a new consensus³ has emerged: many of the poor can save, invest and repay their loans. They need access to financial services, particularly:

- deposit facilities for accumulating and safely keeping their savings, consumption smoothing and self-financing of economic operations;
- credit for consumption smoothing and external financing of their operations; and

³ In recent years, most major donors and many international NGOs have prepared rural finance policy papers or guidelines, which converge on the fundamentals of rural and microfinance systems development. The Consultative Group to Assist the Poorest (CGAP), of which IFAD is an active member, has played a leading role: formulating guidelines, providing operational manuals, and organizing training for donor staff and MFI practitioners.

- insurance for social security and loan protection.

8. Savings tend to be more important for the financing of subsistence agriculture and low-return activities whereas credit is used more for activities with high returns. IFAD contributes to speeding up the savings and credit cycle by enhancing either savings first or credit first as entry points, and initiates further steps to contribute to sustainable rural financial institution-building. In security-oriented households, this may result in an increasing share of self-financing; and in entrepreneurial households in a higher proportion of external financing.

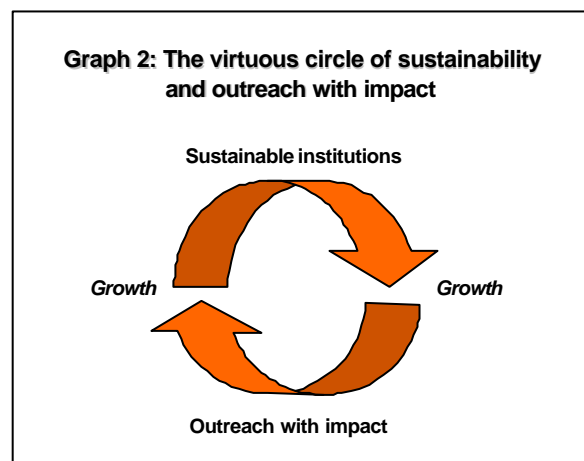


9. Only sustainable financial institutions can reliably provide adequate financial services and continually increase their outreach to the poor. The strength of financial institutions which IFAD helps to build lies in their ability to reduce transaction costs, make their resources grow dynamically, allocate scarce resources efficiently, and manage risks. There are five tenets of sustainability:

- viability: cover your costs from the margin;
- self-reliance: mobilize your own resources;
- financial self-sufficiency: be profitable and preserve the value of your resources;
- outreach: broaden your services for the poor;
- impact: help the poor to help themselves.

10. With sound practices and in a conducive policy and regulatory environment, different types of financial institutions can be sustainable and form the building blocks of an effective rural financial system. With appropriate strategies, institutional sustainability and outreach can be made compatible and mutually reinforcing. However, there may be short-term trade-offs between them which require special intervention. In addition to finance, a functioning system of non-financial services, such as marketing, supply and extension, is needed to achieve an effective impact on poverty. The consensus on the importance of institutional sustainability and outreach to the poor as attainable development goals provides a solid basis for effective donor coordination and policy dialogues with governments.

11. **Goal and objective.** IFAD's development goal is to reduce poverty among the rural poor through sustainable improvements in household food security and incomes. In order to contribute to this goal, one of IFAD's objectives is to provide improved financial and related non-financial services in rural areas. This requires an effective system of rural financial institutions that are accessible to all segments of the rural population. Some 500 million economically-active poor people around the world have no access to financial services, but they represent a vast potential. IFAD's special emphasis is on women and the poor: not as beneficiaries of charity, but as commercial users or user-owners of sustainable financial institutions. IFAD is confident that, through a systems approach, it can substantially contribute to expanding the frontier of institutional



sustainability and outreach to the poor. The Fund cannot by itself do all that is necessary (as outlined in Annex I), but as advocate of the rural poor, it plays a catalytic role and takes responsibility, in close cooperation with other stakeholders, for the continual expansion of that frontier.

12. As a basis for the dynamic growth of institutional self-reliance and of self-financing among smallholders and microentrepreneurs, domestic resource mobilization is of crucial importance. Yet, local savings and other domestic resources are frequently not sufficient to allow full exploitation of economic opportunities. Credit lines may fill that void. However, they have not always adequately responded to the challenge of sustainability. In some regions, this has resulted in low disbursement rates. The poor need local financial institutions offering a broad range of financial services, which at the same time generate internal resources, as addressed by the Rural Development Project for the Central Region (PRODAP-II) in El Salvador (Box 1). In Benin, the poor have established local institutions with their own equity, as users and owners at the same time (Box 2). Not all poor people require credit, as demonstrated by the vast numbers of savers in reformed agricultural development banks (Boxes 10, 12). In response to the universal demand of the poor for deposit services, the Agricultural Development Programme for the Western Region (PLANDERO) in Honduras has helped an indigenous organization to establish rural savings banks for the landless (Box 3). Credit lines may have start-up and bridging functions for new institutions anywhere in the developing world, including the extremely under-monetized rural economies of eastern Europe (Box 4). Care must be taken that they do not counteract a drive for sustainability and self-reliance.

Box 3: Rural savings banks (*cajas rurales*) for the landless poor in Honduras

In Honduras, the management of an IFAD project discovered that, in marginal areas, the indigenous poor need a secure place for depositing the savings they may use for consumption smoothing and microenterprise investments. In response, the project has helped the poor to establish semi-formal savings banks. Building up networks with financial apex organizations will help their integration into the financial market.

Box 4: Rural Financial Services in Albania, Armenia and Macedonia

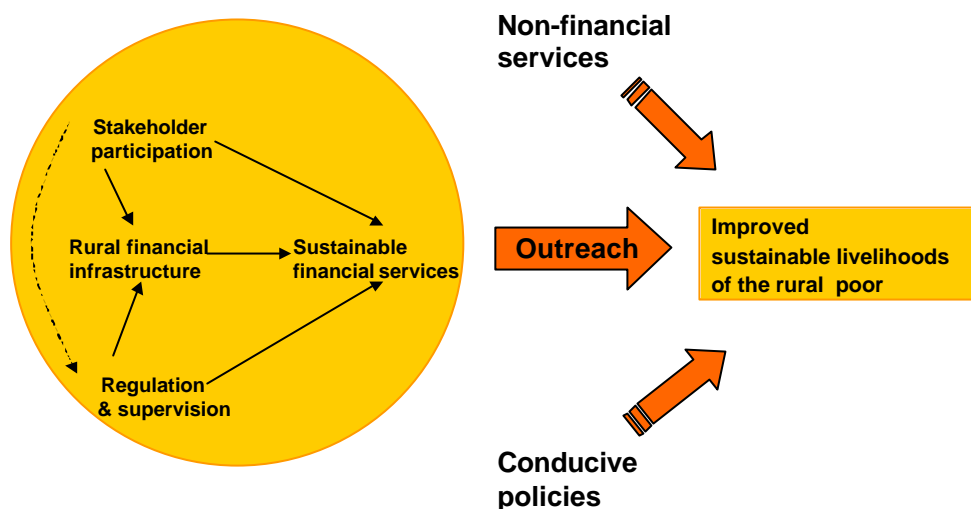
In the transitional economies of Eastern Europe, rural financial institutions are only just emerging. Through credit lines for investments in emerging private agriculture, IFAD provides urgently needed liquidity in extremely under-monetized rural economies. Its support to the cooperative village credit funds in Albania may serve as a model for building local financial intermediaries that adhere to basic banking principles and apply simple standardized procedures.

13. As major areas of its work, IFAD will support solutions to the following key challenges in rural finance:

- participation of stakeholders, including the poor, in the development of rural finance;
- building a differentiated rural financial infrastructure with diverse strategies;
- enhancing institutional sustainability, with outreach to the rural poor;
- promoting a conducive policy and regulatory environment.

14. IFAD's policy for responding to these challenges is described below. Graph 3 depicts the Fund's proposed model of intervention. A systematic framework of challenges, opportunities and options for the planning of interventions is given in Annex I. Some of the experience of IFAD and other donors is summarized in corresponding boxes within the text and in Appendix II.

Graph 3: IFAD's approach to rural finance



A. Encouraging Stakeholder Participation

15. Effective project planning and implementation requires the active participation of all stakeholders. Governments, which are IFAD's direct partners, have generally not performed well in their combined roles of planner, banker and entrepreneur. In rural finance, their special role is to create a conducive policy and legal environment that encourages the active involvement of all private and public stakeholders and permits effective institution-building. Participation patterns according to sex, social strata or group affiliation are culture-bound; where conflict arises, the poor themselves must determine the balance between their social and economic concerns.

16. **Participation by the poor in the development of rural finance.** Participation by the poor in project design, through their representatives in self-help groups, networks and NGOs, is of crucial importance. IFAD will strengthen the decision-making role of the poor and contribute to their empowerment as users and user-owners of local financial institutions. In the Income-Generating Project for Marginal Farmers and Landless – Phase III (P4K) in Indonesia, the poor have initiated the transition from a top-down credit project to a genuine self-help movement, with women as prime movers (Box 5).

Box 5:
Transition to self-reliance in the Income-Generating Project for Marginal Farmers and Landless – Phase III - (PK4) Indonesia

In P4K, a credit project for small farmers and fishermen, agricultural extension workers helped the very poor to form some 50 000 small groups as credit channels. Women in marginal areas were the prime movers to transform these small groups into larger, self-reliant savings and credit associations, thereby initiating the transition from a top-down credit project to a genuine self-help movement. As credit from BRI is drying up, many associations are now registering as financial cooperatives of growing membership and business volume.

17. **Stakeholder coordination.** Stakeholder coordination at the national level is required to ensure an integrated approach to the development of an effective system of rural finance (Box 6). IFAD may enter into strategic partnerships with donors that have a strong presence in the field. Government institutions and parastatal banks - which are IFAD's immediate partners - together with NGOs and other intermediary organizations, may require substantial capacity enhancement inputs to fully participate in the design and implementation of projects. Support for participatory stakeholder workshops to prepare and revise LogFrame planning documents during the project design, initiation and implementation phases, and for the building of moderating capacities at the national and sub-regional levels, is essential.

Box 6:

Stakeholders develop a national system of rural finance and microfinance in Cameroon

One example of effective stakeholder participation is to be found in Cameroon, with IFAD playing a catalytic role. The Ministries of Agriculture and Planning have accepted the lead of the Ministry of Finance to form a team together with staff from networks of microfinance institutions and NGOs in their function as microfinance capacity builders. They have jointly designed a project of rural microfinance systems development, focussing on expanding networks of formal and informal MFIs; their apex organizations; appropriate regulation and supervision; and donor coordination.

18. **International dialogue on rural finance policies.** IFAD is actively involved in an international dialogue on rural finance policies with CGAP, multilateral development finance institutions and bilateral agencies. This prepares the ground work for innovative approaches, provides back-up to national project coordination, and leads to strategic linkages. All such coordination is greatly facilitated by the new consensus on microfinance among donors and practitioners.

B. Building a Rural Financial Infrastructure

19. **Supporting different types of financial institutions and strategies.** Different types of financial institutions and strategies are required; there is no single best type (Box 7). Institutions must be tailored to the potential of the area, the cultural environment and the requirements of the clients:

Box 7: Supporting institutional diversity in Guatemala

Since the end of the civil war in Guatemala, IFAD and other donors have promoted diversity and competition among rural financial institutions, such as financial cooperatives, credit NGOs, community banks, and a restructured AgDB (Banco Rural). Some MFIs, legally barred from deposit-taking, are now mobilizing internal and donor resources to register as banks or finance companies. Others, like the credit union network, adopt self-regulation and supervision of prudential norms as a means of increasing sustainability and outreach.

(a) There are marginal areas with a predominance of subsistence agriculture and low-return activities. Here, user-owned self-help groups or small cooperatives, which are savings-oriented and operate at nominal costs, may be most suitable.

(b) There are high potential areas with high-return agriculture and profitable rural microenterprise activities. In these areas, credit-oriented rural banks with professional management (which may be privately or community-owned), large financial cooperatives and commercial bank branches with individual or group technologies may be more appropriate.

