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**Pawnshops and
Microlending: A Fresh
Look is Needed***

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Pawnshops are an important source of microcredit in many developing countries, especially in Asia. Nevertheless, many practitioners, policymakers, and funding agencies seem to be prejudiced against pawnshops. They consider pawning to be a “desperate measure” and an activity that needs to be curtailed. As a result, some countries have laws that inhibit pawning by private sector operators. In other countries, pawning has not yet received adequate attention, despite its potential as a useful service.

The purpose of this note is to encourage those who are interested in finance for poor and low-income households to take a fresh look at pawning. The note briefly examines some of the assumptions that have contributed to the prejudices against and neglect of pawning, and the need for a fresh look, citing relevant experiences in Indonesia and Sri Lanka.

**Assumptions behind Pawnshop
Prejudices**

Pawnshops exploit poor and low-income clients. Many observers believe that pawnshops exploit poor and low-income households by charging high interest rates and setting predatory terms and conditions on loans. However, evidence to back up these views is weak. Pawnshops provide an important financial service to poor and low-income households by offering credit at rates that are relatively better than those of informal commercial moneylenders. The clients are able to convert their nonfinancial savings or assets quickly into ready cash for short periods, whenever needed. Thus, pawnshops often help clients raise cash urgently needed for emergencies. Most clients eventually redeem their pawned articles. Although pawnshops charge a higher interest rate than

(continued on page 2)

* The author gratefully acknowledges the comments of Klaus Maurer, Richard Meyer, Nimal Sanderatne, and Jayantha Perera.

Pawnshops and Microlending *(continued from page 1)*

many formal or semiformal sector suppliers of microcredit, their clients benefit from the minimal transaction costs. Therefore, the assumption on exploitation appears to be unrealistic. There are possibilities for exploitation, however, when monopoly conditions prevail in the market.

Poor and low-income households do not have assets that can be pawned.

A common but unsubstantiated view is that the poor do not have assets other than their labor and that low-income households have only minimal assets. Although this view may be true for families living in abject poverty, it is not true for a sizeable proportion of the poor and low-income households in many Asian countries, where even poor households have some assets. These assets may take the form of unproductive holdings of gold and jewelry. Given appropriate mechanisms, such assets can be converted for productive purposes by pledging them for loans.

Pawning: an Old Method of Lending

Pawning has a long history. Some researchers describe pawning as probably "the oldest method of lending." It existed in ancient Babylon, Athens, and Rome. The Bible makes references to pawning and states that "you should not take as a pledge anything a man needs to make a living."

In the People's Republic of China, pawning was prevalent in ancient times. Similarly, pawning has been practised for generations in many South Asian countries. ■

Pawnshops do not contribute to financial intermediation.

Pawnshops are viewed as incomplete financial institutions because they only provide loans. For greater financial deepening, more institutions and mechanisms that promote financial intermediation are needed. Although many advocate adding deposit mobilization services to credit-making institutions, this may not always be necessary or even desirable from a financial sector-wide perspective. For example, if a pawnshop borrows funds from a bank, it is participating in, and contributing to, financial intermediation. When a pawnshop transforms its clients' nonfinancial assets into cash, it is also in effect contributing to financial

intermediation. Hence, the nonintermediation assumption is overstated. Moreover, pawning services can be, and are being offered by financial intermediaries in some countries as discussed below.

Pawnshops do not finance productive economic activities.

It is generally presumed that pawnshops mostly finance consumption rather than productive economic activities, and hence do not contribute to development. Empirical evidence on this argument, however, is mixed. Generally, the available data on purposes for which people borrow are not amenable to serious analysis because of the fungibility of money. Clients in many developing countries, however, are known to use pawnshops to obtain cash for expanding their businesses and other productive activities, in addition to financing consumption. In Thailand, for example, low-income households use pawnshops to obtain cash to pay school fees for children. Pawnshops in Shanghai receive frequent visits from a large number of small enterprise operators in need of relatively short-term and small-volume loans in the city. The fact that those who pawn often redeem their goods is perhaps the best evidence that imprudence in personal financial management is not rampant.

