HANDBOOK OF AGRICULTURAL CREDIT INSTITUTIONS

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Abstract

This handbook has been produced to assist agricultural staff in understanding credit institutions and is particularly useful for those staff with limited exposure to agricultural credit. It is set out in a manner that will aid its use as a reference and emphasizes those topics on which staff had most interest. Its author has had many years experience both in the World Bank and in operation credit institutions in developing countries.

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The views and interpretations in this document are those of the author and should not be attributed to the World Bank, to its affiliated organizations or to any individual acting in their behalf.

Agriculture and Rural Development Department
Central Projects Staff
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I. INTRODUCTION

1.01 This "handbook" does not pretend to be exhaustive, and it is not intended to prescribe the details required for the presentation of credit projects in Staff Appraisal Reports. It, hopefully, puts forward points which are of relevance to both the Bank and the institution when considering agricultural credit and related projects, particularly those projects directed to small farmers, and where possible suggests alternatives and, in some cases, remedies for common problems. It is primarily intended for staff who may have only a limited knowledge of agricultural credit and who may be called upon to appraise the credit aspects of projects, particularly those which whilst not designated as credit projects nevertheless contain a credit element.

1.02 The paper deals mainly with institutional aspects. This is quite deliberate. Agricultural credit is a diversified and complex subject and can be approached from several different angles. However, experience has shown that the existence of a strong and efficient credit institution is more than half the battle and the possibility of successful projects is considerably enhanced.

1.03 That is not to imply that credit per se is the answer to all agricultural problems. It is not a panacea but one tool (albeit an important one) in the whole process of agricultural development. The paper stresses that credit must not be viewed, nor can it work, in isolation; it must take into account other aspects of agricultural development such as extension, marketing, transport, storage, and pricing policy to mention but a few of the main factors.

1.04 Amid all the technicalities let us not forget the most important persons—the borrowers—especially the small peasant farmers. How often are they forgotten in the desire to accommodate the wishes and desires of governments or institutions. Yet they, the customers, are the very reason for the establishment of the credit systems. Unless their production increases and their standard of living improves a project cannot be called a success even though the institution makes its profit and recovers all its loans.

1.05 It is suggested that the following aims should not be forgotten: to provide credit to farmers at the right time, at the right place and in the right amounts, to ensure that it is used for the purposes for which it was granted and to recover such credit promptly.

1.06 There will of course be disappointments. Agriculture at best is a chancey business dependent as it is on the vagaries of the weather. To this hazard must be added other factors over which lending institutions and borrowers have no control, such as political upheavals, armed conflicts, the fluctuation of world commodity prices, worldwide recession, and so on. Nevertheless, some ways must be found to raise the standard of living of rural communities and agricultural credit, if properly used, has an important role to play in this task.
II. LENDING INSTITUTIONS

2.01 In the field of agricultural credit lending institutions are of paramount importance. There are various types, and the selection of the right type can be critical to the success of a project. That is not to say that any one kind of institution is necessarily better than another per se; the suitability of an institution will depend upon several factors such as type of project, availability of staff, social considerations, number and class of borrowers to be dealt with etc. Careful consideration must be given to all relevant factors before deciding on the most appropriate type of institution. The most usual kinds of institution which have been used are:

(a) Central Banks
(b) Commercial Banks
(c) Development Banks - both specialized and multi-purpose
(d) Co-operatives
(e) Project Units, and
(f) more informal groups such as Farmer's Associations, Savings and Loan Associations, etc.

There may well be, and often are, variations and combinations of several of the above types in a project. The following is a brief description of the various types of institutions mentioned above with some advantages and disadvantages under given circumstances.

2.02 Central Banks. In many countries, the Central Bank plays a traditional role of general supervision and control of the financial sector. However in some countries, it plays a more direct role in projects due to Government preferences, or lack of trained banking staff elsewhere. Often where a number of financial institutions are participating in a project, it will be necessary for some central rediscounting facilities and the Central Bank may well be suited to such a role. In some countries, this role is largely financial but in others substantial technical units have been established to help appraise subprojects and to act as a general apex institution coordinating agricultural credit (e.g., Mexico, India). On the other hand, some countries expressly forbid by law the direct participation by their Central Banks in projects.

2.03 Whilst a Central Bank can be a useful tool, particularly when there is an acute shortage, or indeed a complete lack, of trained staff within a country, or a major coordinating role is required, there are disadvantages to their use. Their major fiscal regulating duties, lack of technical expertise, (agricultural, extension), rigid and complicated procedures, lack of contact with borrowers and potential clients, particularly small farmers (no branch network) and want of interest in the project are some of such disadvantages.

2.04 However, in the absence of a developed banking system within a country and given an existing Central Bank or Monetary Authority it may well
be necessary to consider using such an organization, despite its drawbacks, pending the establishment of a viable credit system.

2.05 Commercial Banks. Although commercial banking is often fairly well established in many developing countries, up until comparatively recently commercial banks were not interested in medium and/or long term credit to agriculture and certainly not to small farmers with less than acceptable commercial security. The position has changed over the past few years particularly as in several countries (i.e. India, Pakistan,) commercial banks are required by law to devote a given percentage of their loanable funds to agricultural purposes. Nevertheless, understandably, commercial banks are inclined to concentrate on loans to larger farmers with acceptable security. They are less expensive to administer and recovery is considered to be more certain.

2.06 Commercial Banks should be very seriously considered as a channel for agricultural credit. They usually have the advantage of a developed branch network and are therefore in closer touch with borrowers and potential borrowers. Their managers and senior staff are knowledgeable about local conditions. The staff, although commercial bank lending orientated, usually have integrity and fraud and corruption are much less likely than with some other organizations. Another great advantage is that Commercial Banks can grant all types of loans (short, medium and long term) which simplifies a borrower's life when he can obtain all his credit needs under one roof and make repayments to only one institution.

2.07 However, it must be admitted that there are still disadvantages to the use of Commercial Banks as channels for agricultural credit. If they are to be used (and if at all possible they should be) then every effort must be made to persuade them to change both their policies and systems. They must be encouraged to lend to small farmers and to accept less than usually acceptable collateral (para. 4.41). To this end, there must be incentives. Small farmer lending is expensive and it must be remembered that Commercial Banks (even if nationalized) are profit-making concerns for their shareholders. Whilst a Government owned institution may operate at a loss, Commercial Banks cannot be expected to do so. Reasonable margins or spreads must therefore be allowed (para. 4.57).

2.08 Commercial Banks usually, at the outset, lack technical expertise in agriculture. It will be necessary to persuade them to recruit and employ technically qualified personnel (e.g. agronomists, agricultural economists, particular project specialists such as livestock, fishery, etc.). For further discussion on staffing and training see para 3.06.

2.09 Perhaps the most serious constraint to the success of Commercial Banks in agricultural development projects is the ingrained caution of senior staff. Only time and patience and a demonstration of the benefits of projects will overcome this obstacle. Such reasons and the profit making requirement of commercial banking has led to the establishment of Development Banks.

2.10 Development Banks. Many countries have established such banks under a variety of names (Land Mortgage Banks, Credit Banks, Agricultural Banks, etc.) and ownership (Government, quasi-Government, private, etc.). Their main objectives are to grant loans under terms and conditions which commercial
lending institutions find difficulty in accepting and to charge reasonable rates of interest in line with commercial rates thereby providing competition and an alternative source of finance to moneylenders. There are basically two types of Development Banks - (a) specialized purpose and (b) multi-purpose.

(a) **Specialized**. These are established to provide loans for specific purposes such as agriculture, housing, industry, commerce, tourism, etc. The main advantage of a specialized institution is that it employs expertise on the one subject and concentrates all its know-how on the purpose for which it was formed. Its main disadvantage is its often narrow base and its inclination to operate in isolation (agriculture will ignore commerce and vice versa). Also they are often limited by legislation or Government policy to providing medium and long term credit which means borrowers have to resort to other sources for their seasonal requirements. This is unsatisfactory as it reduces the closeness of ties between borrower and lender and may lead to inadequate seasonal financing and poorer repayments. Borrowers should be able to obtain all their credit under one roof. It must be remembered that development banking expertise is in short supply and in other than large countries it may not be wise or practical to proliferate specialized banks and multi-purpose institutions should be considered.

(b) **Multi-purpose**. These may well be established in smaller countries where experienced staff is a constraint and individual purpose loan volume may be comparatively small. They have the advantage of concentrating staff which may be used for more than one type of loan. On the other hand there is a danger of too much generalism and lack of specialized expertise resulting in inadequate appraisal of loans with a consequent overall poor quality portfolio. As the institution grows this may be overcome by dividing it into specialized departments headed by subject specialists.

2.11 Cooperatives. As with Development Banks there are various types of Cooperatives from specialized credit societies through consumer, production, special crop to multi-purpose societies, all or some of which may dabble in credit. Then, of course, there are the recognised Cooperative Banks (e.g., India, Kenya) which operate as Development Banks, the main difference being in their capital structures and clientele; otherwise they are virtually the same.

2.12 The principal advantage of the cooperative structure is its potential to reach the lower strata of borrowers often more cheaply than through other institutional systems. The savings in operational costs can be considerable when the credit institution deals mainly with the society rather than the individual members. The repayment of loans may be facilitated by the compulsory marketing of crops through a society and consequent immediate recovery from crop proceeds. In the event of default it may be possible to exert pressure through denying further credit to the whole society until all debts are paid.
2.13 Coopératives too suffer from staffing problems and one of the main drawbacks in dealing with Cooperatives (Cooperative Banks excepted) is often the poor standard of management with consequent fraud and corruption. The management and accounting and auditing practices of cooperative societies which are considered for participation in a credit project must be very carefully examined.

2.14 Project Units. It may happen that there is no established agricultural credit system within a country or the project is in such a remote area that existing credit facilities cannot be used or again there may be a very weak credit system which cannot be used without substantial rehabilitation and the size of the project does not justify such major effort. In such cases it may be necessary to establish a Project Credit Unit or a Credit Section within an overall Project Unit.

2.15 It must be realized that the setting up and operation of such a Unit is expensive and unless there is a substantial loan portfolio, operating losses are very likely. Care must also be exercised to guard against profligacy of Project Units (Para 2.10(a) - Specialized Development Banks). If projects multiply or if it is obvious from the start there will be a series of projects, the establishment of a central credit system should be considered at the outset.