20. Depending on the situation, IFAD encourages variety and competition rather than the replication of single models. It engages in dialogue with stakeholders and is prepared to support initiatives such as:

- promoting informal financial institutions, as in Benin, Indonesia and The Philippines (Boxes 2, 5, 11), including financial grass-roots organizations of indigenous origin, as in Ghana;
- mainstreaming savings and credit cooperatives, as in the United Republic of Tanzania (Box 9);
- supporting networking and apexing among MFIs, as in Cameroon (Box 6);
- strengthening private and community-owned rural banks, their bank associations and apex organizations, as in Ghana, Indonesia, Nigeria and The Philippines;⁴
- transforming credit programmes into user-owned institutions, as in Nepal (Box 8);
- reforming agricultural development banks as major microfinance providers, as in Indonesia and Thailand (Boxes 10, 12) – or closing them if unreformable;
- linking banks and self-help groups, as in Ghana, India, Indonesia and several other Asian and African countries;
- promoting commercially-operated apex organizations for refinancing MFIs, such as the People's Credit and Finance Corporation (PCFC) in The Philippines, and apexes with additional functions like liquidity exchange, credit rating, credit guarantees and reinsurance;
- supporting trader, processor and supplier credit⁵ and promoting their access to refinancing institutions, as in various East African countries;
- promoting institutional innovations, such as (micro-) leasing companies; and
- strengthening microfinance units in central banks, as in Cameroon and Ghana.

Box 8: Transforming an unsustainable credit programme into autonomous institutions in Nepal

Until 1992, IFAD assisted the Agricultural Development Bank of Nepal (ADBN) to establish an infrastructure of small farmers' groups which, in turn, formed intergroups and management committees under sub-project offices. On that basis, ADBN is now helping the farmers to establish autonomous local financial institutions, transforming a credit project into a network of vibrant financial cooperatives.

21. Grant support is required for social intermediation through training, capacity- and institution-building, and for action-research to test innovative approaches and disseminate their results. Four of these approaches are presented below in more detail.

22. Upgrading and Mainstreaming Informal Financial Institutions. The upgrading and mainstreaming of informal financial institutions deserves special attention on the part of IFAD. Whereas financial self-help groups are widespread among the poor, they are usually small and isolated. Mainstreaming and upgrading to higher legal forms

will be encouraged by providing incentives for joining

TABLE 2: MAINSTREAMING: A STEPWISE INCENTIVES-DRIVEN SERVICE TO IFIS

Mainstreaming	Incentive
1. Registration	Basic training (accounting)
2. Reporting	Financial management training
3. Legal status	Consultancy services
4. Prudential norms	Liquidity exchange and refinancing
5. Supervision	Accreditation with a seal of quality

⁴ The terms rural bank and community bank refer here to regulated institutions which fall under the banking law or a special law for rural or community banks, as in Ghana, Indonesia, Nigeria and The Philippines. IFAD does not use the term bank or village bank for unregulated institutions such as *caisses villageoises*, *sanadiq* (sg. *sandug*) or other informal and semi-formal MFIs.

⁵ Traders, processors and suppliers may act as important channels of credit, particularly in the absence of a functioning local financial system. These channels tend to be less sustainable than institutions and less efficient in terms of transaction costs, but may provide interim solutions in the process of building up smallholder assets and rural financial systems.

a network, such as training and consultancy services, liquidity exchange and refinancing, and accreditation.

23. Networking among MFIs and establishing apex services.

Networking among MFIs and assisting them to establish apex services is a major strategy, to be supported by IFAD, for the expansion of rural financial services and institutions (Box 9). Apex services may include interest articulation, policy dialogue, training, consultancy, self-regulation and supervision, liquidity exchange and bank linkages, research and development, information dissemination and donor linkages. Professionally-managed services should be provided by network apexes as part of an officially recognized sustainable structure, rather than by external agencies. Non-financial services may be provided by subsidiaries. With assistance from the Fund, government agencies and NGOs may act as facilitators until such time as the networks and their apexes are fully self-sustained.

Box 9: Reforming savings and credit cooperatives (SACCOs) in Tanzania

In the United Republic of Tanzania, IFAD has supported the transformation of savings and credit cooperatives (SACCOs) in upland areas from credit channels into real self-help organizations. They have vigorously mobilized savings and diversified their lending to the agricultural and microenterprise sectors including women traders.. Results in terms of impact include: empowerment of the poor including women as user-owners, substantial improvements in food security and income, and enhanced institutional sustainability.

24. Linking banks with local financial institutions and self-help groups. The strategy whereby banks are linked with local financial institutions and self-help groups is a three-pronged process: (a) improving the access of rural people to credit from commercial sources through local intermediaries; (b) integrating local financial institutions into national financial markets; and (c) enabling banks to reach out to smallholders and microentrepreneurs as a new market segment. IFAD will support this strategy as a means of reaching the poor in a cost-effective way, in both high-potential and marginal areas. Linkage banking is most developed in India, Indonesia and The Philippines, but it is also found in other Asian and in various African countries. It requires banks with an effective rural delivery network and local MFIs or self-help groups with sustainable operations. IFAD, as in Ghana, may provide funds for establishing a linkage programme to strengthen the capacity of all linkage partners, bridge shortcomings in domestic resources for refinancing, and engage in international exchanges of experience.

25. Transforming agricultural development banks. The transformation of AgDBs into sustainable providers of agricultural finance and other rural financial services, or their closure if

unsustainable, represents a great challenge. Vast numbers of rural people involved in agricultural and non-agricultural activities may be offered credit and deposit services by reformed AgDBs such as the Bank for Agriculture and Agricultural Cooperatives (BAAC) in Thailand (Box 10) and Bank Rakyat Indonesia (BRI) in Indonesia (Box 12). AgDB reform is a complex process in which close donor cooperation will be required with the banks, the

Box 10: BAAC: gradual AgDB reform in Thailand

The reform of BAAC has been a gradual, 30-year process resulting in a viable and efficient government-owned AgDB: mobilizing most of its resources through savings, lending to 86% of farm households at low interest rates, and making a profit. Its outreach encompasses 4.8 million borrowers and 7.6 million savers.

respective governments and the regional agricultural credit associations (RACAs) whose members are AgDBs: African Regional Agricultural Credit Association (AFRACA) for Africa; Asia-Pacific Rural and Agricultural Credit Association for Asia and the Pacific; and Near East-North Africa Regional Agriculture Credit Association for North Africa and the Near East. IFAD has taken the lead in initiating dialogue on AgDB reform with CGAP, the Food and Agriculture Organization of the United Nations and the RACAs. The latter, which are recipients of IFAD technical assistance grants, may play a catalytic role in the reform process.

C. Enhancing Institutional Sustainability with Outreach to the Rural Poor

26. **Institutional sustainability.** Institutional sustainability is of fundamental importance for the dynamic growth in number, size and outreach of rural financial institutions. IFAD assists these institutions to enhance their self-reliance, operational viability and financial self-sufficiency. It also strengthens their capacity to mobilise their own resources, to cover their costs and to preserve the value of their capital, respectively. BAAC, a government-owned AgDB, has succeeded in attaining sustainability by providing low-cost financial services to the vast majority of farmers in Thailand (Box 10). The Centre for Agriculture and rural Development (CARD), a bank in The Philippines set up along similar lines to the Grameen Bank in Bangladesh and serving exclusively poor women, is an example of rapid progress to sustainability through credit discipline and innovation while adhering to a corporate mandate of banking with the poorest (Box 11). As a booster, both local and external resources (including credit lines as bridging funds) may be mobilized in order to enhance outreach and sustainability, as demonstrated by IFAD's early support to the Grameen Bank. Capacity enhancement includes assistance to build up and strengthen the crucial elements of sustainability:

Box 11: Are Grameen Bank replicators sustainable, and do they reach the poor?

CARD in The Philippines, a Grameen Bank replicator, has changed from being an unsustainable credit NGO to a viable rural bank. By mobilizing its own resources from 40 000 poor and non-poor clients and enforcing a strict credit discipline, it has substantially increased its lending outreach to its target group: 28 500 very poor women (Dec. 1999). With support from IFAD, CARD disseminates its technology to other MFIs.

- autonomy and flexibility in all operational matters within the institution's mandate;
- strategic planning for sustainability (cf. Annex I);
- demand-oriented, properly priced financial products;
- local resource mobilization (savings, equity; borrowings by MFIs barred from deposit-taking);
- access to capital markets;
- inflation- and subsidy-adjusted market rates of interest, with positive real returns for savers and lenders;
- appropriate loan and instalment periods;
- operational efficiency with low transaction costs and high repayment rates;
- well-trained human resources;
- staff performance incentives;
- adequate risk management;
- appropriate forms of collateral and collateral substitutes;
- incentives for timely loan repayment;
- insurance as an instrument of borrower and loan protection;
- prudential standards;
- effective management information systems, including microbanking software;
- effective internal control of portfolio quality;
- annual external audits; and
- good governance, with emphasis on combining ownership by the poor with professional management.

27. Good risk management is based on appropriate loan terms and timeliness, clients' track records, suitable collateral and collateral substitutes, insurance, peer pressure, staff incentives to enforce loan recovery, and borrower incentives for timely repayment. The Fund supports the enhancement of risk management. In innovative approaches such as linking MFIs and self-help groups with banks, it may

also cautiously assist in the establishment of credit guarantee arrangements, with due provision for the phased transfer of risk-management functions to the banks.

28. There is no clear evidence as to the superiority of group vs. individual technologies. Depending on their local effectiveness, either one may be promoted, whether in marginal or in high-potential areas. IFAD may also encourage innovations such as short-term all-purpose loans with regular instalments from non-agricultural incomes; reciprocal products of long-term contract savings combined with access to term finance; tied collection of savings and instalment at doorsteps; and food-cum-savings-deposits-for-work in remote areas.

29. **Good practices.** Good practices and their continual improvement in a competitive environment are indispensable for ensuring the sustainability and outreach of MFIs. Examples are indigenous institutional knowledge in informal finance; innovations in short- and longer-term agricultural finance; and special approaches for marginal and upland areas, inflationary economies, and barter economies. Among the issues calling for special action-research are agricultural finance and rural microenterprise finance, where there is wide scope for innovation.

30. Good practices in IFAD projects are disseminated through its Evaluation Knowledge System. This system contains summaries of evaluations since 1990 and lessons learned, which are accessible by topic, country and region.

31. The present policy paper will also serve as a basis for a conceptual framework for supporting action research, monitoring and evaluation of innovations, and the dissemination of results through training, workshops, technical papers and a website. Support may be provided to networks of national and regional banking and microfinance research and training institutes.

32. **Mobilization of domestic and external resources.** Domestic and external resources are mobilized with the objective of building a sustainable rural financial system for the poor. IFAD will support rural financial institutions in improving their savings mobilization and capital built-up. Equity financing through appropriate apex institutions may be developed by IFAD as a new instrument, which would provide the much-needed external capital and leverage multiples of domestic capital. In the current era of globalization, new ways must be sought to direct private capital flows to the rural economy, to supporting bank linkages of MFIs and creating autonomous apex funds for equity participation in MFIs such as those in Argentina (the Social Capital Fund), Bangladesh the Palli Karma-Sahayak Foundation and The Philippines (PCFC). IFAD may also provide credit lines. All such external liquidity should be tailored to the strengthening of domestic resource mobilization at all levels and to the efficient allocation of scarce resources to high-yielding investments on the part of the poor. The impact of external resources on productivity and returns, and their implications in terms of a country's indebtedness, need to be carefully monitored.

D. Promoting a Conducive Policy and Regulatory Environment

33. **A conducive policy environment.** A conducive policy environment is a prerequisite for an efficient financial system, rural development and effective poverty alleviation. Of particular importance are: macroeconomic stability; deregulated interest rates, exchanges rates and agricultural prices; and a legal system that protects property and land-use rights, the autonomy of financial institutions and regulatory authorities, and due legal

Box 12: BRI, the AgDB that revolutionized rural finance

Within a framework of financial deregulation, BRI was cut off from subsidies and granted management autonomy. With good governance, carefully-crafted financial products, staff productivity incentives and rewards for on-time repayment, BRI turned into one of the largest and most profitable providers of rural financial services in the developing world. Its 3 700 sub-branches serve some 20 million savers and 2.5 million borrowers. This has set new standards for AgDBs – they can be reformed! – and the microfinance industry: sustainability and wide outreach to the poor are compatible!

process (Box 12). As an advocate of the poor, IFAD will participate in policy dialogues aimed at promoting a conducive environment.

34. **Prudential regulation and supervision.** Prudential regulation and supervision of financial institutions is crucial for the evolution and stability of financial systems. Without properly regulated local financial institutions, which mobilize savings and attract private capital, there can be no sustainable rural development. Under conducive conditions, IFAD will support efforts to enact and adopt appropriate legal forms for cooperatively and privately-owned local financial institutions. IFAD will also assist self-regulatory organs of MFI networks, as part of a delegated system of self-regulation and supervision under a central financial authority, and the adoption of prudential norms and standards. Where conducive conditions are lacking, IFAD may support informal start-ups and join with other donors in policy dialogues to adjust the policy and legal framework.