A Fresh Look is Needed

The demand for financial services among poor and low-income households is diverse. To meet this varied demand, institutional diversity is needed. Specialized institutions that serve specific market niches may be an important part of an efficient financial system. Institutional diversity can potentially reduce the probability of systemic failures in the microfinance subsector.

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However, diversity in demand does not mean that each service provider must offer a range of products and services. Some institutions may be more efficient in providing credit-only services while others may be more efficient in providing deposit-only services. Still others may be more efficient suppliers of multiple financial services and realize economies of scope and scale in the process. It is unrealistic to expect each microfinance institution to provide both credit and deposit services and do so efficiently. Economies through specialization may also exist.

Pawning has the following attractive features for both the lender (the pawnshop or the financial institution providing the service) and the borrower (the pledger).

- A pawning transaction is simple: the borrower pledges an asset for a specified sum of money (a percentage of the appraised value of the asset) and retains the right to redeem it within a specific time by returning the original sum plus interest. If the item is not redeemed by the agreed time, the borrower loses the asset. This is the end of the transaction and hence there is no “ever-increasing debt” in pawning. For the pawning service provider, the main costs include labor, cost of capital, building, security, and insurance.
- Pawning reduces the lender’s risk substantially, compared with other types of microcredit if the value of the asset pledged is appraised reasonably carefully. Also, the lender’s transaction costs are minimal because there is no need to collect and analyze information about the client’s cash flow and creditworthiness, although the lender has to ascertain that the pledged asset has not been stolen. A

pawning loan can be processed very quickly. Thus, the lender can make a large number of small transactions in a short period to achieve the required volume to make a profit. There is no need for frequent contact with clients because each loan involves only two transactions (disbursement and recovery). Record keeping/accounting is also simple and low cost. These characteristics are powerful incentives for the expansion of pawning services.

- Pawnshops are attractive to potential borrowers as well. The borrowers are not subjected to high transaction costs. A borrower makes only one trip to secure a loan and one to make the repayment. Disbursement is quick. Pawnshops, therefore, can be a reliable source of credit for emergencies. The need for distress selling of assets can also be minimized if pawning facilities are available. Clients can get a lower interest rate from pawnshops than from most informal commercial moneylenders. Another advantage is that clients are not involved in complex “explicit and implicit social reciprocity arrangements” because the transaction is straight forward with “no strings attached”.¹ Innovative pawnshops serving niche markets accept a range of mobile assets and, thus, increase access to loans for many poor and low-income households.

Indonesia’s Experience with Pawning

In Indonesia, private institutions are not permitted to engage in pawning, which is done exclusively by *Perum Pegadaian* (PP), a state-owned company. PP has 722 branches (increasing from 450 branches in 1980) and 14 regional offices

throughout the country. PP provides small loans against movable assets. It has a large outreach that includes rural areas. In 2001, it provided 22.2 million loans to about 15.7 million clients. In comparison, the *unit desas* of Bank Rakyat Indonesia, a flagship microfinance institution in the developing world, served no more than 2.9 million borrowers in the same year. Thus, PP has become the major supplier of microcredit in Indonesia in terms of number of clients served. The total amount lent in 2001 was about \$702 million. At the end of 2001, its outstanding loan portfolio was \$159 million. Most loans are small: about 88% of the loans disbursed in 2001 were less than \$56 each. PP accepts for pledging a wide range of items including used clothes, clothing materials, and small electrical appliances like rice cookers and irons, in addition to gold and jewelry.

Transactions by PP take no more than 15 minutes to complete. Administrative costs are about 20.75% of the average loans outstanding. PP’s return on assets and return on equity for 2001 were 4.5% and 17.0%, respectively. Its main sources of funding include equity capital, long-term bonds, and short-term bank loans.

PP charges commercial interest rates that vary according to the loan size, from 1.25% to 1.75% per 15 days with 120 days maturity.