2.16 Informal Credit Organizations. By this is not meant moneylenders and traders but rather such organizations as Farmer’s Associations, Savings and Loan Associations and the like. Such organizations may be useful in reaching the "grass roots" level of borrowers but they must invariably be used with a "parent" institution usually a Development Bank. The legal status of these organizations as borrowers is always a problem and must be carefully examined. Joint and several liability may be the answer (para. 4.46). They should be considered only as a channelling arm of some other financial institution.

Selection of Credit Institutions

2.17 As has been stated previously in para. 2.01 no hard and fast rules can be laid down as to the most suitable type of credit institution. It will depend upon several factors but the cardinal principle which must always be borne in mind is that the function of an Agricultural Credit System is to provide credit to the farmer at the right time, in the right amount at the right price (para. 5.01).

2.18 The following questions, which are not exhaustive, may serve as a guide in the selection of the most suitable type of credit institution. Several of the criteria will be dealt with more fully in subsequent chapters of this paper:

(a) What is the purpose and intent of the project? This will determine whether or not a suitable institution already exists, whether it needs re-organization or rehabilitation or whether some new type of organization is required?

(b) if an institution does exist, what is its present condition (Chapters III & IV)?
(c) what is its past experience?
(d) is there a willingness to undertake the project and effect the necessary institutional changes?

Use of Credit Institutions

2.19 An efficient credit institution is vital to the success of a credit project and indeed may be a key factor in other types of projects where credit is an important element. It is therefore necessary at appraisal, to ensure that the chosen credit institution is effective or can be made effective early in the project cycle.

2.20 However, the temptation to establish new institutions rather than rehabilitate existing ones should be guarded against. If an existing credit system has failed it is important to find out why. Merely establishing a new institution may be to perpetuate ongoing mistakes and this institution too will fail. Yet it is surprising how often the "solution" to a credit problem is thought to be the establishment of a new organization.

2.21 Remember that setting up a new institution is expensive (premises, equipment, staff, etc.) and it takes several years for it to build up sufficient business to pay its overheads. Moreover it will be competing for scarce trained staff (para. 2.10(a)) and it may well not be too long before it is in the same parlous condition as the institution it was established to replace.

2.22 Use existing institutions, if possible, by adaptation, rehabilitation or reorganization. Existing institutions usually have at least a nucleus of reasonably experienced staff, premises and equipment. It may well be that with some reorganization an efficient credit system can be built up. However, the temptation should be resisted to insist upon the reorganization of a large institution (often multi-purpose) when the proposed project represents only a very small fraction of that institution's lending. For immediate project purposes it may be possible to solve the problem by establishing a special project unit or department within the institution staffed by the necessary subject specialists. If follow-up projects are contemplated then a long-term rehabilitation programme should be formulated, and implemented in stages, within an agreed time frame. The agreement and cooperation of the institution concerned are of vital importance if success is to be achieved; an imposed solution on a reluctant client will be doomed to disaster.

2.23 Agriculture Credit Institutions, if they are to be successful and achieve their objectives (para. 2.17) must be flexible and imaginative and be prepared to take calculated risks. Loan application procedures should be kept as simple as possible and customer relations fostered. Institutions must be prepared to change to meet changing circumstances. Merely because an institution has been in existence for 50 years does not necessarily mean that it is efficient and effective under present day conditions - far from it; it may be completely unresponsive to changing development policies and patterns and may be a hindrance rather than a help to development.
III. INSTITUTIONAL ORGANIZATION

3.01 An effective Credit Institution must be well organized, properly staffed and have accounting and information systems which will provide management with up-to-date data to facilitate speedy decision making. Yet it is surprising how many people think that a credit institution can be run on a shoestring by one man and a boy and controlled by "instant bankers", particularly if credit is only part of a wider project. Nothing could be further from the truth. This Chapter will attempt to put forward some of the more important aspects of institutional organization which merit consideration, but it does not pretend to be exhaustive.

Legislation and Objectives

3.02 The institution’s enabling legislation should be examined to ensure it has the legal scope to provide the range of services needed and to see the degree of independence the institution has on such things as its lending terms. While changes in legislation may on occasion be necessary or desirable, such changes are usually time consuming and may be politically difficult. The overall objectives of the institution should also be considered as its interest and enthusiasm for one project may vary substantially from another.

Management

3.03 Management is of paramount importance, no matter how big or small the institution, from a giant like the National Agricultural Credit Bank of Mexico to the smallest Primary Cooperative Society in India. The first thing which must be looked at when appraising an institution is the quality of top management followed by an evaluation of in-line management. In the case of a banking institution this would mean down to branch manager level. Are managers experienced and well trained? Is responsibility well delegated? For example, a Development Bank cannot possibly work effectively unless branch managers have discretionary powers to approve loans up to reasonable limits. If all loan applications, no matter how small, have to be referred to Head Office the time taken to approve loans will frequently be so long as to make the loan ineffective from the borrower’s point of view. Yet it is surprising how often this happens, the excuse being that branch managers do not have sufficient experience to be trusted.

3.04 One of the major management problems, particularly associated with parastatal or quasi-government institutions, is the appointment of the top manager, be he called Chairman, President, Managing Director or whatever. This is often a prestigious political appointment, and may well go to someone with no financial experience. It is extremely difficult to oppose such appointments without running the risk of being accused of unwarranted interference with sovereign powers. Probably the best thing that can be done under such circumstances is to try and obtain the appointment of an experienced and qualified Deputy. Boards of Management or Boards of Directors can also present problems. Whilst the day-to-day conduct of business may be left in the hands of a competent General Manager (or whatever he is called) an inept, or politically motivated, Board can wreck an institution or a project. The composition of a Board must therefore be scrutinized and if it is too narrow (e.g. all civil servants) efforts must be made to broaden its membership, preferably by the introduction of commercial and agricultural expertise.
3.05 It cannot be stressed too strongly that good management is a key to success. Without it failure is almost inevitable.

Staffing

3.06 Whereas good management is of prime importance for the successful operation of an institution, this needs to be complemented by adequate numbers of experienced staff. Such staff should include not only accountants, tellers, lawyers and the like but also technical and field staff.

3.07 Whilst the employment of a complete extension staff is very costly and is not advocated, it is essential in an agricultural credit institution for management to receive expert technical and guidance in respect of the types of loans to be granted. Thus if a large number of livestock loans are contemplated it would be advisable to employ a livestock specialist and possibly also a veterinarian. And so for other specialities such as fishery, agronomy, silviculture, etc. The number of such technical experts will depend upon the volume of loans to be processed in each particular discipline. However, these experts, and if the number of loans is substantial their back-up staffs, should not be confined merely to office routine; they must make field visits; get to know local conditions; test customer reaction to the technical aspects of loans; where appropriate advise customers; in the event of natural disaster (flood, drought, pestilence, etc.) be in a position to advise management on the remedial measures required; and advise on the feasibility of introducing and financing new techniques. They must, of course, develop a close working relationship with the Extension Services (para. 3.36).

3.08 A class of staff which is often overlooked or under emphasized by institutions is that required for follow-up and debt collection. It is pointless just issuing loans without knowing what their impact has been. It is also necessary to ensure that, as far as possible, loans are used for the intended purposes. It is also essential to obtain repayment of loans to the fullest extent possible. To achieve these objectives special staff will be required, such tasks cannot be left to the ordinary clerical and technical staff. Again the numbers required will depend upon particular circumstances. For instance, if a large number of loans are issued in instalments against progress certificates, then a considerable staff will be required to verify the accuracy of such certificates. If, on the other hand, most loans are made to merchants against invoices for the supply of goods direct to borrowers more clerical staff may be necessary. The follow-up of defaulters (those who have failed to repay their loans on time - para. 4.05) is very important. Again the numbers of staff required will depend upon the repayment morality of borrowers. If this is good few staff need be employed. The whole question of arrears will be dealt with more fully in Chapter IV.

3.09 The type of staff needed by credit institutions is frequently in short supply in developing countries. There is fierce competition for such staff from governments, commerce and amongst financial institutions themselves. It is therefore necessary to have competitive salary scales and other conditions of service (e.g. leave, sick benefits, housing concession etc.). Often in the case of government-owned or controlled institutions, salary scales are pegged to civil service scales which in many cases are out of line with commercial remuneration and are too inflexible. In some instances government, or central banks, insist upon staffing the credit institution with
members of their own staffs or their nominees. A case in point is the Agricultural Refinance and Development Corporation of India (ARDC) where staff has been provided by the Reserve Bank of India. Staff should be employed directly by the institution concerned, on terms and conditions laid down by the management of the institution. The right to hire and fire (with appropriate safeguards) should be with the General Manager (or equivalent). There should be clearly defined channel of advancement to encourage people to make the institution their career. All too many credit organizations suffer from a constantly changing staff, often because outsiders are brought in to fill senior vacancies. In credit work, experience and knowledge of past events are tremendous assets, particularly in the higher management echelon.

3.10 In order to maintain an efficient staff and increase it as business expands a planned training program for all levels and categories of staff is required.

Training

3.11 As mentioned in the previous paragraph, a training program for all levels of staff is essential if the calibre of staff is to be maintained and to allow for expansion. Yet this aspect is all too often neglected. So called "on the job" training consists of giving a person a job to do and letting him get on with it. And that is the extent of "training".

3.12 There should be proper training courses for each different category of staff. However such training should not be too rigidly departmentalised. For example loan clerks will benefit and have a better understanding of their work if they have an elementary knowledge of the crops which are being financed. Similarly technicians will benefit from knowing how the accounting system works. The problem is how to achieve the desired standard of training at reasonable cost.

3.13 There are basically two methods (a) in-house training and (b) external training which may be sub-divided into part-time or full-time training, the latter either within the country or overseas. The choice of method will depend to a large extent on the calibre of staff to be trained, the standard to be achieved, and the funds available.

3.14 For basic training on entrance, in-house training should suffice except in the case of some very specialized staff. Training can usually be done by existing senior staff in evening sessions and time specifically set aside during working hours. This is comparatively cheap, the major expense being some form of overtime pay for those involved. However, if there is a substantial number of trainees a Training Officer should be employed to coordinate courses, prepare curricula, ensure teaching materials and aids are available, etc. (para. 3.17).