35. **Effective supervision of IFAD Projects.** Effective supervision of IFAD projects that contain rural finance components requires adequately regulated and supervised participating financial institutions. Adherence to the ground rules of institutional sustainability is a condition for their selection. IFAD will support performance measurement, internal control and annual audits, using indicators and benchmarks as presented in Appendix III. In rural finance projects, effective performance measurement will be an essential ingredient of direct project supervision.⁶

36. IFAD also monitors the impact of its support on the poor and on rural financial institutions, local resource mobilization and external indebtedness. The results are stored in its institutional memory and made available in web pages and technical papers.

III. IMPLICATIONS FOR IFAD AND RECOMMENDATIONS

37. IFAD provides loans and grants as its main instruments in improving food production systems and the income, productivity and nutrition of the rural poor. Its respective policy is laid down in the Agreement Establishing IFAD (Article 7, Section 2, and in its Lending Policies and Criteria). Through financial support for rural finance, the Fund helps to strengthen the capacity of rural financial institutions to mobilize domestic resources and allocate them efficiently to high-yielding productive and other purposes in rural areas. Loans are only given for projects with expected net gains to the country and the poor, taking due account of future repayment from earnings in national currencies of decreasing value.

38. As a tool to be used in the participatory process of designing a project, IFAD has prepared a planning framework (Annex I) as a basis for a comprehensive LogFrame. In every country and project involved, national and local decision-makers are required, in collaboration with IFAD, to select a set of opportunities and options and to operationalize the opportunities as LogFrame key result areas and options as LogFrame results (or outputs). Depending on the scope of a given project, several key result areas may be combined to form a project with a specific objective; alternatively, a project may comprise a single key result area as its objective. Lists of activities, indicators and assumptions, plus inputs and their costs, will be agreed by the planning participants and added to each result selected. The list of key result areas and results is indicative only and may be modified as seen fit by the participants. Ultimate responsibility for the design and implementation of a project rests with IFAD's government partner or, in the case of grants, with the beneficiary NGO or research institution.

⁶ For details see: Rural Finance Working Paper No. C3: *Direct Supervision of IFAD Projects and Credit Institutions*.

39. IFAD has also prepared an instrument for Performance Measurement and Internal Control of Microfinance Institutions (Appendix III), which includes the CGAP disclosure guidelines for MFI Financial Statements. This will be used in project supervision and in the preparation of LogFrame indicators.

40. Grants, up to 7.5% of annually committed resources, may be awarded to public or private regional and local institutions for innovative project- and action-oriented research and training activities, and for project preparation. High priority is given to activities that strengthen the technical and institutional capacity essential to agricultural and rural development, including rural finance. An IFAD policy and strategy for grant financing is to be submitted for approval to the Executive Board. That policy strategy proposes five priority areas, all of which are relevant to rural finance: (a) enhancing impact; (b) promoting innovations; (c) sharing knowledge; (d) training and capacity-building; and (e) promoting partnerships, flexibility and responsiveness. The creation of a network of rural and microfinance research institutions similar to the Consultative Group on International Agricultural Research may present a major opportunity for IFAD to cooperate with CGAP and other donors.

41. IFAD's resources may be used in rural finance either for direct assistance to institutional enhancement or for the supply of external liquidity as an indirect contribution to the development of sustainable services. The main focus of resource allocation should be on investments that promote access by the rural poor to financial services and the use of rural finance for income and employment generation.

42. Liquidity may be provided in the form of credit lines, equity participation in apex institutions and rural financial institutions, credit guarantees, and start-up capital for micro-insurance, micro-leasing or other schemes. Wherever feasible, liquidity is to be provided only to regulated and properly supervised financial institutions as wholesalers or retailers. Among the performance criteria for their selection, which may be reinforced through IFAD support, are professional management and commercial orientation, autonomy from political interference, orientation towards self-reliance and sustainability as short- or longer-term goals, additionality of services, satisfactory annual external audits, and exit options. Interest rate subsidies and administratively imposed targeting are to be rigorously avoided. IFAD makes every effort to reduce or abolish any discrimination against women and other disadvantaged groups.

43. Credit lines may be used to bridge a temporary shortage of loanable funds in expanding or innovating institutions, but they should not be seen as a lasting solution in the absence of local resources, institutions, or term finance. Their impact on domestic resource mobilization and institutional governance will be monitored.

44. Equity participation, which avoids some of the pitfalls of credit lines, strengthens the capital base of apex funds and rural financial institutions and leverages additional domestic resources in the form of savings deposits or additional equity. It may also be used to fulfil legal minimum capital requirement when transforming non-formal institutions into formal entities.

45. IFAD proactively pursues strategic linkages with multilateral, bilateral and private donors, providing leverage to its projects in terms of quantity and quality and to its dialogue with governments on the policy and regulatory framework. Through co- and parallel financing, additional resources are mobilized for larger projects and rural financial sector investment programmes. In many cases, technical assistance will be needed to give extra value to IFAD's support. IFAD will identify, and cooperate with, appropriate partners for the technical assistance components of projects.

46. Given its emphasis on rural financial institutions, which operate according to commercial principles, IFAD will seek new forms of cooperation with the private sector. These include the cofinancing of rural finance initiatives with international private donors; cooperation with foreign banks in the provision of training and consultancy services; and promotion of linkages of local financial institutions and self-help groups with commercial banks.

47. **Follow-up.** Implementation of IFAD's rural finance policy will be effected through the incorporation of its principles into regional and country lending strategies prepared by the regional divisions. Implementation will be closely monitored at the project level and periodically evaluated through thematic studies. In support of this process, working papers will be prepared on specific operational issues and other topics in rural finance on which the Fund wishes to take a position or provide information to its staff and partner organizations. Operational guidelines and regional strategies, together with selection criteria and monitoring indicators will, in due course, be submitted to the Executive Board for approval.

48. Building rural financial systems that provide sustainable services to the poor is to be measured more in terms of decades than of years. Such a perspective exceeds the duration of individual projects and will be reflected in IFAD's long-term country strategies.

49. The Executive Board is hereby invited to consider and endorse the policy framework for an IFAD Rural Finance Policy, as contained in part III, implications for IFAD and recommendations, of the present document.

**DEVELOPING A SYSTEM OF RURAL FINANCE FOR THE POOR:
A PLANNING FRAMEWORK OF CHALLENGES, OPPORTUNITIES AND OPTIONS¹**

DEVELOPMENT GOAL: The livelihoods of the rural population, especially women and the poor, are sustainably improved
OBJECTIVE: An effective system of sustainable financial institutions accessible to all segments of the rural population, including women and the poor, as users or user-owners is established
A. PARTICIPATION: Stakeholders, including the poor, participate in the development of the rural financial system
1. Low-income people participate actively in the development of rural finance (1) IFAD's poverty focus is defined and sharpened (2) IFAD's gender focus is defined and sharpened (3) Effective participatory techniques and processes for all partner institutions and users are initiated (4) The poor, with their MFIs and network or NGO representatives, effectively participate in policy dialogues on the development of rural and microfinance (5) The poor and their representatives effectively participate in IFAD project development (6) The poor actively participate in the establishment and expansion of MFIs and their networks (7) The poor and their self-help groups have access to MFIs and their savings, credit and other financial services (8) MFI ownership by the poor is facilitated (9) The poor themselves decide on joint, or separate, ownership and governance of MFIs with the non-poor (10) Men and women themselves decide on joint, or separate, ownership and governance of MFIs
2. The activities of stakeholders in rural finance are coordinated at the national level (1) The political will to develop a sustainable system of rural and microfinance is promoted through national and international dialogues (2) Rural and microfinance networks, government agencies, NGOs and donors coordinate their respective activities (3) Providers of financial and technical assistance cooperate and form strategic linkages (4) Projects with rural and microfinance components as first or second-order activities observe the ground rules of viable and sustainable microfinance systems (5) As advocate of the poor, IFAD participates actively in the negotiations of the International Monetary Fund and the World Bank with governments on financial-sector reform and poverty-alleviation programmes (6) LogFrame planning documents are prepared and revised through participatory stakeholder workshops during the project design, initiation and implementation phases (7) Participatory project planning and moderating capacities are built at the national and subregional levels
3. The rural and microfinance policies of donors are coordinated at the international level (1) Policy dialogue among donors is effective (2) Rural and microfinance policies are coordinated (3) Ground rules of viable and sustainable microfinance systems are observed in all projects that contain rural and microfinance components

¹ The challenge areas are itemized by capital letters; opportunities by Arabic numerals and options by numbers in brackets. They are presented in a comprehensive manner, like a checklist, to be used by any development agency or stakeholder including IFAD. In every particular country and project, IFAD, together with national and local decision-makers, will have to select a set of opportunities and options, operationalizing options as LogFrame outputs or results and adding activities, indicators and assumptions for each result. Ultimate responsibility for the design and implementation of a concrete project normally lies with IFAD's government partner, which may in turn delegate some of this responsibility to development finance institutions, networks of MFIs or other non-governmental agencies.

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<p>(4) International policy dialogue provides direction to international organizations and movements of microfinance</p> <p>(5) Technical and financial assistance partnerships with private-sector institutions.</p>
<p>B. FINANCIAL INFRASTRUCTURE: A differentiated system of rural financial institutions is operational</p>
<p>4. Basic strategies for the development of rural finance are tested and disseminated</p> <p>(1) Reorienting MFIs towards sustainability and scaling up</p> <p>(2) Upgrading and mainstreaming of informal and semi-formal MFIs to higher legal forms (local banks, finance companies, commercial banks, financial cooperatives)</p> <p>(3) Promoting MFI networks and apex services of networks</p> <p>(4) Promoting private and community-owned rural banks</p> <p>(5) Promoting commercially-operated apex funds or banking institutions for refinancing, liquidity exchange, credit rating, credit guarantees and reinsurance</p> <p>(6) Adapting banks to the requirements of microfinance (downgrading)</p> <p>(7) Transforming credit programmes into user-owned MFIs</p> <p>(8) Reforming the cooperative and rural banking sectors</p> <p>(9) Reforming agricultural development banks and their microfinance services</p> <p>(10) Linking banks with MFIs and self-help groups (linkage banking)</p> <p>(11) Supporting trader, processor and supplier credit and related institutions such as warehousing companies; and promoting their access to banks and MFIs as refinancing institutions</p> <p>(12) Grameen-type banking</p> <p>(13) Facilitating the establishment of new MFIs</p> <p>(14) Facilitating private MFI initiatives through an appropriate legal framework</p> <p>(15) Identifying, testing and implementing special strategies for marginal areas, subsistence economies, barter economies, cultural and ethnic areas, and financially repressive environments</p> <p>(16) Promoting institutional innovations such as (micro-) leasing companies</p> <p>(17) Strengthening microfinance units in central banks and other financial authorities</p> <p>(18) Appropriate strategies are prudently adapted to the cultural and economic environment</p> <p>(19) International exchange of experience, including exposure training, is facilitated</p>
<p>5. Informal financial institutions (IFIs) are upgraded and mainstreamed</p> <p>(1) Networking among IFIs is facilitated</p> <p>(1.1) Institutional patterns of forming financial grass-roots organizations (IFIs, savings and credit associations, Self-help groups, deposit collectors) are analysed</p> <p>(1.2) Existing IFIs of the poor are identified</p> <p>(1.3) The poor are assisted in joining local IFIs owned and managed by the poor</p> <p>(1.4) Networking among IFIs is facilitated</p> <p>(1.5) Central services are promoted as incentives to join the network</p> <p>(1.6) Voluntary registration of IFIs is facilitated</p> <p>(1.7) NGOs are supported as facilitators of IFI networks and trainers of IFIs</p> <p>(1.8) Agreement is reached on prudential norms</p> <p>(2) Mainstreaming is initiated by incentives to IFIs</p> <p>(2.1) Basic accounting training is provided as an incentive for registration with a network</p> <p>(2.2) Financial management training is provided as an incentive for financial reporting to the network</p> <p>(2.3) Consultancy services on good practices are provided to IFIs as an incentive to acquire legal status</p> <p>(2.4) Liquidity exchanges and refinancing services are provided as an incentive to follow prudential norms</p> <p>(2.5) Accreditation with a seal of quality is provided as an incentive to submit to supervision</p> <p>(3) The upgrading of IFIs is facilitated</p> <p>(3.1) Legal upgrading to attain suitable legal status is facilitated</p> <p>(3.2) Human upgrading is facilitated through staff and financial management training</p> <p>(3.3) Organizational upgrading and converting rotating groups (RoSCAs, <i>tontines</i>), funeral societies, deposit collectors and other IFIs into permanent institutions with a loan fund built from equity, deposits, fees or premiums</p>