Additionally, PP charges insurance costs and a deposit fee on all loans. Loan recovery rates are very high, which is not surprising because the pledged good is auctioned if a client fails to repay on time. However, before the auction is conducted, the client is notified by mail and the date of the auction is posted on the branch’s notice board. After the auction, if the sale yields more than the total amount due to PP, the client receives the excess. (In

Key Advantages of Pawning

The rural economy of most Asian countries can well be characterized as penny economies, in which transactions between households and between them and rural firms are frequent but extremely small. Viable financial intermediation between participants in a penny economy needs a mode of operation that is adapted to the nature, size, and frequency of transactions in such an economy. In terms of banking practice, this implies low overheads, low risk, and quick procurement of loans in order to attain a sufficiently high volume of business. Pawnbroking of gold and valuables meets all three requirements. It remains one of the mysteries of banking wisdom in Southeast Asia as to why those financial institutions that have been given the express tasks of promoting rural welfare and of providing the poor with access to institutional credit, seem so diligently to avoid a profit-making enterprise that enjoys such great popularity in the private sector and has so much appeal to savers and borrowers. ■

Source: Bouman, F.J.A. 1989, *Small Short and Unsecured: Informal Rural Finance in India*. New Delhi: Oxford University Press. pp. 99-100.

¹ Bouman, F.J.A. and R. Houtman. 1988. *Pawnbroking as an Instrument of Rural Banking in the Third World*. Economic Development and Cultural Change. 37(1): 76.

countries that permit private pawning companies, clients normally do not get this benefit.) PP has auctioned only 0.5% of all pawned goods, indicating that nearly all clients eventually redeem their pawned items.²

Sri Lanka's Experience with Pawning

Sri Lanka has a relatively liberal environment for pawning operations. It has transformed a largely informal sector financial activity into an efficient institutional form of microcredit. Private sector companies, private commercial banks, state-owned commercial banks, and cooperative rural banks (CRBs) engage in pawning. This has encouraged competition and led to a reduction in interest rates charged on pawning loans in recent years.

The institution with the longest history of pawning in Sri Lanka is the state-owned People's Bank along with the cooperative rural banks (CRBs) that first carried out pawning as agents of the People's Bank. At the end of 1999, the CRBs had more than \$33 million in outstanding pawning loans, accounting for about 39% of their total outstanding loan portfolio. In general, the largest contribution to CRB profits has come from pawning operations. The higher relative profitability of pawning has led several private sector commercial banks to offer this service in recent years.

There have been negative repercussions also. Pawning made the People's Bank and CRB branches more

Distribution of Perum Pegadaian Loans by Size, 2001

Loan Size (\$ Equivalent)	Number of Loans (million)	%
1.1– 4.5	8.6	39
4.5–16.7	5.4	24
16.7–55.5	5.6	25
>55.5	2.6	12
Total	22.2	100

Source: Perum Pegadaian, *Annual Report 2001*.

vulnerable than other bank branches to attacks by insurgents and robbers during the 1980s. As a result, the insurance and security costs associated with pawning increased sharply. Indeed, the experience of Sri Lanka shows the risks that are associated with pawning and highlights the significance of law and order for the pawning business to achieve its potential as a significant source of microcredit.

Conclusion

Although pawning has its limitations, pawnshops add to the institutional diversity of the microfinance landscape and provide a useful service as microcredit institutions to poor and low-income households in countries where there are no severe legal restrictions on their operations. The prejudices often held against pawning are usually based on either unrealistic or incorrect assumptions. If an appropriate legal framework exists, financial institutions can add pawning

loans to their menu of products and achieve a significant outreach profitably.

Pawning also makes microcredit markets more competitive than otherwise would be the case. Often, institutions providing pawning services compete with informal, commercial money lenders. Liberalizing pawning markets and introducing a conducive and enabling regulatory and legal framework may enable pawnshops and other financial institutions to play a more dynamic role and provide services more efficiently.

It appears that those who are interested in microfinance development have yet to look seriously at the possibilities of pawning as a useful means of improving access by poor and low-income households to microcredit. However, research on the pawning industry in Asia is badly needed to explore this potential comprehensively. ■

² Asian Development Bank. 2003. Technical Assistance No. 3810-Indonesia: Rural Microfinance Indonesia. Solid Interim Report. Frankfurt: Bankakademie International. January.