3.15 For more advanced training, particularly to prepare personnel for advancement or to acquire knowledge of new technology, it will probably be necessary to use external sources. Only very large institutions or a consortium of institutions will be able to afford their own training organization for this type of training. Perhaps the outstanding example of this is the College of Banking at Poona in India, where the courses on agricultural credit and banking are conducted under the aegis of the ARDC. Where such facilities do not exist it may be possible to make arrangements with local universities,
cooperative colleges, agricultural colleges and the like. Courses may be part- or full-time according to time and staff availability.

3.16 The question of overseas training should be very carefully examined to ensure that it is justified and that real benefits will accrue to the institution, remembering always that this type of training is expensive. Overseas conditions and technology are not always appropriate for transfer to developing countries and great care should be exercised in choosing overseas countries and institutions for training purposes. Make sure that the systems and/or technology to be studied are not too sophisticated or inappropriate for the trainee’s own country. It may well be, of course, that the required expertise is not available in the country and must be obtained elsewhere. In such cases, it is frequently more advantageous for staff to go to countries such as India or Mexico rather than to a developed country. Before deciding to send trainees abroad consider the possibility of bringing outside expertise to the trainees. It may be more effective to bring one or two experts from abroad to teach the trainees in their own environment. It is impossible to lay down any hard and fast rules, each case must be judged on its merits and the conditions existing in the particular country. The point is to consider all the options and not assume that overseas training will necessarily achieve the desired results.

3.17 Whilst on this subject of training it should be remembered that in-service training is also important. Methods and technology are constantly changing and personnel require refresher and up-dating courses. Remember also that this applies equally to management and senior staff as to junior employees. This is another field in which a Training Officer (para. 3.13) can prove useful.

3.18 Field Staff also need training, particularly the technical staff. Probably the best way of achieving this is to arrange for them to be attached to the Extension Service for specific training and attend courses at an agricultural college.

Accounting Systems

3.19 An efficient accounting system which also provides information for management decision making is essential for the proper functioning of a credit, or indeed any type of financial institution. The information provided should enable management to frequently review levels and trends of loan sizes, arrears, bad debts, etc., by branch or activity. The system must be able to produce up-to-date information and enable accounts to be finalized speedily at the end of a financial year or other accounting period. Final accounts produced six months after the end of the financial period to which they relate are of little value, except as historical documents.

3.20 It is not possible to say that any one accounting system is better than another. Much will depend, as in other cases, on the particular circumstances ruling in a particular country. However, there seems to be a growing tendency to assume that computerization will automatically solve all problems. This is by no means necessarily so, in fact more problems may be created than are solved. The introduction of computers should be very carefully studied in relation to feasibility, maintenance and servicing facilities, availability of trained staff, reliability of electricity supply, etc. Alternatives, which may produce acceptable results with less trouble should be examined,
particularly in less sophisticated countries where the level of education and expertise may not be conducive to advanced technology. An accounting system which does not work will ensure rapid financial disaster.

Audit

3.21 Auditing of the accounts is essential. It should be carried out by qualified personnel, who are completely independent of the institution concerned, and whose report will be published. For Bank projects, our statutes require that funds be utilized for the purposes claimed. In the case of credit where the institution is usually reimbursed for its loans to farmers, we need an audit to have a reasonable assurance that these funds have been utilized correctly. Having stated the need it must be admitted that there are frequently problems in obtaining an acceptable audit.

3.22 In some developing countries private audit facilities are almost non-existent and government audit services cannot cope. In such cases it will be necessary to explore the possibility of arranging for qualified outside auditors to come in for a limited period to conduct the audit and, if the volume of future business is likely to be substantial, to encourage such auditors, perhaps in partnership with local people, to establish local offices.

3.23 Another quite common problem is a legal requirement for the government audit service to audit the institution concerned. This presents no problem if the government audit department is well staffed and up-to-date in its work program. But so often government departments are under-staffed, with unqualified personnel, and are way behind in their program, sometimes as much as two years. Such an "audit" is worthless, particularly in the detection and prevention of fraud. If the government will not agree to an alteration in the law to permit independent outside auditors, then some arrangement must be agreed whereby the government audit service will give priority to the institution's requirements or alternatively the efficiency of the entire audit service must be up-graded.

3.24 Similarly there may be a legal provision for the Central Bank to "audit" the institution. Such an "audit" may well consist only of ensuring compliance with legal requirements in respect of deposit ratios, cash deposits with the Central Bank, exchange control regulations, etc. Auditing of accounts, as such, is not done. In such cases agreement should be reached for a complementary audit by independent outside auditors under specific terms of reference such auditors to produce an independent report which shall be annexed to the published accounts.

3.25 Whatever type of audit is used it should be carried out under specific terms of reference so that all parties know precisely what is expected of each. It may well be that the auditors will be expected to do more than just a straight audit of accounts. They should, for instance, be asked to spot check a percentage of all loans, communicating independently with the customers concerned, to guard against fictitious borrowers. The point is the scope and duties of the auditors must be clearly defined. This will also minimize arguments over remuneration.

3.26 An institution unless small should generally set up its own internal audit department. This should be staffed by qualified auditors and answerable direct to the General Manager (or equivalent). It should conduct a running
audit of the institution and provide reports at agreed intervals (quarterly at least) to top management. It should work hand-in-glove with the outside auditors and can greatly facilitate the latter’s work. Such an audit, if properly conducted, can help to minimise loss by fraud and theft.

3.27 Auditing is important although it is inclined to be ignored. It is really the only check we have on whether the published accounts bear any relation to the truth. And a study of an institution’s annual accounts over a period of time can often reveal trends which give warning that all is not well. An expansion of an audit to encompass a check of the validity of loans and Statement of Expenditure can also assist in ensuring our funds are being disbursed for the correct purposes.

Monitoring and Evaluation

3.28 Monitoring and evaluation systems are now obligatory in all Bank projects. A unit (RORSU) within the Agricultural and Rural Development Department provides assistance in the establishment of such systems and so further comment in this paper would be superfluous. However, whilst admitting the benefits flowing from a well conducted evaluation, a note of warning may be sounded on behalf of institutions. These systems are expensive of staff time, often the time of scarce experienced staff. Unless the demands are kept to the minimum which will provide really relevant information, the lending activities of the institution may well suffer, since the experienced staff who should be processing new loans are bogged down in evaluation work. The temptation to demand superfluous data should be resisted for the benefit of institutions.

Increased Workload Resulting from Project

3.29 Since Bank lending is planned to be additional and not substitu-
tional it follows that projects will involve institutions in increased work. The size of the increase will depend, to a large extent, on the magnitude and complexity of the project. It must also be borne in mind that the increased workload does not cease abruptly at the end of the disbursement period; far from it, it may well continue to increase particularly in the case of a credit institution where the collection of loan repayments will be an ever increasing burden. The ability of an institution to cope with the additional workload should be assessed as realistically as possible and agreed time-framed program drawn up to ensure the timely provision of the required staff and facilities.

3.30 Some aspects have already been touched upon when discussing staff and staff training (paras. 3.06 – 3.18). Adequate trained staff will be the key to successful project implementation and the staffing pattern of an institution, both existing and planned for the future, must be examined critically. Too often such plans are unrealistic taking into account recruitment and training facilities.

3.31 It is extremely difficult to quantify exactly how much work particu-
lar types of staff can undertake since there are so many variables—standards of education, environmental, social, equipment available, etc. For instance an ordinary teller (paying and receiving) working six hours could be expected to deal with some 200 customers. however, if that same teller were expected to deal with a majority of illiterate peasant farmers, then he might be doing very well to deal with 30. Similarly a field technician, if provided with
motorized transport and assuming a reasonable road network, and also assuming
visiting each client once every two months should be able to deal with 200
borrowers. But if he has to use a bicycle or public transport, if the roads
are bad, the distances greater, then any one or all of such variables will
reduce drastically the number with which he can cope. These are the types of
problems which can be solved only by physical appraisal and must of necessity
vary from country to country, even from district to district within the same
country. No hard and fast rule can be laid down as to precisely the number
of staff required.

3.32 Whilst staffing is the key element in coping with increased work
other aspects should not be ignored. People require a reasonable environment
within which to function. Adequate premises (not palatial) permitting of
expansion, should be provided. Record storage and retrieval is of great
importance in credit work and cramped quarters militating against good record
keeping can have serious consequences. Similarly the provision of adequate
office furniture and equipment is essential for efficient operations. All
these items should be examined and improvements suggested and possibly
financed. The ability of an institution to cope should be based on
projections and not conditions as they presently exist.

3.33 Perhaps the real measure of the ability of an institution to under-
take successfully all that is involved in the implementation of a project
is the enthusiasm and driving force of top management and the cooperation of
the government. If there is a genuine desire for the project and a demons-
trated determination to make it succeed then many of the problems of expansion
can be overcome. If, on the other hand, there is only lukewarm acceptance of
the project by either the institution or the government, success will be
problematical.

Relationships with Other Organizations

3.34 A successful credit institution cannot work in isolation. Neither
will it achieve its objectives if it ignores other factors such as Extension,
Marketing, Storage, Price Policies, etc. To quote one simple example. What
is the use of increasing production of a crop if the additional produce cannot
be marketed at realistic prices and there is insufficient storage to hold any
surplus? Producers would have been better off without the project.

3.35 It is therefore essential for a credit institution to maintain
close liaison and establish working arrangements with other relevant organi-
izations particularly those concerned with the subjects mentioned in para.
3.34 above. The best way to do this is by direct contact between the senior
management of the credit institution and that of the organization concerned.
However there will be a need for interchange between the organizations them-
seves. For example pricing policies may well be influenced by the avail-
ability of storage and transport and whether controlled markets are used. It
will be useful to establish some sort of forum or committee where matters of
mutual interest can be discussed and decisions made.

3.36 It is appropriate to comment here on the importance of adequate
extension services as an adjunct to agricultural credit. If credit is to be
used properly to assist in the introduction of new farming techniques, thereby
increasing production and the living standards of farmers, technical advice
to borrowers is essential. No credit institution can afford to provide a
complete extension service on its own (para. 3.07). It must therefore enter into an agreement with government whereby government extension services assist the institution and its clients, if necessary on a priority basis. The provision of agricultural credit without the support of adequate extension service is a waste of time and money. At appraisal therefore it is vital to ensure that sufficient technical support will be made available to the institution and it is perfectly legitimate to provide project funds for improvements to the extension services.