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<p>(3.4) Operational upgrading is facilitated, including proper book-keeping, effective financial products and reporting to the network</p> <p>(3.5) Financial upgrading is facilitated in terms of self-reliance (mobilizing internal resources), viability (covering costs from operating income) and sustainability and outreach (increasing earnings for expansion)</p> <p>(4) Access to banks (linkage banking) on commercial terms is facilitated</p> <p>(4.1) Refinancing services are provided</p> <p>(4.2) Deposit services are provided</p> <p>(4.3) Payment services are provided</p> <p>(4.4) Financial consultancy services are provided</p>
<p>6. A comprehensive system of networks of rural finance institutions with cost-effective apex services for network members is operational</p> <p>(1) MFI networks and network federations are strengthened</p> <p>(2) The outreach of MFI networks is increased to encompass rural areas and the poor</p> <p>(3) Central services or apex organizations of MFI networks and their federations, with cost-effective services for member institutions, are established and strengthened, including:</p> <p>(3.1) Interest articulation and representation</p> <p>(3.2) Training (including exposure training) and consultancy services</p> <p>(3.3) Self-regulation through second-tier authorities, including mandatory and voluntary adoption of prudential norms</p> <p>(3.4) Supervision through on and off-site inspection and auditing services, including enforcement of prudential norms and certification of compliance</p> <p>(3.5) Liquidity exchange and refinancing, including bank linkages</p> <p>(3.6) Deposit insurance</p> <p>(3.7) Credit rating</p> <p>(3.8) Research and development</p> <p>(3.9) Exchange of experience, information packaging and dissemination</p> <p>(3.10) Facilitation of non-financial supporting measures by cooperating agencies</p> <p>(3.11) Policy dialogue of MFI networks with government and donors</p>
<p>7. Bank linkages of local financial institutions and self-help groups are operational</p> <p>(1) Banks with effective financial services in rural areas are identified</p> <p>(2) Local financial institutions with sustainable savings and credit operations are identified, including self-help groups, FSAs, financial cooperatives and other informal and semi-formal microfinance institutions</p> <p>(3) The capacity of NGOs and bank associations in providing consultancy services and training in linkage banking is enhanced</p> <p>(4) A commercially-viable linkage strategy is jointly worked out by the participating agencies in collaboration with a lead financial authority</p> <p>(5) Banks and local financial institutions work out the terms and conditions of their financial contracts as autonomous commercial partners</p> <p>(6) Linkage opportunities are initiated through rural mobilization campaigns, joint consultation workshops and training of linkage partners</p> <p>(7) Local financial institutions are given access to bank funds on commercial terms</p> <p>(8) Access of members and clients of local financial institutions to credit is enhanced</p> <p>(9) Banks are given access to sources of refinancing</p> <p>(10) The capacity of local financial institutions as autonomous financial intermediaries is enhanced</p> <p>(11) Opportunities are provided for local financial institutions, graduating from linkage programmes, to mainstream sources of refinance</p> <p>(12) International exchange of linkage banking experience is promoted by RACAs</p>

8. AgDBs are transformed into sustainable providers of financial services to the rural population

- (1) The political will to reform the AgDB is activated
 - (1.1) The political decision is taken by government to reform its AgDB
 - (1.2) Agreement is reached on a participatory planning process that involves all stakeholders
 - (1.3) The AgDB management and the stakeholders agree on the mandate and market of the AgDB
- (2) Adequate reform strategies are worked out
 - (2.1) Alternative reform strategies are examined, including:
 - government-owned AgDB under autonomous management
 - government-owned AgDB under commercial bank management
 - full or partial privatization
 - transformation of microbanking operations into user-owned local financial institutions
 - closure or fusion
 - (2.2) Appropriate reform strategies are selected
 - (2.3) Adequate process technologies are developed
 - (2.4) Implementation phases of the reform process are determined and periodically revised
 - (2.5) Logistic support of multilateral institutions is secured
 - (2.6) Reform strategies of international financial institutions are coordinated
- (3) The planning process is implemented
 - (3.1) A feasibility study is carried out
 - (3.2) An operational plan is prepared for implementation of the reform process
 - (3.3) External technical/financial support for the reform process is mobilized and coordinated
 - (3.4) The restructuring and reform process is monitored
- (4) Operational autonomy is effective
 - (4.1) The AgDB is granted operational autonomy
 - (4.2) A commercially experienced, politically independent general manager is appointed
 - (4.3) The central bank or bank superintendency enforces the attainment of operational autonomy
- (5) An appropriate legal and regulatory framework is provided
 - (5.1) A dialogue is initiated on the policy, legal and regulatory framework conducive to AgDB reform
 - (5.2) The AgDB law is revised
 - (5.3) Politically motivated loan forgiveness is excluded by law
 - (5.4) Prudential norms are defined and enforced
- (6) The AgDB's finances are restructured
 - (6.1) The portfolio is cleaned
 - (6.2) The bank is recapitalized
- (7) The bank structure is reorganized
 - (7.1) Microfinance services are organized in an autonomous corporate division
 - (7.2) Savings deposits are recycled among the microfinance units
 - (7.3) Branches are decentralized into profit centres
 - (7.4) The branch network is expanded
 - (7.5) Outreach is expanded to the poor and their self-help groups
- (8) Effective delivery schemes are operational
 - (8.1) Viable wholesale schemes are operational
 - (8.2) Linkages with self-help groups, IFIs and NGOs are initiated if feasible
 - (8.3) Viable retail schemes are operational
- (9) Effective financial services are offered according to demand
 - (9.1) Savings are mobilized through appropriate savings products and collection services
 - (9.2) Interest rates on savings are adequate, with positive real returns
 - (9.3) Credit products with appropriate terms and collection services are provided

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<p>(9.4) Insurance and other financial products are provided</p> <p>(10) Financial sustainability is attained</p> <p>(10.1) Viability is attained through adequate interest rate spreads and adequate repayment performance</p> <p>(10.2) Self-reliance is attained through savings mobilization and retained earnings</p> <p>(10.3) Financial self-sustainability is attained through adequate returns on capital</p> <p>(11) Human resources are developed</p> <p>(11.1) Staff selection procedures are established for the hiring of appropriate staff</p> <p>(11.2) Training and retraining schemes are established to inculcate the reformed operational practices</p> <p>(11.3) Staff training and retraining is implemented on a continuous basis</p> <p>(11.4) Staff incentive schemes are operational</p> <p>(11.5) A performance-based staff testing and promotion system is established</p> <p>(12) Internal and external supervision are effective</p> <p>(12.1) International accounting standards are operational</p> <p>(12.2) Prudential norms are observed</p> <p>(12.3) A management information system, with effective on-time monitoring of loans and a prompt-action mechanism is operational</p> <p>(12.4) Internal supervision is operational</p> <p>(12.5) External supervision is operational</p> <p>(12.6) Effective supervision services are provided by the AgDB to wholesale clients.</p>
<p>C. INSTITUTIONAL SUSTAINABILITY AND OUTREACH TO THE RURAL POOR: SUSTAINABLE RURAL FINANCIAL INSTITUTIONS PROVIDE FINANCIAL SERVICES TO THE RURAL POOR</p>
<p>9. Rural microfinance institutions are sustainable</p> <p>(1) Autonomy and flexibility are guaranteed in all operational matters within the institution's mandate</p> <p>(2) Strategic planning for sustainability is in place</p> <p>(3) Demand-driven financial products (microsavings, -credit, -insurance) are provided</p> <p>(4) Inflation- and subsidy-adjusted market rates of interest, with positive real returns for savers and lenders, are in place</p> <p>(5) Loan and instalment periods are appropriate</p> <p>(6) Prudential standards and good practices are internally enforced</p> <p>(7) Transaction costs are lowered</p> <p>(8) Operational efficiency is increased through performance-related staff incentives</p> <p>(9) Loan recovery is assured through incentives for timely repayment</p> <p>(10) Viability is maintained, covering all costs from the income</p> <p>(11) Profitability is increased (to finance expansion, to reward owners, to generate equity)</p> <p>(12) Self-reliance is attained through savings deposits, equity and retained earnings; plus borrowings in MFIs barred from deposit-taking</p> <p>(13) Access to banks and capital markets is provided and strengthened</p> <p>(14) Full financial self-sufficiency is maintained, covering costs and preserving the value of the capital</p> <p>(15) Risk management is adequate (regarding collateral and collateral substitutes; loan protection insurance; credit guarantees; provision for bad debts; incentives for on-time repayment; timely write-offs)</p> <p>(16) Insurance, as an instrument of borrower and loan protection, is provided</p> <p>(17) User information is improved; asymmetric information is reduced</p> <p>(18) Portfolio quality is adequate</p> <p>(19) As an instrument of internal control, the management information system is effective, with adequate accounting and reporting standards, and providing timely information and transparency to management and supervisory agencies</p> <p>(20) Annual audited balance sheets are produced</p> <p>(21) Access of the poor to timely and convenient microfinance services is enhanced</p> <p>(22) Cost-effective group technologies are available to the very poor and in marginal areas</p> <p>(23) Individual lending technologies are available to the poor and non-poor in high-potential areas</p> <p>(24) Well-trained human resources are available</p> <p>(25) Good governance is strengthened, with emphasis on combining ownership by the poor with professional management</p>

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<p>10. Good practices are identified through applied research and disseminated</p> <ul style="list-style-type: none"> (1) A network of national and regional rural finance institutions is operational (2) Action-oriented applied research is carried out, for example, on: <ul style="list-style-type: none"> (2.1) Innovations in agricultural credit (2.2) Innovations in rural microenterprise finance (2.3) Institutional innovations and good practices (2.4) Local (indigenous) institutional knowledge (2.5) Financial and non-financial services of local organizations, including water users' associations, farmers' organizations, local chapters of mass organizations, local administration (2.6) Financial innovations and special instruments for marginal and upland areas (2.7) Prerequisites and strategies for linking formal and informal finance (2.8) Strategies of upgrading informal financial institutions (2.9) Interlinkages of microfinance and agricultural markets (2.10) Strategies for combining outreach with institutional sustainability (2.11) Instruments of local resource mobilization (savings, equity, commercial and private borrowings) (2.12) Product and service innovations, including "doorstep" services (2.13) Appropriate loan and instalment periods (2.14) Marketing strategies and target groups (including products and services for women and the very poor) (2.15) Factors of institutional self-reliance and sustainability (2.16) Methods for lowering transaction costs (2.17) Risk management (2.18) Incentives for repayment, including timely repayment (2.19) Regulation and supervision of small, medium and large MFIs; bank linkages and wholesaling (2.20) Ownership and good governance incentives (3) Management information system and accounting software are tested and disseminated (4) Good practices are packaged and disseminated 	
<p>11. Domestic and external resources are mobilized for rural finance and for poverty alleviation</p> <ul style="list-style-type: none"> (1) Capacities for domestic resource mobilization are strengthened at all levels, including MFIs, AgDBs and low-income people (2) Domestic resources are mobilized by MFIs, including equity and retained earnings, savings deposits, private and commercial borrowings (3) External resources are mobilized to bridge resource and guarantee gaps and to strengthen the internal resource mobilization capacities of MFIs and apex funds (4) External resources are mobilized to substantially improve the income and production capacities of the poor and their use of local resources (5) External indebtedness of partner institutions and partner countries is prudently supervised 	
<p>D. REGULATION AND SUPERVISION: A CONDUCTIVE POLICY AND REGULATORY FRAMEWORK IS OPERATIONAL</p>	
<p>12. A conducive policy and legal framework is operational</p> <ul style="list-style-type: none"> (1) A conducive political economy is in place (2) A conducive macroeconomic framework is operational, comprising: <ul style="list-style-type: none"> (2.1) Macroeconomic stability (2.2) Foreign exchange deregulation (2.3) Liberalization of external and internal trade, including agricultural price liberalization (2.4) Liberalization of interest rates and easing of terms for establishing financial institutions and branches (3) A conducive legal framework is established, comprising: <ul style="list-style-type: none"> (3.1) The provision of different legal forms for regulated rural financial institutions, including financial cooperatives, other user-owned institutions, and privately - or community-owned rural banks (3.2) The provision of appropriate forms of registration and legal recognition for privately - and user-owned non-regulated institutions (3.3) A judicial system for protecting property rights, land-use rights of the poor and due legal process (3.4) Legal guarantees for the autonomy of financial institutions, including the central bank and AgDBs 	