Pawning by a Commercial Bank

The People's Bank of Sri Lanka has been providing pawning services for more than 3 decades. Its pawning operations have increased substantially since 1995. In recent years, it has established 188 separate pawning and savings centers (PSCs). At the end of 2001, the bank had 2.58 million pawn accounts and an outstanding pawning loan portfolio of about \$134 million. The bank disbursed \$117 million for 2.1 million pawning loans during 2001. Note that Sri Lanka's total population is about 19 million and the country has probably no more than 4.2 million households.

Pawning loans represent one of the bank's most profitable business activities. The PSCs have proved to be very popular with the poor and low-income segments of both urban and rural customers.

Clients need only an identification card and the gold item to be pawned. The term of the loan is 12 months, but the client is allowed to pay the entire loan at any time before the maturity date. If a client repays the loan before the maturity date, interest is charged only for the actual term of the loan, subject to one month minimum. The bank does not charge any other fees for pawning loans. If a pawning loan is greater than \$50, loan repayment can be made in installments.

The interest rate on pawning loans is higher than the rate on other commercial loans but significantly lower than that charged by commercial money lenders in the informal sector. Processing a pawning loan at an PSC takes no more than 15 minutes. ■

Source: People's Bank, Colombo.

Going Postal to Deliver Financial Services to Microclients

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Microfinance institutions (MFIs) in Asia serve a large number of clients, primarily through loans. The *MicroBanking Bulletin* (November 2002) tracked the performance of 147 leading MFIs worldwide, of which 39 are in Asia. These 39 MFIs reported 7.5 million active borrowers (83% of total active borrowers from 147 MFIs) with \$1,110 million in outstanding gross loan portfolio (56% of total). These numbers speak of the achievement of the microfinance industry in Asia.

As MFIs proliferated, the market for borrowers with the capacity to repay has been saturated in some countries, leading to a surge in debt and a decline in portfolio quality. As of 2002, few MFIs are viable—46% of the 39 leading MFIs in Asia included in the *Bulletin* are reported to be financially sustainable. The microfinance clientele have a high demand for other financial products aside from credit. Such financial products include savings, payment, and transfer services.

Many MFIs, however, are unable to provide new products due partly to high costs in developing and marketing them under the current microfinance technology. The regulatory and legal environment also restrict the MFIs from offering savings products. The microfinance industry needs to expand on a sustainable basis by offering diverse financial products. Given the limitation of MFIs, alternatives need to be identified and developed to provide various financial services efficiently.

The rural poor can be provided certain types of financial services through post-office savings banks (POSBs) operating in several developing countries. Advocates of microfinance exclude as MFIs those POSBs that are owned by the government and are operating from regular post offices.² But the role of POSBs in providing financial services to the poor, especially in rural areas, is significant. More than 50 developing countries in the world have some form of postal savings system in place for several decades.

Many poor Asian countries use POSBs to mobilize savings (see Table 1 on page 6). It is interesting to note that, as of 2000, POSBs in Indonesia, where unit *desas* of the Bank Rakyat Indonesia is very active in capturing deposits from over 25 million savers,³ could service over 7 million savings accounts through more than 2,500 branches.

¹ The author acknowledges documents provided by Isabelle Andreas, World Bank; and comments from Nimal A. Fernando, ADB.

² POSBs, although called banks, do not engage in full financial intermediation or universal banking services. They generally only provide savings services and accept insurance payments from federal employees. Money transfer services are performed by regular post office branches. They are not bound by banking laws and prudential regulations.

As of 2000, the banking system in India, comprising 2,200 banks with about 67,000 branches, mobilized deposits of over \$205 billion, accounting for 44% of GDP. In comparison, POSBs have about 154,000 branches, of which 137,000 are in rural areas, accounting for \$38.5 billion in outstanding deposits. Total financial savings of households, including deposits and insurance products, was \$43.8 billion, about 12% of which was held by POSBs and 37% by banks.