Political Interference

3.37 Unfortunately as an institution becomes more effective so the likelihood of political interference may increase. Whilst it is perfectly legitimate for a credit institution to assist in the implementation or government policy, the day-to-day running and decision making of the organization should be left to its professional management. Regrettably all too often this is not so. Government will interfere in, in some cases dictate, staff appointments, interest rates, recovery procedures, etc. If a government is determined to do this, there is not much that can be done to circumvent it. Trying to influence the composition of Boards of Management (para. 3.04), obtaining policy statements which should not be altered without the Bank’s consent, the right of consultation in changes of top management and agreed lending terms and conditions which can only be amended after consultation, are a few ways in which political interference can be lessened but it can never be wholly eradicated.

3.38 One of the worst forms of political interference is the blocking by government of the right of an institution to realize collateral (particularly land) to recover bad debts. This destroys repayment morality and leads to an unacceptable increase in arrears. If pursued too far it can lead to the bankruptcy of the organization. It is extremely difficult to counter such a policy. Perhaps the only effective way is to make it clear to the government that if the arrears situation increases beyond a given amount (which must be stated) then disbursements will be suspended or the loan cancelled, and these sanctions must be rigorously enforced if this type of interference is to be broken.

IV. INSTITUTIONAL FINANCIAL ASPECTS

Financial Positions of Institutions

4.01 The overall financial position of an institution is important, not just the financial status of that part of the institution involved in the project. It is not proposed to deal here with the financial analysis required in Staff Appraisal Reports (SAR). Suffice it to say that an institution should be financially viable or capable of financial rehabilitation to make it viable within a reasonable period. The following are points of particular significance when dealing with an agricultural credit institution.

(1) Capital Structure. Who owns the majority of equity? This may influence managerial and Board appointments and the autonomy of the institution. Is its capitalization adequate? There is an unfortunate tendency by governments to try and
capitalize this type of institution "on the cheap". They are established under-capitalized with pious hopes that more will come from somewhere.

(ii) **Sources of Funds.** From whence does an institution derive its funds? Is it solely dependent upon deposits and/or government grants or loans or does it have access to the financial markets (bonds, debentures, etc.) and funds from international organizations (World Bank, Asian Development Bank, etc.)? This information will be particularly relevant when drawing up the financing plan.

(iii) **Earmarking of Funds.** What are the requirements (if any) for the earmarking of funds? Is there a legal requirement for the holding of a minimum cash balance as a percentage of deposit liabilities? If not, does the institution have its own policy on this? Must a given percentage of deposits be invested in Central Bank or other securities and not in loans made by the institution? These questions may have a significant effect on the lending funds actually available. Deposits may be substantial, but if only 50% may be used for lending the situation is not as good as it at first appeared.

(iv) **Terms of Funds.** This is important when one remembers that in many cases most of the institution's lending will be medium or long-term. Borrowing short term to lend long can be a quick road to financial disaster. An analysis must be made of the repayment terms of an institution's funds and these must be related to its existing and projected lending terms.

(v) **Debt/Equity Ratio.** This is often used as one of the important measures of an institution's financial soundness. In this context it is the ratio between long-term debt (i.e. over twelve months repayment) to equity plus free reserves. It is impossible to lay down any hard and fast rule as to what this ratio should be, particularly as it may be complicated by legal permissiveness. Thus in India Land Development Banks may legally borrow up to 20 times their equity. However, under ordinary circumstances an acceptable ratio is probably between 4:1 and 7:1.

(vi) **Arrears Position.** This is of paramount importance and is dealt with in some detail in paras 4.03 to 4.05 below. It is suggested that the maximum percentage of arrears (as defined in para 4.04 should not exceed 25%. This may not be achieved at once and there should be some flexibility. A time-framed program should be instituted within which the percentage of arrear. will be reduced to the agreed level. It is stressed that an examination of the above questions does not constitute a full financial analysis. It serves to draw attention to some very important points which must be taken into account in the financial appraisal of an agricultural credit institution. More detailed instructions on the above points are in the course of preparation.
Past Performance of an Institution

4.02 An analysis of the past performance of an institution can be very revealing. To this end its Balance Sheets and Profit and Loss Accounts, together with related documents, for the previous five years should be analyzed. What should be looked for are trends as well as absolute figures. For instance, what is the trend of loan collections? If arrears show a tendency to increase sharply then a warning note is sounded. What is the trend in the number of customers? Although the total amount of loans has increased if the trend shows a decreasing number of customers it may indicate an increase in lending to larger farmers. Past performance should also be looked at in relation to projected future performance. It will help in determining whether such projections are reasonably realistic. When comparing past and future performance it will be necessary to take into account the effects of inflation. While the figures may appear impressive at first sight, in fact if they are translated into real terms using consumer price or similar index the picture may be quite different and in recent years many institutions have failed to increase their lending in line with the rate of inflation. This has resulted in a reduction in their real lending and been responsible for failure and ineffectiveness of institutions. This may well apply with particular force to long-established conservatively-run institutions (para. 2.23). A most important trend is that of arrears and since it is so important and of universal interest it is proposed to deal with the subject in considerable detail in the following paragraphs.

Arrears (Out-of-Time Repayments)

4.03 Before entering into discussions it is vital that there should be an agreed definition of "arrears" so that everyone knows what is being talked about. Definitions vary from country to country, from institution to institution and even from Region to Region within the Bank. This not only leads to confusion but makes any meaningful global comparisons impossible. The aim should be to determine how much of the money owing to it in respect of principal and interest has been collected by the institution within a given time-frame, and then for comparison purposes to express such amount as a percentage of an agreed item. As a few examples of the present confusing position, arrears are shown as: (a) a percentage of amounts due including past arrears; (b) a percentage of total loan portfolio; (c) a percentage of total loans fallen due during the period; (d) total loans fallen due during the period and (d) total amounts collected without relation to any other figure.

4.04 It is suggested that the most accurate definition, which gives the truest picture of the situation, and comes nearest to achieving the aim mentioned in para. 4.03 above is as follows:

"Arrears shall be calculated as the total of the amount fallen due during the year (A) plus the amount overdue at the beginning of the year (B) less the amount actually collected during the year (C) and the percentage of arrears shall be calculated as the amount outstanding at the end of the year (A + B - C) as a percentage of total demand (A + B)."

There should be separate calculations in respect of both principal and interest.
4.05 Even the word "arrears" needs to be used with the same agreed connotations. In no circumstances should the expression "bad debts" be used to describe "arrears". Another expression often used is "default" and "defaulter". This is acceptable since it conveys the right meaning, and in fact "defaulter" is perhaps the best way to describe a borrower who is in arrears. However, this should be an agreed definition and used only in that context. "Overdue" is another expressive description which conveys the correct idea. Perhaps the best definition of "arrears" which leaves no room for misunderstanding is "out of time repayments" which is what they are until they are repaid or crystallize into bad debts. Whatever terms are finally decided upon their definition should be agreed and only those terms should be used in all reports. The expression "arrears" and "defaulters" for those in arrears will, in the meantime, be used in this paper.

Significance of Arrears

4.06 Too often the significance of arrears and their effect on an institution is not understood. An increasing percentage of arrears is a sign of an unhealthy financial position. Firstly, interest charged on loans is usually the major source of an institution's income from which it pays its operating expenses. If this interest remains uncollected the institution must either pay its expenses from funds which should be available for lending or borrow from other institutions. Either way will be costly and cannot continue indefinitely. Another aspect of unpaid interest must also be watched. It is the practice of some institutions to include uncollected interest, sometimes unpaid for years, in their Profit and Loss accounts without making any corresponding provisions for non-recovery. This artificially inflates profits and distorts the financial picture. It is suggested that only interest actually collected should be taken into profits, the remainder should be reflected in a separate collectible account. Once a debt has been classed as irrecoverable (para. 4.30) the calculation of interest should cease. Non-repayment of principal can have equally devastating effects on the institution. Funds will cease to revolve and unless other sources of finance can be found, lending must cease. Losses must be made which can only lead to erosion of capital. Sooner, rather than later, the institution will be bankrupt. It is therefore vitally important to control arrears and establish an effective collection system.

Collection Methods

4.07 If arrears are not controlled, an institution cannot continue to operate unless additional funds are made available. But in such an event we are not really talking about credit, but rather grants or gifts. A fundamental canon of credit is that it shall be repaid. If there is no likelihood of repayment do not set up extensive institutions allegedly to administer credit but accept that the money is by way of grants and proceed accordingly. Moreover, to permit arrears to accumulate destroys the repayment morality of borrowers and militates against an effective credit system.

4.08 With credit, every effort must be made to compel repayment of loans and interest. To do this an institution must establish a proper collection system with appropriate staff. In a large organization this may well require a separate department. Debt collection is expensive but it is imperative if an institution is to survive. The successful administration of agricultural credit is one of the most expensive credit operations in the world (Staff
4.09 Borrowers, particularly those with little experience of credit, must be constantly reminded of their obligations. A satisfactory system should include that at least three weeks before repayment is due, a notice be sent telling the borrower precisely how much to pay and by what date (specifying any penalty for late payments or rebate for early payment). This may not be easy in countries with rudimentary postal services. However, every effort must be made using such devices as are available like the institution's own debt collectors, District Commissioners or equivalent District Administrative staff, tax collection staff, other Government departmental staff, etc. The point is that borrowers must be reminded of their obligations. It is unrealistic to rely only on borrowers' memory and problematical willingness to repay. If repayment is not received within say seven days of the due date a reminder should be sent. If within 21 days repayment has still not been effected, the defaulter should be visited by a member of the collection staff (debt collector) who should determine the reason for default and endeavour to obtain at least partial repayment at the same time warning the borrower of the serious penalties he may incur. If, however, the debt collector is satisfied that there are extenuating circumstances he may recommend re-scheduling. If no such recommendation is forthcoming, and repayment is not made within six weeks of the due date, a final notice should be sent which will warn that legal proceedings may commence immediately. Such threats should not be made idly and after a reasonable interval steps should be taken to realize the defaulter's security. Unless punitive action is taken against willful defaulters arrears will accumulate until the position becomes impossible. Experience has shown that it is necessary to make an example of only a few of the worst defaulters to bring the others into line.

4.10 No further loans should be granted to defaulters (except under special circumstances and after debt re-scheduling) (para. 4.22) and this sanction may assist in recoveries where seasonal loans are a necessity. It may also be used in the case of group loans (cooperatives) whereby unless the whole loan is repaid both the group and all individual members will be refused further credit until full repayment has been effected. If a loan has been made under the joint and several guarantee of the group, or certain members of the group, proceedings against one or two members may bring about sufficient social pressure on the remainder to obtain full repayment. Social pressures should certainly not be ignored as a means of getting loans repaid, they are often more effective than so called tangible security. Thus it may be possible to extend this concept to larger units such as say a District or County or other Administrative division whereby if total arrears within the area exceed a given figure (25%) no further loans will be granted to anyone within that region until the arrears have been reduced. It is surprising what pressures can be exerted on defaulters by their peers under such circumstances.