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13. An effective system of prudential regulation and supervision of rural finance institutions is operational

- (1) Responsibilities are assigned, an overall coordinating body is operational, and a microfinance unit is established in the central bank or bank superintendency
- (2) MFIs have autonomy in setting the terms of financial contracts, including interest rates
- (3) An appropriate legal framework for MFIs is established, with suitable cooperative and non-cooperative legal forms, including local private banks and community banks
- (4) A regulatory framework, with appropriate prudential norms for various types of MFIs, is established
- (5) A system of effective supervision of MFIs, including financial cooperatives, is established, comprising a national first-tier authority and network-level second-tier authorities for the auditing and enforcement of prudential norms
- (6) A system of effective regulation and supervision is established for AgDBs and other DFIs, commercial banks and non-bank financial institutions, including rural and microfinance operations
- (7) The financial health of cooperatives, other MFIs and AgDBs is protected against inappropriate loan channeling and targeting
- (8) Regulatory and supervisory agencies are institutionally strengthened
- (9) An incentives-driven system of voluntary registration for unregulated MFIs, with opportunities for upgrading to higher levels of regulation and legal form, is established (cf. V)
- (10) Policy dialogues on regulation and supervision effectively include MFIs and representatives of the poor
- (11) In non-conducive environments, policy dialogue and informal beginnings of regulation and supervision are supported

14. IFAD's projects with financial service components are adequately supervised

- (1) Partner banks and their projects with IFAD are adequately supervised
- (2) The health of partner banks is strengthened by IFAD's supervision
- (3) Ground rules of viable and sustainable microfinance systems are observed as conditionalities in all projects with rural and microfinance components as first or second-order activities
- (4) Credit lines for end-users (as last-resort resources) are monitored and evaluated in terms of disbursement, institutional impact, effect on domestic and local resource mobilization, and impact on productive capacity and income enhancement of the poor
- (5) Achievement of objectives and conditionalities is supervised in a phased time perspective
- (6) Impact finance evaluations are carried out on:
 - Rural finance and microfinance subsectors;
 - MFIs, MFI networks and their central services;
 - AgDBs and other bank partners;
 - Strategic approaches;
 - User-oriented quality of rural finance services; and
 - User households and their income-generating activities
- (7) Results of impact studies are fed back into project implementation
- (8) Results are stored in IFAD's institutional memory and made accessible to the public
- (9) Project supervision is improved through evaluation research by IFAD's Office of Evaluation and Studies and independent institutes.

Appendixes

IFAD'S ACTIVE PORTFOLIO OF PROJECTS WITH RURAL FINANCE COMPONENTS, DECEMBER 1999 (in USD million)

West and Central Africa

COUNTRY	PROJECT NAME	IFAD MICROFINANCE	
		IFAD LOAN	COMPONENT
Benin	Income-Generating Activities Project	12.0	4.0
Benin	Microfinance and Marketing Project	12.2	5.7
Burkina Faso	Special Programme for Soil and Water Conservation - Phase II	17.5	1.5
Burkina Faso	South West Rural Development Project	14.8	1.3
Burkina Faso	Rural Microenterprise Support Project	9.4	1.2
Cameroon	National Microfinance Programme Support Project	11.0	11.0
Cape Verde	Rural Poverty Alleviation Programme	9.3	3.7
CAR	Savannah Food Crops Rural Development Project	11.5	1.4
CAR	Livestock Development and Rangeland Management Project	4.9	1.5
Côte d'Ivoire	Rural Development Project in the Zanzan Region	11.1	1.1
Côte d'Ivoire	National Agricultural Services Restructuring Project	9.8	2.8
Côte d'Ivoire	Marketing and Local Initiatives Support Project	10.4	1.5
Equatorial Guinea	Peasant Production and Marketing Promotion Project	4.4	0.3
Gambia, The	Rural Finance and Community Initiatives Project	9.2	5.1
Ghana	Rural Enterprises Project	7.7	2.2
Ghana	Upper West Agricultural Development Project	10.1	2.0
Ghana	Upper-East Region Land Conservation and Smallholder Rehabilitation Project	11.5	2.2
Guinea	Smallholder Development Project in the Forest Region	13.8	2.4
Guinea	Fouta Djallon Local Development and Agricultural Rehabilitation Programme	10.0	1.2
Guinea	Village Communities Support Project	7.0	1.1
Guinea	Programme for Participatory Rural Development in Haute-Guinée	14.0	2.5
Mali	Zone Lacustre Development Project – Phase II	12.7	1.8
Mali	Income Diversification Programme in the Mali Sud Area	15.0	5.9
Mali	Sahelian Areas Development Fund Programme	22.0	2.2
Mauritania	Maghama Improved Flood Recession Farming Project	10.9	0.7
Mauritania	Oasis Development Project – Phase II	7.8	2.6
Niger	Special Country Programme – Phase II	14.9	1.2
Nigeria	Sokoto State Agricultural and Community Development Project	9.6	2.2
Senegal	Rural Micro-enterprises Project	7.3	1.1
Sierra Leone	North-central Agricultural Development Project	14.7	2.2
Togo	Village Organization and Development Project	7.6	1.5
Togo	National Agricultural Services Support Project	10.0	0.3
	Total projects for Western and Central Africa	354.1	77.4

¹ Source: Project and Portfolio Management System (PPMS) "Project Financial Progress: Planned vs. actual (column: sub-component type = credit + rural financial services). Where no data available in PPMS, source is the relevant Report and Recommendation of the President.

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East and Southern Africa

COUNTRY	PROJECT NAME	IFAD MICROFINANCE	
		IFAD LOAN	COMPONENT
Burundi	Bututsi Agro-Pastoral Development Project	9.0	4.00
Burundi	Rural Recovery and Development Programme	20.0	0.80
Comoros	Support to Economic Grass Roots Initiatives Project	3.5	1.10
Ethiopia	Southern Region Cooperatives Development & Credit Project	17.5	8.30
Kenya	Western Kenya District-based Agricultural Development Project	6.2	0.30
Lesotho	Rural Finance and Enterprise Support Project	4.0	0.05
Madagascar	North-East Agricultural Improvement & Development Project	11.7	0.60
Malawi	Rural Financial Services Project: Mudzi Financial Services Sub-project	12.0	12.00
Malawi	Smallholder Flood Plains Development Programme	12.5	1.50
Mauritius	Rural Diversification Programme	8.7	2.00
Mozambique	Nampula Artisanal Fisheries Project	6.0	2.00
Mozambique	Niassa Agricultural Development Project	12.4	0.40
Mozambique	PAMA Support Project	22.8	1.80
Rwanda	Byumba Agricultural Development Project - Phase II	8.7	2.00
Rwanda	Intensified Land Use Management Project in the Buberuka Highlands	9.5	0.60
Swaziland	Smallholder Agricultural Development Project	7.1	1.20
Tanzania, United Republic of	Agricultural and Environmental Management Project	14.8	3.30
Tanzania, United Republic of	Southern Highlands Extension and Rural Financial Services Project	15.8	5.90
Uganda	Vegetable Oil Development Project	19.9	7.40
Uganda	Smallholders Cotton Rehabilitation Project	10.0	2.50
Uganda	Cotton Sub-sector Development Project	12.5	9.80
Uganda	District Development Support Programme	12.6	3.00
Uganda	Area-Based Agricultural Modernization Programme	13.2	0.30
Zambia	Northwestern Province Area Development Project - Phase II	16.3	3.70
Zambia	Forest Resource Management Project	12.6	0.80
Zimbabwe	South Eastern Dry Areas Project	11.2	3.10
Total projects for Eastern and Southern Africa		310.5	78.45

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Asia and the Pacific

COUNTRY	PROJECT NAME	IFAD MICROFINANCE	
		IFAD LOAN	COMPONENT
Bangladesh	Netrakona Integrated Agricultural Production and Water Management Project	8.9	1.2
Bangladesh	Employment-Generation Project for the Rural Poor	14.8	14.8
Bangladesh	Agricultural Diversification and Intensification Project	18.9	5.1
Bangladesh	Smallholder Agricultural Improvement Project	18.6	1.8
Bhutan	Second Eastern Zone Agricultural Programme	9.5	1.0
Cambodia	Agricultural Development to Seila	8.6	1.3
China	Yunnan-Simao Minorities Area Agricultural Development Project	25.8	4.3
China	Quinghai/Hainan Prefecture Agricultural Development Project	20.0	17.5
China	Jiangxi/Ganzhou Integrated Agricultural Development Project	23.8	23.1
China	Northeast Sichuan and Qinghai/Haidong Integrated Agricultural Development	27.9	22.3
China	Southwest Anhui Integrated Agricultural Development Project	26.5	3.9
China	Wulin Mountains Minority-Areas Development Project	28.0	24.6
China	Qinling Mountain Area Poverty-Alleviation Project	28.0	18.4
India	Maharashtra Rural Credit Project	29.2	29.2
India	Andhra Pradesh Participatory Tribal Development Project	26.7	6.0
India	Rural Women's Development and Empowerment Project	19.2	0.4
India	North Eastern Region Community Resource Management Project for Upland Areas	22.9	1.2
India	Bihar-Madhya Pradesh Tribal Development Programme	23.0	2.1
Indonesia	Pembinaan Peningkatan Pendapatan Petani Kecil (P4K) - Phase III	24.9	24.9
Korea, D.P.R.	Crop and Livestock Rehabilitation Project	28.9	5.7
Kyrgyzstan	Agricultural Support Services Project	7.9	1.8
Laos	Northern Sayabouri Rural Development Project	7.3	0.6
Laos	Xieng Khouang Agricultural Development Project - Phase II	6.9	0.9
Maldives	Southern Atolls Development Project	2.9	1.5
Nepal	Poverty Alleviation Project in Western Terai	8.9	3.6
Nepal	Hills Leasehold Forestry and Forage Development Project	7.8	1.9
Pakistan	Barani Village Development Project	15.3	2.7
Philippines	Rural Micro-enterprise Finance Project	14.7	11.0
Philippines	Western Mindanao Community Initiatives Project	15.5	4.2
Sri Lanka	North-Central Province Participatory Rural Development Project	8.5	0.5
Sri Lanka	Matale Regional Economic Advancement Project	11.7	3.0
Viet Nam	Participatory Resource Management Project - Tuyen Quang Province	18.4	5.3
Viet Nam	Agricultural Resources Conservation and Development Project in Quang Binh Province	14.4	4.2
Viet Nam	Ha Tinh Rural Development Project	15.4	2.5
Viet Nam	Ha Giang Development Project for Ethnic Minorities	12.5	0.7
	Total projects for Asia and the Pacific	602.2	253.2

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Near East and North Africa

COUNTRY	PROJECT NAME	IFAD MICROFINANCE	
		IFAD LOAN	COMPONENT
Albania	Northeastern Districts Rural Development Project	11.6	4.3
Albania	Small-scale Irrigation Rehabilitation Project	9.0	1.8
Albania	Mountain Areas Development Programme	13.2	2.4
Armenia	North-west Agricultural Services Project	13.0	4.5
Azerbaijan	Farm Privatization Project	9.3	5.9
Egypt	Newlands Agricultural Services Project	22.1	16.5
Egypt	Agricultural Production Intensification Project	20.2	11.9
Egypt	East Delta Newlands Agricultural Services Project	25.0	12.4
Egypt	Sohag Rural Development Project	25.0	9.7
Georgia	Agricultural Development Project	6.6	4.6
Jordan	Income Diversification Project	10.0	5.4
Jordan	Agricultural Resource Management Project in the Governorates of Karak and Tafilat	12.8	0.4
Jordan	Yarmouk Agricultural Resources Development Project	10.1	4.4
Lebanon	Smallholder Livestock Rehabilitation Project	10.0	4.9
Macedonia	Southern and Eastern Regions Rural Rehabilitation Project	8.1	7.5
Moldova	Rural Finance and Small Enterprise Development Project	8.0	8.0
Romania	Apuseni Development Project	16.5	16.0
Sudan	Southern Roseires Agricultural Development Project	10.4	3.5
Sudan	White Nile Agricultural Services Project	10.7	2.0
Sudan	North Kordofan Rural Development Project	10.5	3.0
Tunisia	Sidi M'Hadheb Agricultural and Fisheries Development Project	11.9	0.6
Yemen	Southern Governorates Rural Development Project	11.3	5.7
Yemen	Raymah Area Development Project	12.1	3.0
Yemen	Al-Mahara Community Development Project	12.3	2.0
	Total projects for Near East and North Africa	309.7	140.4