The majority of POSB clients were located in rural areas, with small deposits with an average balance of \$22 in passbook savings schemes, accounting for 13% of total volume of deposits and 52% of total number of clients of POSBs (World Bank, 2002).⁴

Advantages of POSBs in Microfinance

POSBs offer several advantages in expanding financial services to the rural poor. Located even in the remotest part of the country, POSBs are able to facilitate better financial intermediation, payment, and funds transfer services. They accept deposits, regardless of amount. They operate longer hours than most MFIs. They have a reputation as a friendly neighborhood formal institution; mail carriers are familiar with the community and can help reduce some information problems. Their deposits are protected by the government and are often provided tax benefits.

POSBs are readily accessible to small depositors, but are also open to all types of clients. Serving a wider clientele may help in diversifying their portfolio and cross-subsidizing cost for an efficient operation. Human and physical resources of several POSBs, however, are underutilized. This offers an opportunity to add new services at a lower cost compared with MFIs.

Since POSBs are generally owned by the government, they can deal with shortfalls in their cash flows through budgetary allocations, and, therefore, do not have to depend on donors. Because POSBs lend deposits to the government, there is an automatic sovereign guarantee/protection for the deposits. This may be important in countries that do not have deposit insurance schemes. However, if used inappropriately, these advantages will adversely affect POSBs.

POSBs offer a potential alternative to MFIs for mass financial services. POSBs have the advantage of reaching and providing clients with financial services, which formal financial institutions and MFIs may find it difficult to provide due to high costs. But major issues restrict the use of POSBs as a viable alternative to expand microfinance services to the unbankable.

³ Robinson, Marguerite 2002. *The Microfinance Revolution: Volume 2, Lessons from Indonesia*. Washington, DC: World Bank, p. 388.

⁴ In 2001, POSBs worldwide mobilized deposits worth \$3 trillion from over 700 million account holders and facilitated more than 10,000 million money transfers (Universal Postal Union, 2002). With \$2 trillion in deposits and another \$1.5 trillion in insurance policies, the post office in Japan is the world's largest financial institution, controlling a quarter of Japan's household assets (*The Economist*, 10 August 2002, p.63).

Issues Related to POSBs as Microfinance Providers

POSBs in the Asia and Pacific region have diverse institutional structure. They operate as a government entity as seen in India and Pakistan; an agent of a national bank for deposit collection in Sri Lanka; and as a public-private joint venture in Turkey (Table 2).

Since governments in general own POSBs, the ownership structure raises issues on effective governance and prudential supervision, and increases opportunities for political interference that may limit outreach to the poor who may lack political clout. Political elements may also influence the location, and staff selection and human resource management such as transfers that can affect staff productivity.

POSBs have been passive collectors of deposits. Although the types of products offered have expanded in recent years, the products only include deposits and money transfer services offered through regular post office branches (Table 2). Deposits and revenues from money transfer and payment services are often used to finance state and federal deficits. While retail lending may help in financial intermediation, it may not be essential for their growth and viability. Instead, adequately priced and good quality deposit, money transfer, and payment

Table 1: Outreach of POSBs in Asia

Country (year of data)	Number of Savings Accounts	Assets in Postal Savings Accounts at End of Year (\$ million)	No. of Branches for Financial Services, Including Mobiles
Bangladesh (1998)	3,400,020	163.00	9,245
People's Republic of China (2000)	110,000,000	55,697.00	66,649
India (2000)	116,187,772	4,058.00	154,551
Indonesia (2000)	7,700,612	8.00	2,536
Republic of Korea (2000)	20,360,000	19,033.00	2,804
Nepal (2000)	9,000	.06	519
Pakistan (2000)	864,161	592.00	12,828
Philippines (2000)	63,083	0.03	1,762
Sri Lanka (2000)	4,727,240	9.10	4,499

Source: Universal Postal Union web site, www.upu.int, September 2002.

services—that fill in the niches in rural financial markets—can help POSBs become viable.

POSBs are supported with heavy subsidies. In India, for instance, the government subsidized 55% of the operating costs of the post offices in 2000. Subsidies are justified if it is not feasible to expand on a commercial basis to serve remote areas, although subsidies may also hamper efforts to become efficient and self-sustainable.