4.11 To discourage late repayments a penalty should be added to the interest rate. This penalty should be sufficiently large to act as a real deterrent. It often happens that institutional rates of interest are below ruling market rates and are negative. It therefore pays borrowers not to repay their institutional debts since they can use the money more profitably. In such cases the penalty should be high enough to raise the effective interest rate to match the highest market rate.
4.12 To encourage timely repayment a bonus or discount should be considered. This too must be large enough to offer an incentive to borrowers. This idea of incentive to pay can also be extended to collecting agents. Thus if a cooperative society collected repayment on time from all its members a rebate of say 1% of the interest rate could be made to the society to be used for the benefit of its members. Such rebates, if they do in fact encourage timely repayments, may well be less expensive than employing a large debt collecting staff.

4.13 Undoubtedly the most effective and cheapest collection method is by direct deduction from sale of crop proceeds. This can be arranged if there is compulsory central marketing (e.g. sales must be made through Cotton or Coffee or other Crop Marketing Boards); or members must market through their cooperative society; or if say there is only one ginnery or coffee processing plant and no other selling outlet. Not only is this very effective from a collection point of view but it can ease collateral requirements (para. 4.44). Of course the system is not foolproof, it can be overcome by those determined to avoid repayment. As an example (and there are other ways) a grower may persuade a friend to sell the produce in his, the friend's, name. However, if the purchasing organization cooperates efficiently this is undoubtedly the safest and most effective method of collection. A variation of this method is for a bulk loan to be made, say to a sugar or tea company which will pass on individual loans to outgrowers and be responsible for their collection. The company assumes liability for repayment to the institution.

4.14 Loan repayments should be geared to crop maturities, the time when borrowers have most cash available. If the direct deduction method (para. 4.13) is not feasible then an institution should use its debt collecting staff (para. 3.08) to visit markets, auctions, etc. on sale days to collect as much as possible. The longer collection is deferred after the sale of crops the more difficult it becomes. If the loan is not for the cultivation of specific crops but for such purposes as dairy produce, cottage industry or the like, then repayment should be arranged on a monthly or quarterly basis; it should not be made annual since much of the early income will be then have been spent. The motto should be "strike whilst the cash is available"! Too many institutions regard their own financial periods as sacrosanct and require repayments to be made to suit their own particular accounting periods.

4.15 Whatever method is used let us not forget the other party to the transmission - the borrower. He is much more likely to repay if it is made easy and inexpensive for him. Direct collection (para. 4.13), market visits (para. 4.14), branch networks (para. 2.06) all help. If necessary, part-time agencies (one day per week) should be established in centers or borrower concentration. Mobile units, combined with savings schemes (para. 5.12) should be considered. The point is that if a borrower can effect repayment without having to travel long distances, at his own expense, he is encouraged to do so. This is all part of an incentive package (paras. 4.11 to 4.12) with the lender and borrower working together.

4.16 The importance of keeping arrears to a minimum cannot be overstressed and to achieve this an institution must have an efficient collection system. It must also have an effective data system whereby at any time the arrears position can be determined, particularly the composition of arrears by age and loan category.
Aging of Arrears

4.17 It is surprising how many institutions do not keep statistics which show the age of arrears, i.e. how much has been overdue for more than a given period. For example the amounts which have been overdue for six months, one year, two years, etc. Without such information the significance of arrears cannot be measured properly. For instance if the full bulk of arrears has been overdue for less than six months it may be only because of seasonal problems and the position will right itself shortly. If, on the other hand, a substantial proportion has been overdue for long periods, say 4 or 5 years, then the position is serious. Any loans which have been in arrears for more than 4 years should be regarded as possible bad debts (para. 4.25).

4.18 Without data as to the age of arrears, a realistic reserve for bad debts cannot be calculated. The longer a debt has been overdue the less likelihood there is of repayment so, in the case of long overdue accounts, the collateral position must be kept under constant review and the feasibility of legal action considered.

4.19 As well as age of arrears it is useful to know the make-up by category. This may well lead to an investigation into the viability, and perhaps even the suspension, of certain types of loans. If, for instance, a larger percentage of loans for farm mechanization is in default the causes should be ascertained. There may be several reasons (inadequate hire charges, lack of suitable implements, scarcity of fuel, etc.) which can be remedied or it may be fundamental (not enough work) and that no further such loans should be issued. Unless such an analysis by category is made the fact that this type of loan is heavily in default will probably escape management's notice and the mistakes will be perpetuated leading to a continuing increase in arrears. If the institution deals in short-term credit as a distinct operation then separate statistics should be prepared for this type of lending.

4.20 Management should be made aware of the importance of the analysis of arrears as a tool in the efficient operation of an institution. Once the magnitude of the problem is known, including the types of loans which appear to be unsuccessful, the causes for failure should be investigated. It may well be that this will lead to a change in loan policies and purposes and prevent the continued issue of bad loans.

Re-Scheduling

4.21 Agriculture is at the mercy of the weather. Natural disasters (drought, flood, pests, etc.) are bound to occur and farmers will, in many cases, be unable to pay their debts. Under such circumstances, to foreclose on all defaulters will be impossible, and counterproductive. It will therefore be necessary to re-schedule repayments of loans, in anticipation of better harvests in the future. Re-scheduling should however be undertaken only after careful investigation of the impact of any such disaster. It may well be that some areas will have escaped the full effects and thus only partial re-scheduling will be required.

4.22 If re-scheduling is justified the method used should be one that will not place too heavy a burden on the borrowers. They should be given a realistic chance to repay. Thus a method often used (allegedly for the sake of simplicity) is merely to postpone the repayment of one installment and require payment of two installments next time. Unless the amount due is small
in relation to the borrower's income it may well be impossible for him to meet the condition and default will continue. The best method and one which can be geared to a borrower's circumstances, is to lengthen the repayment period of the loan and re-calculate the repayment installments. This is admittedly a more complicated and time-consuming exercise but in the long-run will pay off. Again it should be emphasized that the welfare of borrowers should not be ignored, and that if they are consulted and encouraged and feel they are getting a square deal they will be less likely to try and avoid repaying.

4.23 A word of warning on re-scheduling. It is very tempting to "re-schedule" if arrears are high, often to "window dress" a balance sheet. After all once a debt has been re-scheduled it no longer appears as overdue. In all statistics relating to overdues a return of re-scheduled repayments, together with reasons for re-scheduling, should be required. This will give some indication of whether re-scheduling is being used properly and whether the figure for arrears is realistic. Some institutions euphemistically call their re-scheduling "rolling over" and this must also be guarded against.

4.24 It should be a cardinal principle that a defaulter should not be granted further loans. However, an exception for seasonal loans may be made in the face of a natural disaster, particularly if re-scheduling is involved. After all the main purpose of re-scheduling is to obtain eventual repayment without resort to the realization of borrowers' securities. If a farmer has suffered a natural calamity, he will require assistance with the purchase of seeds, fertilizer, etc. for the next crops. Without these he cannot continue to farm and the whole purpose of re-scheduling will be defeated. In such circumstances the granting of further seasonal loans is justified — indeed it may be imperative. It is suggested that this should be regarded as an integral part of the re-scheduling exercise.

Bad Debts and Provisions

4.25 No matter how careful an institution may be, sooner or later it is bound to incur bad debts. In this context the expression "bad debt" is given the meaning of a debt which it will not be possible to recover in full. To guard against such a contingency institutions (particularly commercial banks) take security or collateral. Something tangible of value which may be sold and the amount of the debt recovered from the proceeds of the sale. Even the security may not be sufficient, it may have depreciated or disappeared or otherwise be unavailable (para. 3.38). In such event a bad debt will have been incurred and represents an outright loss to the institution.

4.26 It is therefore necessary to provide for such losses in order to safeguard the capital structure of the institution. This is usually done by creating a "Reserve for Bad Debts" by a transfer of an agreed amount from profits (before the declaration of any dividends). How large the Reserve should be will depend upon circumstances and past experience. If the majority of loans are unsupported by tangible securities the Reserve may have to be somewhat higher than if loans are secured (para. 4.40). This does not necessarily follow however; if repayment morality is good, arrears low, and past experience shows few bad debts, the Reserve can be set accordingly.

4.27 Bad debts may however arise from unforeseeable reasons which have nothing to do with institutional expertise, or lack of it. Thus there may be an irretrievable natural disaster (permanent inundation of an area) or inter-
national causes such as the collapse of world prices for particular commodities or major increases in input prices (oil, fertilizer, etc.), circumstances over which neither lenders nor borrowers have any control. However, there is one cause of bad debts which can, and should be, guarded against and that is the desire on the part of some institutions and/or government organizations to increase the volume of lending without due regard to the wishes of borrowers why may be forced into accepting loans against their better judgement. The Reserve may prove totally inadequate in such cases and government may have to mount a rescue operation if the institution is to survive. Such cases should not be frequent, although risks from international happenings have increased dramatically over the past few years. If an institution suffers a high bad debt ratio under reasonably normal circumstances, then its lending policies, criteria and methods require critical examination.

4.28 The adequacy or otherwise of any provision for bad debts and the amounts written off, or which should be written off, in respect of bad debts, should be the subject of comments by the auditors. Adequate provision should be mandatory and if necessary the approval of Bank assistance should be made contingent upon the creation of suitable Reserves.

Foreclosures and Write-Offs

4.29 As has been said in para. 4.25, sooner or later bad debts will be incurred (para. 4.27). When to classify a debt as "bad" (i.e. irrecoverable from normal sources) is a matter of judgement. When all avenues of reasonable persuasion and accommodation (perhaps including an initial re-scheduling (para. 4.21)) have been exhausted then punitive action should be taken. Defaulters should not be allowed to escape retribution: if they are, default will snowball and arrears will become unmanageable. This is one reason why political interference (para. 3.37) is so unfortunate.