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Latin America and the Caribbean

COUNTRY	PROJECT NAME	IFAD MICROFINANCE	
		IFAD LOAN	COMPONENT
Argentina	Rural Development Project for the Northeastern Provinces	16.5	9.5
Argentina	North Western Rural Development Project (PRODERNOA)	17.5	6.0
Belize	Community-Initiated Agriculture and Resource Management	2.3	0.6
Bolivia	Camelid Producers Development Project in the Andean High Plateau	7.6	3.1
Bolivia	Sustainable Development Project by Beni Indigenous People	6.3	1.1
Brazil	Low-Income Family Support Project in the Semi-arid Region of Segipe State	18.0	3.4
Brazil	Community Development Project for the Rio Gaviao Region	20.1	1.7
Brazil	Sustainable Development Project for Agrarian Reform Settlements in the Semi- Arid North-East	25.0	0.6
Chile	Agricultural Development Project for Peasant Communities and Smallholders of the IVth Region	12.2	3.6
Colombia	Rural Micro-enterprise Development Programme	16.0	5.7
Dominica	Rural Enterprise Project	2.6	0.5
Dominican Rep.	South Western Region Small Farmers Project - Phase II	12.0	1.4
Ecuador	Indigenous and Afro-Ecuadorian Peoples' Development Project	15.0	7.5
El Salvador	Rehabilitation and Development Project for War-torn Areas in the Department of Chalatenango	13.0	3.3
El Salvador	Rural Development Project for the North-Eastern Region (PRODERNOR)	18.0	3.3
El Salvador	Rural Development Project for the Central Region (PRODAP II)	11.7	1.0
Guatemala	Cuchumatanes Highlands Rural Development Project	7.5	2.7
Guatemala	Programme for Rural Development and Reconstruction in the Quiche Department	15.0	1.7
Guatemala	Rural Development Programme for Las Verapaces	15.0	1.2
Guyana	Poor Rural Communities Support Services Project	10.5	2.5
Haiti	Small-scale Irrigation Schemes Rehabilitation Project	10.6	0.6
Haiti	Food Crops Intensification Project - Phase II	15.4	3.8
Honduras	Agricultural Development Programme for the Western Region	7.7	2.2
Honduras	Rural Development in the Central Eastern Region	12.3	3.3
Honduras	Rural Development Project in the South-Western Region	19.3	1.0
Mexico	Development Project for Marginal Rural Communities in the Ixtlera Region	30.0	9.6
Mexico	Rural Development Project for the Indigenous Communities of the State of Puebla	25.0	11.0
Mexico	Rural Development Project of the Mayan Communities in the Yucatan Peninsula	10.4	6.7
Nicaragua	Project for the Capitalization of Small Farmers in the Tropisec Area of the Segovias – Region I	11.4	8.4
Nicaragua	Rural Development Project for the Southern Pacific Dry Region	12.2	9.3
Panama	Rural Development Project for Ngobe Communities	7.9	2.7
Panama	Sustainable Rural Development Project in the Provinces of Coclé, Colón and Panama	12.2	2.7
Paraguay	Peasant Development Fund Credit Project - Eastern Region of Paraguay	10.0	7.7
Peru	Development of the Puno-Cusco Corridor Project	18.9	4.5
Saint Lucia	Rural Enterprise Project	2.2	0.4
St. Vincent-Grenadines	Smallholder Crop Improvement and Marketing Project	2.2	0.5
Uruguay	National Smallholder Support Project	11.7	6.8
Venezuela	Economic Development of Poor Rural Communities Project	12.0	6.3
Total Projects for Latin America and the Caribbean		493.2	147.9
Grand Total of Projects		2 067.0	697.4

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THE EXPERIENCE OF IFAD AND OTHER DONORS: SELECTED CASES

Box 1

El Salvador: Transforming rural financial services

In Latin America and the Caribbean, IFAD's interventions are in a state of rapid transition. From 1990 to 1999, the Smallholders' Agricultural Development Project in El Salvador has provided credit as part of a technical assistance package for agricultural and rural production and diversification. A trust fund was set up in Banco de Fomento Agropecuario (BFA), which assumed the full credit risk. Credit assessment was left to the project's agricultural extension agents, without a mechanism for effective loan recovery, which was further affected by loan forgiveness for ex-combatants. Together with incentives for quantitative disbursement, this resulted in both, high disbursement and default rates.

PRODAP-II builds upon this experience. Its objective is to promote a broad range of financial services for poor households, including savings, credit, insurance, transfers of remittances and currency exchange. The new strategy is based on the promotion of competition among various financial intermediaries that cater to different market segments; the strengthening of the selected institutions; the separation of financial and non-financial functions between BFA and project staff; and the introduction of incentives for timely loan repayment.

The poor need both financial services and non-financial inputs. However, the institutions and staff providing them need to be separated: technical inputs should be in the hands of extension agents, banking in the hands of bankers.

Box 2

Benin: FSAs, an equity-based financial innovation

Building on traditions of self-help and informal finance, IFAD took a bold step in Africa when it introduced a new type of institution: FSAs, which are self-financed and self-managed. In Benin, The Congo, Gabon, FSAs, Guinea and Mauritania mobilize local resources in the form of equity. Members with investment opportunities may take short-term loans for which they pay rural market rates of interest agreed upon by the shareholders. Dividends are paid annually from the profits, according to the size of the investment. In addition, withdrawable savings are accepted for safekeeping. However, these savings are not remunerated and they cannot be used as loanable funds.

In Benin, SYFIPRO (Système financier de Proximité), a local NGO, acts as a facilitator for the FSAs and prepares other NGOs for the task. During the one-and-a-half year period from November 1997 to April 1999, 20 FSAs started business, membership grew from 2800 to 5000, and paid-up equity increased from USD 27 000 to USD 75 000. About half the shareholders are also borrowers; while the other half are only investors – not everyone requires credit! Thirty-two per cent of the borrowers and shareholders are women, holding 18% of the share capital.

The FSAs are still in an experimental stage. Over 200 FSAs are expected to start operating within the next five years, with their own business associations and apex services for training, auditing, liquidity exchange and bank linkages. Legal recognition, perhaps as private rural banks or finance companies, and self-regulation are among the issues that the associations might deal with.

The experience with FSAs in Africa is yet another example of how the rural poor can mobilize their own resources locally and establish sustainable local financial institutions owned and managed by the poor.

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Box 3

Honduras: Rural savings banks (*cajas rurales*) for the landless poor

Many of the very poor indigenous people in the marginal areas of Honduras own no land and have only limited use for credit. Living in small rural towns, they are more concerned with placing part of their meagre income from wage labour in a secure place and eventually using their accumulated savings for consumption smoothing or some income-generating activities. In response, the national indigenous organization, Lenca, requested help from the management of the PLANDERO to set up small rural savings banks. There are now 132 *cajas*, registered as semi-formal financial institutions under the association law, serving some 2750 families, i.e. approximately 20 families per bank.

This indigenous initiative has opened up new avenues of support by PLANDERO. The project, which was funded by IFAD, has helped set up a small technical unit in Lenca and has trained three people in each *caja*. This, in turn, has created an atmosphere of communication in which the newly-trained are now planning the consolidation of their young financial institutions and the establishment of financial apex organizations at both the municipal and the departmental level.

Responding to local indigenous initiatives, PLANDERO, an agricultural development project, has learned a new lesson: rather than just credit, many of the very poor in marginal areas need savings-deposit facilities for the self-financing of non-agricultural activities,.

Box 4

Albania, Macedonia and Armenia: Rural financial services in transitional economies

IFAD has supported the development of rural financial services in Albania (Northeastern Districts Rural Development Project), Armenia (North-West Agricultural Services Project) and Macedonia (Southern and Eastern Regions Rural Rehabilitation Project), which are at different stages in developing individual farming and private-sector banking. The principal lessons for effective credit delivery are that:

- (a) The credit component must have a clear concept, of which the cooperative village credit funds in Albania may serve as a model case. Their success is due to the fact that it is a simple operation, readily understood by members and field staff alike, with standard procedures that can be easily implemented. Deviations from its simple design have run into problems.
- (b) Organizational and administrative components must be pilot-tested and prove their effectiveness anew at each stage of implementation.
- (c) Few donors have been able to develop successful wholesale or retail credit mechanisms for improved agricultural and livestock production. The availability of credit for production, moving beyond the establishment of social credit mechanisms, should continue to be one of IFAD's concerns.
- (d) The technical specifications for IFAD-financed credit operations lack a consistent approach. While it is important for the design to meet local needs, there are requirements which are common for all categories of credit development. These concern accounting specifications, legal and financial requirements, and key monitoring and management information systems.

When banks are involved in the delivery of rural financial services for IFAD-financed credit lines, a due-diligence assessment is required, together with guidelines for effective supervision.

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Box 5

Indonesia: Self-initiated transition to self-reliance in P4K

IFAD has supported P4K, a credit project which effectively targets the very poor, since 1989. Field extension workers in the Ministry of Agriculture receive special training and financial incentives to identify the poor, organize them into solidarity groups of ten, and help them prepare business plans. Through standardized repeat loans of increasing size, credit is channeled by the government-owned BRI through its district-level branch network. BRI enforces timely repayment by cutting off the supply of credit to villages and sub-districts when arrears go above 5%. By mid-1998, two risks, diagnosed five years earlier, had materialized: one deriving from incentives to extension workers geared to group establishment rather than group quality; and the other due to BRI's limited interest in government credit projects, which it found riskier, more restricted in outreach and less profitable than its own savings and credit scheme at the village unit level. Of the 49 917 small groups formed, only 70% had deposited compulsory group savings and only 32% had loans outstanding. Of the latter, 42.5% had arrears amounting to 23.4% of the outstanding portfolio.

Almost from the outset, many of the participants in various parts of the country found the project's terms of standardized group size and financial contracts too limiting, credit application procedures too cumbersome, and actual access to credit unpredictable. By mid-1998, some 9 000 groups had carried the group formation approach one step further and established a total of 1 805 informal associations. Membership size ranges from about 30 to 300 per association, which is more in line with the traditional practices of group formation than a standard size of ten.

Women have been among the prime movers. The associations, whose resources are entirely internal, mobilize voluntary savings, give short-term loans without delay and at conditions set by the participants, and charge interest rates geared to the rapid growth of their loan fund. Saver and borrower transaction costs are minimal. Rescheduling is frequent, but defaulting is rare. The project's well-functioning monthly monitoring system now records the number of associations, but not their financial activities. After the deregulation of the cooperative sector in 1998, some of the associations are now registering as savings and credit cooperatives. This makes them officially recognized financial institutions and opens up new opportunities for institutional enhancement, financial deepening and increased outreach to the poor.

In this project, important lessons have been learned by the users:

- Only self-reliance guarantees sustained and timely access to financial services.
- Formal cooperative status is stifling and therefore avoided under a repressive regulatory regime in which the government uses cooperatives for its own purposes. But under a more liberal regime, the protection of the law may be useful and provide new avenues for the growth of self-organized financial services.

Box 6

Cameroon: Stakeholders develop a national system of rural finance and microfinance

In Cameroon, where IFAD's lending was interrupted for several years, the Fund is now involved in a process of intense interaction with various government agencies, networks of rural financial institutions, NGOs representing the poor, and donors. Together, they are designing a comprehensive national programme for the development of rural finance and microfinance. This comprises MFI regulations and supervision, the expansion of networks of formal and informal MFIs, and the establishment of central network services for MFIs. Such services may include training, consultancy, auditing, liquidity exchange, refinancing and interest articulation, and the collection and dissemination of appropriate savings and credit products with outreach to the poor. Similar programmes are under preparation in Ghana and Niger.

There are two special aspects to be noted here:

- One is the quality of the participatory process, which rests with the experts from the participating institutions and includes donor coordination.
- The other is a systems approach, geared to the development of the whole system of rural finance and microfinance in Cameroon with a long-term perspective.

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Box 7

Guatemala: Supporting growth and institutional diversity in rural finance

Over the last few years, access to financial services has considerably increased in the rural areas of Guatemala. When the civil strife ended, the macroeconomic environment improved markedly and provided a breeding ground for a diversity of rural financial institutions, among them savings and credit cooperatives, village banks (*bancos comunales*), credit NGOs, and a restructured, partly privatized agricultural development bank (Banco Rural). The latter has a two-pronged strategy of increasing outreach: microenterprise support, and apex lending to intermediaries closer to the grass-roots.

Most of these institutions have received donor support. There is still a bias in favour of credit lines, but increasing attention is given to institutional development. Two donor-supported credit NGOs are now operating on a self-sustaining basis and have applied to become regulated financial institutions: Genesis - a commercial bank, and ACT (*Asociación para la Cooperación Técnica*) - a finance company. With assistance from the World Credit Organization, the Federation of Savings and Credit Cooperatives has expanded its services to members. With support from CGAP, it is now in the process of establishing a self-regulatory system to uphold prudential standards and increase confidence in its banking operations. IFAD has been part of the effort to build up institutions, first with support to Fafidess in the Cuchumatanes Highlands Rural Development project and now, in the Rural Development for Las Verapaces Programme, with a portfolio of funding for the institutional development of a variety of institutions.

Despite these achievements, policy and regulatory shortfalls continue to jeopardize the healthy development of MFIs. On the one hand, MFIs are left in a legislative vacuum and the barriers to entry in the formal, regulated banking system are extremely high. On the other hand, legislation concerning the formal banking sector is recognized as deficient and has led to a lack of transparency. This in turn has resulted in a number of crises in the financial sector. Therefore, considerable scope remains for policy dialogue to be promoted by donors.

Box 8

Nepal: Transforming an unsustainable credit programme into viable financial institutions

Since 1975, ADBN has been building up its Small Farmer Development Project, a subsidized credit programme targeted at the poor. With assistance from IFAD, as the first major donor until 1992, farmers were organized into some 25 000 small groups (end-1998 data). With repayment rates of 39-54% since 1980 and a savings ratio consistently below 1%, plus high transaction costs, the programme was unsustainable and the growth of outreach to poor farmers remained restricted. However, the credit line to ADBN enabled poor farmers, including women, to build up a group structure. In the more liberal policy environment of the 1990s and with assistance from a bilateral donor, the German Agency for Technical Cooperation, ADBN has now embarked on positively responding to farmer initiatives. The groups under each subproject office are transformed into autonomous Small Farmer Cooperatives Ltd. (SFCLs), which mobilize savings and cover their own costs. The initial results have been spectacular: the repayment rate of channeled funds doubled; internal resource mobilization is progressing rapidly; and the repayment rate of loans from internal resources is almost 100%. By the end of 1998, 73 SFCLs had been established, comprising 6 083 small groups. Some groups are now receiving a limited banking licence, which allows them to further increase their outreach.

Two lessons derive from this experience:

- Through user-ownership and vigorous savings mobilization, unsustainable credit programmes can be transformed into networks of viable local financial intermediaries.
- As progress may build up only after policy changes have been made and several donor interventions, lessons can be drawn only if information is stored and reassessed in the institutional memory beyond the closing of a project.

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Box 9

United Republic of Tanzania: Reforming savings and credit cooperatives (SACCOs)

In thinly-populated rural areas of the United Republic of Tanzania, poverty is inextricably interwoven with the lack of financial services. The country's commercial banks are unwilling, and its development banks unable, to serve the rural poor. In this void, IFAD has supported the transformation of rural SACCOs from credit channels to autonomous, self-financed and self-managed institutions functioning like private rural banks. Starting on a pilot basis in the southern highlands in 1996, 192 SACCOs, comprising 23 000 members (February 1999) have actively participated. Among the accomplishments are annual increases of 70% in savings deposits; diversification of loan products to finance microenterprises in addition to agriculture, including petty trading by women; and, as a result, an increase in the membership of women to 40%. The repayment rate stands at 91%, which is a substantial achievement but still not satisfactory.

The impact of the reform within the local communities has been substantial. At the institutional level, credit is no longer treated as a mere agricultural input. Instead, it is one of several financial services provided by local financial institutions on the basis of demand and cost-effectiveness. By mobilizing their own resources, lowering their transaction costs and raising the repayment rate, the SACCOs have vigorously embarked on the road to sustainability. At the household level, a mix of agricultural and non-agricultural activities are being financed, partly from savings and partly through credit. With two- to three-fold yield increases of maize and Irish potatoes, this has tended to maximize food security and income. At the social level, the SACCOs have brought about fundamental changes within the community in terms of empowerment of the poor. Through access to financial services, ownership of the institutions and self-management of their operations, the poor have gained the necessary confidence and sense of commitment to participate actively in the running of their community and its institutions. Further assistance is needed to improve their commercial capacity and national coverage, their network's auditing and supervisory services, and their compliance with the prudential norms being developed by the central bank.

The poor in the upland areas of the United Republic of Tanzania have demonstrated that they are able to form their own self-help organizations and provide savings and credit services on a sustainable basis.

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Box 10

Bank for Agriculture and Agricultural Cooperatives (BAAC), Thailand: The gradual reformer

IFAD has examined BAAC's reform as part of an initiative with CGAP and the RACAs. BAAC's reform has been a perennial process guided by two objectives: outreach to all farm households as its political mandate; and financial viability.

BAAC has gone through four major phases of reform: 1966-74, laying the foundation for individual lending with joint liability; 1975-87, expanding its lending operations through access to commercial bank and donor funds while greatly reducing loan channeling through cooperatives; 1988-96, striving for viability and self-reliance under conditions of controlled interest rates, through savings mobilization, improved loan recovery and increased staff productivity; since 1997, adjusting to prudential regulation by the central bank and diversifying into non-agricultural lending.

Important elements in the reform process have been:

- Respect for the bank's operational autonomy on the part of the government.
- A corporate culture emphasizing cost-effectiveness, productivity and efficiency.
- Decentralization and expansion of branch networks operating as profit centres, reducing saver and borrower transaction costs and permitting cost-effective microsavings and microcredit transactions.
- Individual lending through joint liability groups as a financial technology attuned to Thai culture.
- Substantial improvements in portfolio quality, which created depositor confidence.
- A radical shift in the financial resource base to rural savings mobilization.
- Most recently, a diversification of its portfolio to include rural microenterprise lending.

Outreach and performance are impressive: as of end-1998, BAAC had served 4.8 million borrowers (86% of rural households) with USD 5.2 billion in loans outstanding and mobilized USD 4.1 billion in savings on USD 7.6 million deposit accounts. Capital adequacy was 9.3%; operational self-sufficiency, 228%; financial self-sufficiency, 98%; and self-reliance as measured by the loan-to-deposit ratio, 83%. Administrative costs were 3.1% of loans outstanding.

BAAC has demonstrated how gradual reform can be carried through under a repressive financial policy regime with ceilings on lending rates, directed credit, and mandated agricultural lending quotas. These restrictions enabled BAAC to expand, forced cost-efficiency upon its staff, and prepared the ground for deposit mobilization at a later stage. The reform agenda is still unfinished:

- With the emergence of private depositors as major stakeholders, ownership of BAAC stock needs to be diversified, with adequate representation of the new shareholders on the Board of BAAC.
- Lending rates need to be liberalized and realigned to reflect the true costs.
- BAAC needs a new, performance-related management information system which would enable field-level managers to track the performance of both savings and loans of a particular client.
- Performance-related staff incentives, presently under pilot testing, need to be implemented.

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Box 11

The Philippines: Are Grameen Bank replicators sustainable, and do they reach the poor?

The Grameen Bank in Bangladesh is known worldwide for its success in providing credit to the poor. IFAD was one of its first supporters. Subsequent replications in various countries were less successful. Evaluators of the Grameen replication programme in the Philippines found that while credit discipline was excellent, administrative costs were exorbitant and internal resource mobilization was minimal. Thus, outreach remained mostly insignificant. In 1996, the Agricultural Credit Policy Council – the programme’s executing agency - noted that “excessive brokering of low-cost funds may discourage savings mobilization... and that “... any attempt... to replicate or expand [the programme] should be carried out with great caution.”

CARD is one of a small number of replicators in the Philippines that have recently embarked on a path leading to sustainability and rapid growth of outreach. It is the only replicator that has turned into a formal-sector rural bank. During the five-and-a-half year period until June 1999, its outreach soared from 1 711 borrowers to 25 130, its operational self-sufficiency ratio increased from 0.46 to 1.09, and its repayment rate stood at 99.9% and its financial self-sufficiency ratio at 0.85. CARD provides savings deposit services to both poor and non-poor customers. It thus mobilizes the resources that have enabled it to substantially increase its outreach to poor women, who have remained the sole borrowers, in accordance with the Centre’s mandate.

CARD’s social capital is stated in its Operations Manual (1998) and disseminated through its training services. It consists of (a) a core of Grameen practices: high moral commitment on the part of the leaders, based on values instilled through training, peer control to preclude adverse selection and moral hazard, and strict credit discipline; and (b) innovative adaptations to the Philippine context: the adoption of rural bank status with the prudential norms imposed by the central bank, vigorous deposit mobilization, differentiated loan and insurance products that are profit-making, and a broadening of its outreach to both poor and non-poor clients.

The principal lesson is that a Grameen-type MFI can become sustainable and substantially increase its outreach through a core of good Grameen practices and innovative adaptations. Introducing effective self-regulation and supervision may greatly contribute to the sustainability and outreach of Grameen Bank replicators.

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Box 12

Bank Rakyat Indonesia (BRI): The agricultural development bank that revolutionized rural finance

BRI, the Fund's partner in P4K, bears witness to the fact that, in a deregulated policy environment, the microbanking division of an ailing government-owned AgDB can be transformed into a highly profitable, self-reliant financial intermediary. Since 1984, BRI has evolved into a major microfinance provider. Massive staff retraining in the new microbanking culture, together with its new financial services and incentive schemes, has been of crucial importance. Its 3 700 local units serve some 20 million savers and 2.5 million borrowers (December 1998). With non-targeted loans from USD 5 to USD 5 000 at rural market rates of interest and deposits of any (small) size, it reaches out to vast number of the poor and the non-poor. Making good use of a start-up liquidity injection, it has fully replaced external funds in terms of local savings since 1989.

The ultimate test came with the Asian financial crisis. When the Indonesian banking system collapsed, BRI's microbanking division remained profitable. At the peak of the crisis, June-August 1998, the local units attracted 1.29 million new savers during the three-month period. At the same time, demand for credit stagnated because of a lack of confidence in the future. By June 1999, the division's 12-month loss ratio had dropped to 1.5%, substantially below its already low, long-term loss ratio (1984-99) of 2.1%. Savings balances in the units now exceed loans outstanding by USD 1.8 billion, requiring new strategies to recycle them within the rural economy.

Numerous lessons can be drawn from BRI's experience:

- Financial sector policies work and create an environment conducive to financial innovations.
- With attractive savings and credit products, appropriate staff incentives and an effective system of internal regulation and supervision, rural microfinance can be profitable.
- The poor can save, and rural institutions can mobilize their savings cost-effectively.
- Without credit-biased incentives, the demand for savings deposit services exceeds the demand for credit by a wide margin.
- Incentives for timely repayment work.
- Transaction costs can be lowered, and outreach to the poor can be increased by catering for both the poor and the non-poor with their demands for widely differing deposit and loan sizes.
- Outreach to vast numbers of low-income people and financial self-sufficiency are compatible.
- AgDBs can be transformed into sustainable providers of microsavings and microcredit services.

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PERFORMANCE MEASUREMENT AND INTERNAL CONTROL OF MICROFINANCE INSTITUTIONS¹

1. SELECTED FINANCIAL SUSTAINABILITY RATIOS AND OUTREACH INDICATORS

Viability and sustainability are two interrelated key concepts for the measurement of MFI performance.

Viability. An organization is viable to the extent that it covers its costs from its operational income. Viability is measured by the operating self-sufficiency ratio:

□ Financial income/(financial costs + operating costs + loan loss provision).

Sustainability. An organization is sustainable to the extent that it covers its costs, preserves the value of its resources, and mobilizes its own, non-subsidized resources. Technically, it has two aspects:

(a) **Financial self-sufficiency.** Measured by the *financial self-sufficiency ratio*, it refers to the extent to which an institution not only covers its operational costs (= *viability*) but also preserves the value of its resources by accounting for subsidies and the effects of inflation:

□ Financial Income/(financial costs + operating costs + loan loss provision + imputed cost of capital).

(b) **Self-reliance.** Measured by the *internal resources ratio*, it refers to the extent to which an organization mobilizes its own financial resources internally instead of depending on government or donor funding²:

□ (Non-donated equity + retained earnings + deposits)/total assets.