4.30 Once the decision has been made to classify a debt as irrecoverable through normal channels action should be initiated as rapidly as possible to realize any assets pledged as security for the loan. Speed is particularly essential in the case of moveables (e.g. livestock, machinery, etc) since these have a nasty habit of disappearing. This is why land is so often preferred as collateral since at least it cannot run away (although its real value is problematical (para. 4.43)). Unfortunately, the legal process to enforce sale is often cumbersome and lengthy (chattel mortgages, Bills of Sale, etc.) but it should nevertheless be pursued. If for any reason the proceeds of the sale of tangible securities are insufficient to settle the debt in full, consideration must be given to taking further civil proceedings through the Courts to recover the balance. A defaulter should be allowed to get away with as little as possible not only for financial reasons but also to ensure that others are not encouraged to follow his example.

4.31 Having said that, one must admit there are difficulties, particularly in the case of small value collateral, and the only reason for proceeding may well be to make an example of a few defaulters in order to deter others. Thus, if the debt is say $100 and the sale of the security will realize $110 but expenses of $110 will be incurred is it worthwhile proceeding? Perhaps only if the making of an example is imperative and/or there is a chance of recovering the balance from another source (further civil action).
4.32 However, it must be emphasized that the write-off of bad debts and thereby the admission of actual financial loss, can often lead to a worsening of the position and a steep increase in arrears. Once it becomes generally known that default carries very little or no penalty, repayment morality will be seriously damaged and the credit system may be destroyed. Write-off must therefore be an absolute last resort and it may well be necessary to incur expenses in pursuing willful defaulters in order to preserve both the institution and the system.

Some "Do's" and "Don'ts"

4.33 In the collection of repayments, whether they be overdue or not, the attitudes must always be positive and even aggressive. Borrowers must be made to understand the obligations attaching to credit. Never give the impression that paying on time does not matter.

4.34 Ensure that an adequate collection staff (debt collectors) is available as soon as repayments become due (para. 3.08). Never, however, use extension staff as debt collectors. If this is done they, the extension staff, will come to be regarded as policemen and will lose the trust of borrowers. The extension staff is there to give advice and assistance both to borrowers and the institution but this must not include debt collection.

4.35 Try, as far as possible, to gear repayments to crop maturities (para. 4.14). Repayment should be demanded when borrowers have optimum financial resources available which will generally be at harvest time.

4.36 Whilst never losing sight of the importance of obtaining repayment of loans, it is often necessary to use discretion. If there are really genuine reasons for default (circumstances or events beyond the borrower's control), then every effort should be made to alter the terms of repayment to avoid recourse to foreclosure of the security. The creation of a climate of goodwill between lender and borrower can sometimes be more effective in obtaining repayment than harsh legal measures. Having said that, however, it is not intended to detract in any way from the statement made in para. 4.33. It is the duty of an institution to obtain repayment of loans and every effort should be made to that end.

Government Requests to Operate Non-Viable Schemes

4.37 Whilst it is legitimate for credit institutions to assist in implementing government policies (para. 3.37), this must not be done at the expense of the institutions. Requests will undoubtedly be received from governments for institutions to grant non-viable loans in support of some government aims. The organization may be the best suited to reach intended beneficiaries, particularly if there is a wide rural branch network coupled with an efficient field staff. However the risks of loss will be unacceptable. Participation is not likely to help the institution in maintaining independent standards. If the institution must participate, it should act as agent for the government on the following terms:

(a) government will provide the funds or alternatively give an unconditional guarantee in respect of any institutional funds to be used (the first course is preferred since it is sometimes difficult to enforce a government guarantee);
(b) all monies provided by government shall be used to establish a separate Fund which shall be accounted for separately and which shall not appear in the institution's balance sheet;

(c) government shall be responsible for all losses accruing to the Fund; and

(d) the institution shall be remunerated by way of an agency fee which shall be sufficient to cover all out-of-pocket expenses plus a modest profit (the institution cannot be expected to work for nothing).

4.38 If the institution is to be responsible for the collection of repayments, the agency fee must be carefully calculated. The interest to be charged to borrowers by government (most probably a subsidized rate) may not be sufficient to cover administrative costs and may prove difficult to collect, so beware of accepting the interest as an agency fee.

4.39 If the proposed interest rates to be charged by the Fund are out of line with the institution's own ruling rates, the agency should be strongly resisted. Different rates, particularly if they are lower, will create difficulties and may lead to a reduction in institutional lending.

Security (Collateral) Requirements

4.40 Credit implies repayment (para. 4.07) and to ensure such repayment it is customary banking practice to require borrowers to provide some kind of tangible security which may be sold in the event the borrower is unable to repay from his normal resources. This protection of funds is necessary more especially when the resources being used do not belong to the institution or government. The commercial banks (para. 2.05 - 2.07) are classic examples; for the most part they are using customers' deposits (mainly repayable on demand) or shareholders' contributions. These must be preserved unless there is to be banking disaster.

4.41 The clientele of conventional banking must therefore, of necessity, be limited to those who have acceptable security to offer and this usually takes the form of immovable property (land, buildings, etc.) or such tangible assets as stocks and bonds, gold/silver, plant and machinery etc. However, the development of agriculture in the less developed countries (LDC) demand the inclusion of the small peasant farmer who may require credit if he is to adopt improved techniques beyond certain stages. This introduces a whole new class of people requiring credit facilities, a class which normally does not have conventional banking security to offer. Hence, the establishment of Development Banks (para. 2.10) to accept risks which commercial lending institutions cannot, by the nature of their constitutions, undertake.

4.42 Even these specialized institutions have difficulties with security, particularly if, as often happens, they are staffed by ex-commercial bankers. If we are really going to reach the small farmers (and this applies with particular force to tenant farmers) then we must be prepared to experiment and take calculated risks (para. 2.23). Insistence on only conventional types of security must be put on one side. Flexibility must be a key - to take such security as can be offered within the limits of prudence. It is proposed to put forward some suggestions for consideration.
Mention must first be made of many bankers' favourite security - land. Indeed until recently in India, ARDC was required, by law, to have its debentures backed by mortgages over land. There is no doubt that in the developed Western World land does offer excellent security. It is permanent, valuable and easily realizable. However, this is not necessarily so in LDC. Land is indeed permanent but its value is problematical since it is often impossible to sell it either because of government regulations and/or social sanctions. Insistence on land mortgages as security is bound to exclude large numbers of farmers from credit facilities and, if development at grass root levels is to take place, alternatives must be found.

As mentioned in para. 4.13 one of the simplest and most effective methods of obtaining repayment is by deduction at source from crop proceeds ("stop-orders"). If the central or cooperative marketing systems are efficient and stop orders are conscientiously dealt with, it may be possible to dispense with further security although it might be prudent to take, in addition, a crop lien just in case of attempted evasion (para. 4.13).

Crop liens are useful, but unless centralized marketing is effective, they are a risky security if taken alone. Nevertheless liens can be used together with other types of security to assist in repayment enforcement.

Another type of security which can be effective is the joint and several guarantee. Such guarantees take two main forms. One where all members of say a Cooperative Society or Farmers' Association participate in the guarantee. In the event of default all members may be sued either together or individually and to be really effective such a guarantee must be reinforced by sanctions against all members (para. 4.10). The second is to take a guarantee from say six of the most prominent and well-to-do members of the borrowing association. If default occurs action should be taken against them promptly but again further loans should be denied to all members pending full repayment (para. 4.10).

Chattel Mortgages, or similar types of charges over moveable property, can be useful and effective security. However, the laws under which they operate and may be enforced need careful examination. It can happen, as in Turkey, that actual physical possession of the mortgaged assets by the lender is required. This is obviously impractical in the case of livestock and other farm property. Realization procedures too may be cumbersome and lengthy, particularly if the Courts are involved. The essence of the effectiveness of Chattel Mortgages as security is the lender's ability to move quickly and obtain physical possession of the goods once the charge has crystallized (para. 4.30).

To facilitate the taking of security under some form of charge, if a new institution is being established under statute it may be possible to provide for the institution's own form of charge which will permit speedy action to be taken against defaulters without resource to the Courts. At the same time such charges will have priority over other debts. It has been argued that this gives the institution an unfair advantage over other financial and trading organizations. However, the establishment or existence of special credit institutions pre-supposes the need for them to take unusual risks (para. 2.10) and if they are to operate successfully they must be able to dispense with conventional security (para. 4.42). They should therefore be given every protection possible.
4.49 If loans involve the purchase of farm machinery and the like consideration should be given to using Hire Purchase techniques. Again any legislation governing such instruments should be carefully examined.

4.50 Mention must be made of Insurance Schemes, both Crop and Risk. There is a body of opinion which feels that crop insurance is the answer to all security problems. It is not proposed to deal with this subject here since it will be the subject of a separate paper but a note of warning should be sounded. The feasibility of crop insurance, except in the case of certain high-value crops, is very doubtful. Any proposals should be looked at with great care and a healthy scepticism. Some countries have introduced risk insurance schemes, particularly for commercial banks. For the payment of a premium, the cost of which may or may not be passed on to borrowers or be borne by Government, an agreed percentage of a loan (usually varying between 75 - 85%) is insured against non-repayment. Not every scheme has been successful for a variety of reasons such as cumbersome procedures particularly in respect to claims, time-consuming investigations, and delays in payment of claims. If claiming is made too easy, it may, of course, discourage an institution from making its own collection efforts, and if the borrower has had to pay the premium, he, too, may think there is no reason to repay. All such schemes should be examined in detail and past experience reviewed to determine the real risk coverage.

4.51 In orthodox commercial banking the real tests as to whether or not to lend hinge on the character of the borrower and the viability of the proposed project (i.e. the generation of sufficient incremental income to repay the loan). These tests can still be applied in agriculture lending provided the number of borrowers is not too great. An in the case of some such borrowers security may not be of prime importance - "character" loans can be made. However the requirement of present day agricultural credit in LDC is to be able to lend to very large numbers of small farmers. Many of these will not have used credit facilities before and their characters will be unknown to the lending institution. The viability of the proposed project can be generally but not necessarily individually, determined. This is where the calculated risk comes in and the need to be flexible and to be able to take such security as is available (para. 2.23).

Interest Rates and Spreads

4.52 The Bank's policy on interest rates should be well known. It is that interest rates should be positive and if a negative rate is proposed justification must be provided together with a statement of inflation rates for the past three years and forecasts of future inflation rates. The following paragraphs will therefore be confined to discussing interest spreads.