The converse of self-reliance are donor and subsidy dependency:

(a) **Donor dependency.** In donor-driven MFIs, the *donations ratio* may be used:

□ Donated equity/total equity,
with due inflation adjustments for donations/grants received in different years.

¹ Comments on this section by Richard Rosenberg (CGAP) are gratefully acknowledged. Financial institutions need standards, which are not immutable. The standards proposed here are guideposts that may serve as a basis for further discussion within networks of MFIs. For an overview, see: The SEEP Network, *Financial Ratio Analysis of Micro-Finance Institutions*. PACT, New York 1995. For in-depth presentations see: R.P. Christen, *Banking Services for the Poor: Managing for Financial Success*. Accion International, Washington DC 1997; UNDP, Microstart. UNDP, New York 1997; T. Sheldon & C. Waterfield, *Business Planning and Financial Modeling for Microfinance Institutions*. Technical Tool Series No. 2. CGAP, Washington DC 1998. The *internal resources ratio* and the *donations ratio* are new.

² A variant is the *domestic resources ratio*, which includes domestic commercial borrowings in the numerator:
□ (Non-donated Equity + Retained Earnings + Deposits + Commercial Borrowings)/Total Assets.

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(b) Yaron's subsidy dependence index (SDI).³ The percentage change in the yield on the portfolio (mainly the on-lending interest rate) needed to compensate for existing subsidies (0 = full self-sustainability):

- ❑ Annual subsidy received/average outstanding loan portfolio * weighted average on-lending interest rate

Profitability. In the current debate, there is a tendency to associate the term microfinance with donor support and dependency; and microbanking with self-reliant institutions. This is paralleled by a shift from sustainability to profitability indicators:

Return on Assets (RoA):

- ❑ Net income/average total assets

Return on Equity (RoE):

- ❑ Net income/average total equity

Equity Multiplier:

- ❑ Average total assets/average total equity

Leverage is the factor by which an organization can multiply its own capital, expressed by the debt-equity ratio:

Debt-equity ratio:

- ❑ Total liabilities/total equity

Selected outreach indicators:

(Absolute numbers or amounts and annual growth rates):

- ❑ Number of branches
- ❑ Number of staff
- ❑ Number of clients
- ❑ Percentage of female clients
- ❑ Percentage of rural clients
- ❑ Number of borrowers (or loan accounts)
- ❑ Number of savers (or savings accounts)
- ❑ Loan portfolio
- ❑ Savings (including member shares) balances
- ❑ Average loan size (also a proxy for income level)
- ❑ Average savings balance

³ For a presentation of the full formula see: Jacob Yaron, *Successful Rural Finance Institutions*. World Bank Discussion Paper No. 150 (1992); *Assessing Development Finance Institutions: A Public Interest Analysis*. World Bank Discussion Paper No. 174 (1992); Mark Schreiner and Jacob Yaron, *The Subsidy Dependence Index and Recent Attempts to Adjust It*. Savings and Development (Milan) Vol. 23 No. 4 (1999), pp. 375-406.

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2. SELECTED PORTFOLIO QUALITY RATIOS

A note of caution: Portfolio quality ratios are not universally recognized. They can only be interpreted if their exact mode of calculation is known, and relied on if based on audited balance sheet data. Their definition may change over time, as in the case of the arrears ratio. Many institutions do not reveal their formula and underlying practices. Ratios can be used to mislead the reader. The obfuscation may start with the withholding of information on the size of the portfolio. For example, an institution may report cumulative disbursements (over an undefined period, or from the very start of lending operations) or disbursements during a given year, but conceal the perhaps much smaller amount of loans outstanding at the end of that year. It may choose a time of reporting just before major payments fall due. It may define arrears as payments overdue one month or more (instead of one day). To keep its arrears ratio low, it may calculate it in terms of loans outstanding instead of payments due. If the ratio is calculated in terms of loans outstanding, the assessment of an institution's performance may be unduly positive or negative. For example, the institution may report a substantial improvement in repayment performance from one year to the next, but conceal that its portfolio has been substantially increased through an injection of fresh money, which has not yet fallen due. Conversely, a rapidly shrinking portfolio (perhaps due to the drying up of on-lending funds) may lead to a drastic increase in an arrears ratio calculated in terms of loans outstanding even if repayment behaviour remains unchanged.

Issues that need to be clarified when interpreting balance sheet data and performance ratios include an organization's write-off policy and its accounting technique:

- accrual accounting (recording income and expenditure as they fall due), in which case the cut-off period of interest and penalty accrual needs to be identified; vs.
- cash accounting (recording of actual receipts and payments).

Of the following measures, the repayment rate and the portfolio-in arrears ratio are widely used and therefore explained here; but they are not recommended for further use.

Arrears ratio (on a given date):

- Payments overdue/payments due

Payments may include principal, fees, interest, penalties, incentives.

Repayment rate:

- $\text{Repayment} \times 100 / (\text{repayment} + \text{payments overdue})$

Portfolio-in-arrears ratio:

- Payments overdue/loans outstanding

Loan loss ratio:

- Payments declared unrecoverable or written off/average loan portfolio

Depending on the time period covered, there is a long-term loss ratio (since the start of an organization or a lending programme), a 12-month loss ratio, or a one-month loss ratio.

Portfolio-at-risk ratio:

- Outstanding balance of loans with late payments/loans outstanding
(to be further differentiated by loan classification according to aging of arrears)

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3. PERFORMANCE INDICATORS AND BENCHMARKS

Performance criteria	Indicator	Performance Standard
Capital adequacy	1. Capital adequacy ratio (depending on size: lower in big organizations)	Min. 20%
	2. Loan loss reserve adequacy	100%
Portfolio quality	3. Portfolio at risk (PAR) (applied to 31- or 91-days PAR)	max. 10%
	4. Loan loss ratio	max. 4%
Profitability	5. Return on assets (subsidy-adjusted)	min. 2%
Cost efficiency	6. Operating self-sufficiency ratio	min. 120%
Financial self-sustainability	7. Financial self-sufficiency ratio 8. Subsidy dependency index	min. 100% max. 0%
Productivity	9. Average number of daily transactions/teller 10. Number of active clients/Operational officer	[no standard benchmarks]
Outreach *	11. No. of delivery units (branches, sub-branches) 12. No. of savers or savings accounts 13. Average savings balance 14. No. of borrowers or loan accounts 15. Average loan size	[no standard benchmarks]

* No standard benchmarks are given for outreach, as a small number of large institutions are not inherently superior to a large number of small institutions. What matters is the overall outreach of all institutions in an area or country to the rural poor.

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4. CGAP DISCLOSURE GUIDELINES FOR MFI FINANCIAL STATEMENTS (adapted draft)

CGAP has submitted to its donor members a draft of disclosure guidelines on MFI financial statements for their review and adoption. It is being proposed to donor members to require compliance with the guidelines from all the financial institutions they support; or at least to require them to state whether they are CGAP-compliant or not. The guidelines do not include accounting standards and are not a complete template for MFI reporting.

1. Contents of financial statements

- 1.1 Financial statements include a balance sheet, income statement and notes to financial statements.
- 1.2 A cash flow statement is desirable, but not required.

2. Prior years' information

- 2.1 Financial information for the current year and the previous year are shown in parallel columns.
- 2.2 Inclusion of additional prior years is recommended, but not required.

3. Segment reporting for multi-service organizations⁴

- 3.1 Multi-service organizations provide a consolidated financial statement and a separate income statement for its microfinance business, with information on how shared costs or revenues are allocated.
- 3.2 Additional, unconsolidated financial statements for its non-financial services are desirable.

4. Loan portfolio information

- 4.1 Loan loss reserves are shown in the balance sheet.
- 4.2 Loan loss provision expenses are shown in the income statement.
- 4.3 Loan provisioning and write-off policies are explained in a note.
- 4.4 Movements in loan loss reserve, (loan loss provisions and write-offs) shown are shown in a note.

5. Unpaid interest on non-performing loans (if applicable)

- 5.1 If unpaid interest is accrued, the accrual policy, including cut-off-in-time point, is explained in a note.
- 5.2 If unpaid interest is capitalized, the capitalization policy is explained in a note.

6. Capital account

- 6.1 Shareholder or founder capital registers statutory capital (required by law), share capital and other classes of shareholder or founder capital.
- 6.2 The cumulative total of donations is broken down between prior years and the current year.
- 6.3 Retained operating earnings or losses are broken down between prior years and the current year.

7. Donations

- 7.1 Operating profit or loss is shown as interest and fee income from normal operations (excluding donations), minus expenses of operations.

⁴ CGAP, Cost Allocation for Multi-Service Micro-Finance Institutions. CGAP Occasional Paper No. 2

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- 7.2 Donations (if included in the income statement) are separated out “below the line” as non-operating income.
- 7.3 The source and the amount of the current year’s donations, and their entry in the income statement or their direct recording to the balance sheet, are disclosed in a note.
- 7.4 In-kind subsidies are identified and their imputed value to the MFI is estimated and are also disclosed in a note.

8. Types of liabilities

- 8.1 Commercial (institutional) borrowings
- 8.2 Private (individual) borrowings
- 8.3 Soft loans
- 8.4 Demand deposits
- 8.5 Passbook savings
- 8.6 Fixed deposits
- 8.7 Compulsory deposits
- 8.8 Other savings
- 8.9 Ties between savings and loans are described in a note.

9. Information on main types of liabilities (>10% of total liabilities)

- 9.1 Source
- 9.2 Terms (amount, maturity, grace period, instalment schedule, interest rate, timely repayment incentives)
- 9.3 Collateral, guarantee, joint liability and other risk management practices
- 9.4 Average outstanding principal balance (calculated on a monthly or quarterly basis)
- 9.5 Interest falling due during the year (including cash payments and accruals)

10. Currency mismatch

- 10.1 Assets and liabilities in different currencies are separated out.
- 10.2 Details of any currency mismatch (e.g. loans denominated in local currency against liabilities payable in foreign currency) are disclosed.
- 10.3 Policies used to measure and manage any currency mismatch are indicated.

11. Other significant accounting policies

- 11.1 Accrual vs. cash accounting practices are explained.
- 11.2 Methods (if any) of depreciating fixed assets are described
- 11.3 Methods of providing for the effects of inflation on the MFI’s capital and overall financial situation are described.

12. Audits

- 12.1 There are annual external audits of an MFI’s financial statement.
- 12.2 The auditor states whether financial statement comply with the CGAP disclosure guidelines.

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IFAD WORKING PAPERS IN RURAL FINANCE¹

A. Strategy papers

- A1: IFAD's Rural Finance Policy (Draft)
- A2: Challenges, Opportunities and Options for the Development of Rural Financial Institutions
- A3: Microfinance Strategies: Strategies for Developing Viable Microfinance Institutions with Sustainable Services - The Asian experience
- A4: Informal Finance: Origins, Evolutionary Trends and Donor Options
- A5: Outreach and Sustainability of Rural Microfinance in Asia: Observations and Recommendations
- A6a: Transforming Rural Finance in Africa: The Role of AFRACA in Linkage Banking and Financial Systems Development
- A6b: Transformer les Finances Rurales en Afrique: Le rôle d'AFRACA et le couplage des opérations bancaires et le développement des systèmes financiers
- A7: Agricultural Development Banks: Close them or Reform them?

B. Case and country studies

- B1: Are Grameen Replicators Sustainable, and Do They Reach the Poor? The Case of CARD Rural Bank in The Philippines
- B2: Attaining Outreach with Sustainability: A Case Study of a Private Microfinance Institution in Indonesia
- B3: Microfinance in Laos: A Case for Women's Banking?
- B4: From Informal to Formal Finances: The Transformation of an Indigenous Institution in Nepal
- B5: How an Agricultural Development Bank Revolutionized Rural Finance: The Case of Bank Rakyat Indonesia
- B6: Agricultural Development Bank Reform: the Case of BAAC, Thailand
- B7: Microfinance in Nepal - Determinants of Viability, Sustainability and Outreach among Grameen, NGO, and Cooperative Microfinance Institutions
- B8: Microfinance in the Philippines: A Social Capital Perspective
- B9: Financial Service Associations: A Microfinance Innovation in Benin
- B10: Rural Finance in Ghana

C. Tools and instruments

- C1: Developing a System of Rural Finance for the Poor: A Logical Framework of Key Challenges, Strategic Opportunities and Options
- C2: Performance Measurement and Internal Control of Microfinance Institutions
- C3: Direct supervision of IFAD Projects and Credit Institutions

¹ Available from IFAD's Technical Advisory Division (Y.Diethelm@ifad.org).