4.53 To survive an institution must make profits. Since most institutional income derives from interest on loans it follows that the difference between its borrowing and lending rates - its spread - will be crucial. How large the spread should be will depend upon several factors: cost of staff (salaries, allowances, etc.); other administrative costs (rents, printing, stationery, etc.); volume of lending provision for bad debts; need to build up other reserves, profits, etc. The cardinal principle governing the magnitude of the spread should be that it is sufficient to pay all administrative and other expenses and permit the creation of adequate reserves. It is difficult to lay down hard and fast rules for this. While average spreads for Bank
projects have frequently been in the range from 3% to 5%, costs will depend very much on local circumstances and conditions and may well be several times greater than this if the bulk of an institution’s lending is in small amounts to many small farmers. This highlights one of the disadvantages of institutions specializing in lending only to small farmers—high administrative costs with no income from more profitable types of lending to help offset such costs. In that event a substantial spread will be required which may result in interest rates higher than Government is agreeable to or rates out of line with others.

4.54 Inadequate spreads can have serious repercussions on an institution. If it cannot afford to pay competitive salaries it will not attract top class staff or alternatively, it will be unable to employ sufficient staff. In the latter case the tendency is to skimp on such staff as debt-collating, technical and field with a consequent decrease in the quality of the portfolio and an increase in arrears. Reserves will be insufficient which will affect the financial standing of the institution in the market thereby militating against its ability to raise funds. It will be unable to replace obsolete office machinery or take advantage of new technology and its training program will probably be severely curtailed. Or alternatively it may maintain its services and incur substantial losses which will eventually erode its capital base and further damage its prospects of further fund raising.

4.55 It is therefore necessary to assess with care not only present costs of running the institution but also future costs, particularly if a substantial expansion program is contemplated. In most cases major costs will be incurred in the processing of loans, their issue and subsequent collection. When costing loan processing do not forget the expenses incurred at the preliminary stages of loan application, e.g., cost of application forms, visits to potential borrowers to "appraise" schemes and so on. It may be advisable to make a nominal charge for loan application forms to minimize frivolous applications. Equally some institutions make a charge for initial appraisal visits either by way of a flat fee or a fee based on a percentage of the loan amount. If the number of visits is to be substantial such charges are well worthwhile considering particularly if there is a "squeeze" on the spread.

4.56 Unfortunately spreads are often dictated arbitrarily by government decreeing a maximum rate of interest which may be charged on particular types of loans. The spread obtainable will then depend on the cost of funds and if such cost is high the spread may be unacceptably low. Under such circumstances, every effort should be made to persuade governments to raise interest ceilings, pointing out the necessity for institutional viability. Alternatively, government can provide its share of the funds at very low rates of interest or even interest-free. The institution can then "blend" this rate with its costs of other sources of funds and so obtain an acceptable spread. Failing such courses of action the least preferred other alternative is for government to undertake to subsidize the institution in the event of loss but this is not a satisfactory solution since it invites governmental interference in institutional affairs and leads to institutional degeneration of responsibility.

4.57 If commercial banks are involved the question of spread becomes even more important. Unless the spread is sufficient to give a profit there will be no incentive for commercial banks to participate in agricultural credit schemes. Governments cannot (or should not) directly subsidize commercial
bank operations. The spread may be made more attractive by government providing funds at subsidized rates or even interest-free. However, in the case of commercial banks there should be a proviso that the banks will continue to provide a proportion of the funds from their own resources otherwise one of the main objectives of commercial bank involvement, namely the channelling of some of their funds into the agricultural sector, will be defeated.

4.58 The whole question of interest rates is complicated. Rates in the agricultural sector cannot be viewed in isolation, they must be related to ruling interest rates throughout the economy. The question of subsidized interest for agriculture versus non-subsidized is hotly argued at all levels. The Bank's position is against subsidized interest rates for a variety of very valid reasons. If farmers require to be subsidized there are better and more direct ways of doing it than through interest rates. Nevertheless whatever the rate the spread is still of vital importance to an institution and every effort must be made (possibly in conjunction with a general rise in the interest rate) to ensure that the spread is adequate to enable the institution to function efficiently.

Information to be Provided by Institutional Borrowers

4.59 Certain basic information is essential for the proper appraisal of a financial institution. It will obviously vary with the type of institution and project. The basic information required for an agricultural credit institution is given at Annex I. Some potential borrowers may resist giving some of the information; others may claim it is not available, particularly the data on aging of arrears. In that event a time limit should be set for its production which should normally not be later than the completion of White Cover, preferably not later than the end of appraisal.

V. CUSTOMER RELATIONS

Customer Requirements

5.01 Much has been written and said about agricultural credit institutions and in the process the most important element - the customers - are often ignored. Yet without them the institutions could not, and would not, exist. Borrowers have three main requirements (para. 2.17):

(a) the right amount of credit;

(b) at the right time; and

(c) at the right price.

5.02 The right amount is important if the project is to be successful for the borrower. This does not advocate 100% lending; borrowers should have a reasonable stake in the venture in accordance with their means. The borrower's contribution (often called "down payment") should be fixed at the outset (in many projects a minimum contribution is specified in the Loan Agreement) and after that the full amount required to complete the project should be made available. Of course the amount of the loan will depend upon several factors (security, ability to repay, etc.) and the borrower's original
request must often be scaled down, but the point is that having decided to grant a loan, ensure that it is sufficient to complete the job. Yet it is surprising how many inadequate loans are made, particularly to small farmers, and it is assumed the borrower will obtain the necessary additional funds from other sources. This usually results in driving the borrower into the hands of moneylenders or else he fails to complete the project or skimps on inputs. In any case the chance of the institution obtaining repayment is substantially reduced. Remember, given a choice, borrowers prefer to repay moneylenders before institutions because of their higher interest rates and usually the closer relationship.

5.03 Making credit available at the right time is equally important. It is surprising how often loans for planting are not available until the planting season is over. The issue of such loans is an open invitation to default. The cause of late issue of loans may lie with the institution (cumbersome procedures, insufficient staff, lack of funds and so on) or with the borrowers (late application, insufficient information, etc.) In either event the matter must be remedied if the credit system is to be effective.

5.04 The right price plays its part too. This not only means a reasonable rate of interest but other, perhaps hidden, charges which may make credit overly expensive for the borrower. For instance if mortgages are insisted upon as security (para. 4.43) the costs of registration, stamp duty, attorney's fees, etc. may be high. If borrowers have to travel long distances to complete loan formalities and effect repayment they may be involved in comparatively heavy expenses for lodging, transport and subsistence as well as losing valuable working time.

5.05 It may well be that borrowers themselves may be unaware of some of the pitfalls of credit, particularly if credit facilities have not previously been available. Perhaps a large number may not be literate, but that does not necessarily detract from their farming abilities - but it certainly makes things more difficult for the institution. Time and money spent on the education of borrowers may prove to be a good investment.

Education of Borrowers

5.06 Unsophisticated borrowers, especially those using credit for the first time, need to be educated into its uses and responsibilities. Whilst it is unrealistic to expect commercial financial institutions (commercial banks) to undertake such a task it should certainly be done by special development banks (para. 2.10) and cooperatives (para. 2.11). Government too should be prepared to sponsor training courses for would-be borrowers particularly if the aim is to provide credit for small farmers.

5.07 The topics covered should include: (a) how to decide upon the amount to borrow; (b) security requirements; (c) interest charges and why interest must be paid; (d) the necessity for repayment and the penalties which may be incurred in case of default; and (e) the need to keep simple accounts and, if possible, illustrations of simple accounting systems. Courses, or talks, should be conducted as near as possible to the homes of the borrowers. It is unrealistic to think that people will travel long distances for such purposes. Villages or other centres of population should be used. Much of the training can be relatively inexpensive and cannot only teach people how to use credit but build up a rapport with borrowers. A Training Officer (para. 3.13) can usefully plan and coordinate such training sessions.
Motivation of Borrowers

5.08 Many borrowers, especially small peasant farmers, are automatically suspicious of schemes proposed by governments or institutions. So often schemes are imposed from above without consultation with potential borrowers and without finding out if the schemes really meet farmers' requirements. Before a credit project is finalized a survey should be carried out to determine demand under the proposed conditions. Farmers should feel involved right from the outset and if they believe that the project is really being introduced for their advantage, success is much more likely. Even in their own countries there is an unfortunate tendency to regard small farmers as incompetent; far from it, they derive their knowledge from generations of experience and merit attention. Their knowledge of local conditions (weather, soil, social, etc.) can be invaluable.

5.09 Credit should not be introduced haphazardly. It needs to be accompanied by sound technical assistance. By adopting to him unknown techniques the farmer is taking substantial risks, often putting his most cherished possessions and the welfare of his family on the line. He may well need to be convinced of the justification for this and that benefits will accrue. This is one reason why extension is so important (para. 3.36). If demonstration farms or plots can be arranged so much the better.

5.10 It is important to build up and foster customer relationship. If borrowers regard an institution as an enemy to be cheated and frustrated as often as possible, credit schemes of whatever type are unlikely to succeed. It is necessary to instil confidence in borrowers and demonstrate that by cooperating with the institution real improvements in their standard of living can be achieved.

Mobilization of Rural Savings

5.11 Credit and thrift should go hand in hand. As incomes increase so should savings be encouraged. But all too often the savings aspect (by which is meant the deposit of money in some interest bearing account) is ignored and yet it can provide a very useful additional source of funds. However, people need encouragement and incentive to save, particularly if the habit of hoarding is to be broken. Confidence in the institution, confidence that their money will be safe, is the first requirement. Here a helpful staff, neat clean accommodation, and a general air of efficiency and well-being can go a long way toward establishing confidence.

5.12 Ease of deposit and, more especially, ease of withdrawal are of paramount importance. People are unlikely to be tempted to use savings facilities if they have to travel long distances to do so. Some ways must be devised to bring savings banking to the people and not vice versa. The establishment of a network of branch offices is the obvious and preferred solution but this is, very costly, particularly in the early stages before a substantial volume of business has been built up. Consider setting up small part-time agencies in a shop or community hall for a few hours a week. Try to persuade large employers of labour to institute pay-roll savings schemes where monthly or weekly deduction are made from wages on the written instructions of the employees and credited direct to savings accounts. If this can be arranged withdrawal facilities must also be provided. Employers will not be happy if asked to release employees during working hours to enable them to
withdraw savings. If an institutional office is sufficiently close to the place of work then arrangements must be made to keep such office open after working hours. Alternatively it may be possible to get permission to provide temporary withdrawal facilities within the work place itself, say in the canteen or leisure area. If distances are long and customers scattered, mobile units may be the answer. They are comparatively expensive to operate and certainly present security risks but they can also be used in loan processing and collection and are a valuable publicity medium in remote areas. It is indeed bringing banking to the people and may be regarded as part of the educational process (paras. 5.06 - 5.07).

5.13 Assuming the right kind of physical facilities can be provided, it is equally important to see that the right methods of savings are available. The type of unsophisticated savers which are here discussed often require to be able to withdraw money to meet sudden emergencies (illness, funerals, parties, etc.). Thus to suggest they should tie up their funds for long periods such as three to five years is unrealistic. There is one reason why the Rural Debenture Scheme in India was not successful. Ease and speed of withdrawal are essential if rural savings schemes are to succeed. However over and above what may be termed "ordinary" savings facilities, "incentive" schemes can attract savers and help to mobilize some of the hoarded and dead money which is so much a part of unsophisticated rural economies.

5.14 It is not possible here to go into details of incentive schemes, which are many and varied. Suffice to mention just a few of the simpler variety. Almost invariably housing is much prized by most people, be they rural or urban. Savings linked to house purchase and/or improvement can be very attractive and fulfill two purposes - mobilize internal resources and eventually increase the scarce housing stock. Simple premium or lottery schemes can also prove popular. Instead of interest on deposits there are periodical draws for attractive money prizes, whilst the original deposit remains intact. Saving for a predetermined purpose can also attract savers, particularly if the consumer goods offered are sought-after and not too readily available through ordinary commercial channels (radios, bicycles, sewing machines, etc.). Such schemes may attract a new class of saver who has heretofore been neglected or ignored in many rural communities - the Ladies.

5.15 The mobilization of internal resources, or savings, is important but far too neglected in rural areas. Money dead and buried helps nobody, it must be made to work. To this end savings by the rural population must be encouraged, and the operative word is encouraged. It is very unlikely that savings (para. 5.11) will be spontaneous, expect in a small way. Schemes must be devised to attract savers by offering service (ease of deposit and withdrawal) and incentives be they attractive interest rates, cash prizes (lottery schemes) or a specified objective with preferential treatment (housing, consumer goods, etc.).

VI. PROJECT PROCESSING AND SUPERVISION FROM AN INSTITUTIONAL ASPECT

Project Preparation

6.01 Good project preparation can go a long way to ensuring a successful project. As far as possible institutions should participate in preparation so
that they are involved in a project right from the start and are aware of its background and initial problems. If the institution is ignored at the preparation stage it may well have no enthusiasm for the subsequent project, indeed it may be regarded as an "outsider’s” project foisted upon the institution which does not approve of it. Involvement of institutional staff in preparation can provide useful training and alert such staff to previously unknown or unrecognized problems. It has often introduced them to the concepts of economic and financial rates of return which up to that time have not been used within the institution.

6.02 Some of the more experienced institutions (e.g. ARDC) will be capable of preparing agricultural credit projects on their own. Others quite justifiably, will require substantial help, particularly with technical aspects. But in any event the institution should be required to participate as fully as possible. Details of institutional information to be provided as a minimum are given at Appendix I.

6.03 Just as institutions should be involved in preparation work so too they should participate in appraisal. This will give the institutional staff valuable experience and will given them an insight into rationale for certain project decisions. They should be given opportunities to offer advice and criticism since their local knowledge can be of great value.

6.04 Before appraisal the institution should be given a list of the information which will be required (Appendix I) and the time by which it should be supplied. This should be discussed with the appropriate officials and agreed. No doubt in the course of appraisal further information will become necessary and the institution should be encouraged to provide it. At all times the institution should be involved to the maximum extent possible although of course there will be times when it will be asked to accept unpalatable decisions; at least it will know the reasons for such decisions.

Supervision of Credit Projects

6.05 The Bank is required to supervise (or review) projects from time to time, the timing depending upon the progress of the particular project and staff availability. However, supervision by the institution itself should not be ignored, indeed it should be actively encouraged, since if it is done properly it can lighten considerably the Bank’s supervision load. It is also in the institution’s own interests to know how its projects are progressing, what problems have arisen and what remedial action may be required (para. 3.07).

6.06 Monitoring and evaluation (para. 3.28) cannot be carried out effectively without planned supervision, another reason for encouraging an institution to establish its own supervisory capacity. However it will often be necessary to demonstrate to institutions the necessity for supervision particularly if staffing is a constraint. Supervisory staff are often among the first to be reduced in times of financial stringency (para. 4.54). Perhaps the now mandatory requirement for borrowers to provide the Bank with evaluation reports within six months of project completion will stimulate institutional supervision.
VII. SUMMARY

To summarize the main points:

(i) The main aims of agricultural credit should be to provide credit to farmers at the right time, at the right price, and in the right amounts and to recover such credit promptly (paras. 1.05 and 5.02 - 5.05).

(ii) The selection of the right type of credit institution is critical to the success of a project (paras. 2.01 and 2.17 - 2.18).

(iii) Various types of institution together with some of their advantages and disadvantages are given in paras. 2.02 thru 2.16.

(iv) The use of credit institutions and where possible the adaptation of existing institutions (paras. 2.19-2.22).

(v) Need for flexibility and the taking of calculated risks (para. 2.23).

(vi) The importance of good management including Boards of Directors (para. 3.03-3.05).

(vii) Staff requirements and the types of staff which should be employed including the need for technicians and debt collectors (paras. 3.06-3.08).

(viii) Some conditions of employment with suggestions for incentives to attract scarce skills (para. 3.09).

(ix) The need for staff training (paras. 3.11-3.12).

(x) Types of training which should be considered including training overseas (paras. 3.13-3.18).

(xi) Accounting systems with a note of warning on computerization in developing countries (paras. 3.19-3.20).

(xii) The importance of audit and some of the difficulties which may be experienced in obtaining an acceptable audit including legal requirements in some countries (paras. 3.21-3.27).

(xiii) Taking care not to impose too heavy a burden on institutions in respect of Monitoring and Evaluation (para. 3.28).

(xiv) The need to assess carefully the increased institutional work-load resulting from a Project and some ideas on how much work certain staff can undertake (paras. 3.29-3.33).

(xv) Relationships with other organizations such as Extension, Marketing, Storage, Price Policies, etc., and the requirement for credit institutions not to operate in isolation (paras. 3.34-3.36).
(xvi) The particular importance of adequate Extension Services to support agricultural credit (para. 3.36).

(xvii) Some of the ills of, and ways to, minimize political interference (para. 3.37).

(xviii) The financial status of a credit institution including capital Structure, Sources of Funds, Earmarking of Funds, Terms of Funds, Debt/Equity Ratio and Arrears (paras. 4.01-4.02).

(xix) Arrears definitions and suggested method of calculation (paras. 4.03-4.05).

(xx) Significance of arrears and their effects on institutions (para. 4.06).

(xxi) Collection methods and some remedies and incentives (paras. 4.07-4.16).

(xxii) The importance of aging of arrears and its possible impact on lending policies (paras. 4.17-4.20);

(xxiii) The need for and some methods of Rescheduling (paras. 4.21-4.23).

(xxiv) Exceptional cases and justification for granting further loans to defaulters (para. 4.24).

(xxv) Definition of Bad Debts, Provisions for Bad Debts and Collection thereof (paras. 4.25-4.32).

(xxvi) Some ways of dealing with government requests to operate non-viable credit schemes (paras 4.37-4.39).

(xxvii) Security (collateral) requirements with details of various types of security available particularly other than land (paras. 4.40-4.51).

(xxviii) Interest Rates and Spreads and their impact on credit institutions including the reluctance of some governments to permit adequate margins (paras. 4.52-4.58).

(xxix) The basic information to be provided by Institutional Borrowers for appraisal (para. 4.59 and Annex I).

(www) How customers are often ignored and their basic requirements (paras. 5.01-5.05).

(wwwi) The need to educate borrowers and some ways of doing it (paras. 5.06-5.07).

(wwwii) The motivation of borrowers (paras. 5.08-5.10).

(wwwiii) The importance of mobilizing rural savings, what is required, and some incentive schemes (paras. 5.11-5.15).

(wwwiv) How and why institutions should be involved in preparation and appraisal work (paras. 6.01-6.06).
CHECK LIST OF INSTITUTIONAL INFORMATION
TO BE PROVIDED BY POTENTIAL BORROWERS

PRIOR TO APPRAISAL

1. Organogram - present situation and organization proposed for the future.

2. Staff List - showing salary scales.

3. Management Details - details of senior management, showing experience, present duties, future duties, etc.

4. Recruitment Program - indicating sources and grades of staff.

5. Training Program - showing types of training; in-services; external; local; overseas; costs of the program.

6. Balance Sheets and Profit and Loss Accounts together with Auditor's Reports for the previous five years (minimum three years).

7. Projected Balance Sheets and Profit and Loss accounts for the next five years.


9. Statement showing Arrears by age and loan category.

10. Sources and Application of Funds Statement.


13. Lending Regulations and Procedures including specimen Loan Application Form.


DURING APPRAISAL

15. Time-framed Recruitment Program based on agreed Project content.

16. Time-framed Training Program based on agreed Project content.
DURING APPRAISAL

18. Full details of Sources of Funds including co-financing arrangements.
19. Drafts of any amendments required to Laws, Statutes, etc. to enable the Project to be implemented.
21. Details of cooperation arrangements with Extension, Marketing and other services required under the Project.
22. Time-framed Program for the Establishment of Additional Branch Offices (if required).
23. Monitoring and Evaluation System.
24. Amended Lending Regulations as necessary.
## Illustrative Reports

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>LOAN/CREDIT #</th>
<th>PROJECT TITLE</th>
<th>POINTS ILLUSTRATED</th>
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<tbody>
<tr>
<td></td>
<td>C.539</td>
<td>Agric. Credit II</td>
<td></td>
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<td></td>
<td>C.721</td>
<td>Agric. Credit III</td>
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<tr>
<td>BRAZIL</td>
<td>L.1362</td>
<td>Minas Gerais Int. Rural Dev.</td>
<td>Integration of several different agencies.</td>
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<tr>
<td>INDIA</td>
<td></td>
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<td>The series of agricultural credit projects starting with Gujarat (C. 191) and culminating in the third ARDC Credit (C. 947) give excellent illustrations of the development of the Refinance Corporation and the cooperative Banking systems. Specific points are particularly well illustrated in the following projects:</td>
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