Making POSBs Expand Effective Services for Microclients

While expanding financial services to the rural poor using POSBs is feasible, several issues remain in adapting them as a viable alternative to MFIs without

undermining the financial markets, competition and commercialization. POSBs may need to move away from passively collecting savings and issuing money orders to carrying out more aggressive ways to attract clients to become viable. To that end, POSBs need to be restructured and reengineered.

First, a clear demarcation between regular postal services and financial services is needed so products can be priced appropriately. In addition, governance structure and ownership issues have to be addressed. While privatization may be too early for the majority of POSBs, they may be provided autonomy through a board of directors, selected transparently from the private sector, which is legally empowered to be self-perpetuating and

POSBs in India

Post-office savings banks (POSBs) in India were established in 1882 by the British colonizers to mobilize savings and operate as an agency for the ministry of finance. It is now owned by the Government and governed by the Ministry of Finance.

As of 2000, there were 154,000 POSBs in India, of which 89% were located in rural areas. A post office covered about 6,400 people, comparing well with Singapore and the United States. These offices handled more than 110 million money orders and administered 114 million savings accounts in 2000. All POSBs in rural areas offer 12 different types of savings schemes, ranging from regular pass book savings accounts, to time deposits, and to national savings

certificates that are 100% tax exempt and offer deposit rates higher than banks. Money transfer facilities through money orders and limited life insurance facilities are also provided.

Indian POSBs are heavily subsidized by the post office system, which is financed by the Government up to 55% to cover operating costs. Only few of the deposit schemes are profitable. They lack experience in asset management. Currently, 80% of the savings collected in a state is used to fund deficits in that state and 20% are allocated to central government. Overstaffing, underpaid management staff, and overpaid lower ranked staff, lack of security of tenure and performance incentives, inflexible pricing of products, uniform tariffs, and low productivity are challenges facing the institution. They are also inefficient due partly to the lack of computers for nationwide networking in moving funds

effectively. Only 1,000 offices in major urban areas are computerized.

A clear rural-urban divide exists. Corporate tie-ups with State Bank of India, Industrial Bank of India, Universal Trust India, Western Union, and Master Card are currently being developed for urban areas to provide mutual funds and bonds, automated teller machine facilities, and payment and remittance services across the world. Rural areas have access to only limited types of products and the demand to price the products and develop mechanisms to provide them efficiently need to be assessed.

A lack of separation between owner, operator, and regulator has led to weak governance and political interference. But opportunities exist for POSBs to restructure and re-engineer their activities to use the strengths and develop innovative linkages to serve the rural poor. ■

Table 2: Products and Structure of POSBs in Asia

Country	Products	Agency Responsible
Hong Kong, China	Internet-based banking and smart cards for deposits and paying loan installments	
India and Pakistan	Deposits, postal life insurance for public sector employees, remittances and payment services, money orders. In India, mutual funds, automated teller machines, and fast worldwide money transfer are provided in some cities through partnerships with private and public sector.	Operated by post and telecommunications department and under Ministry of Finance
Iran	Smart cards and retail financial services	Postbank of Iran under postal department
Republic of Korea	Payments, savings, life insurance, and cashless transactions through e-postalbank.	Ministry of posts and telecommunications
Mongolia	Savings, transfer and payment services, and some loans	Postbank licensed by Central Bank
People's Republic of China	Savings and remittances	Bureau of ministry of posts and telecommunications, or State Postal Bureau
Sri Lanka	Deposit services	Amalgamated into national savings bank; agent of national savings bank
Taipei, China	Payments, deposits, and insurance services at branches and through e-banking	Postbank as part of ministry of post and telecommunications
Bangladesh, Lao People's Democratic Republic, Thailand	Postal money orders and other cash-based services	Ministry of posts and telecommunications
Turkey	Partner bank products and postal giro	Postbank as a joint venture between postal division and local bank interested in dense postal network

with ex-officio members to guarantee a stable structure. For example, the local prominent businessmen in Japan—and not the central or local government—undertake the chief representative functions of POSBs to bring in the strength of private-public sector partnerships. In Malaysia, postal savings banks are converted to national savings banks, allowing a broader scope of activities, including credit services.

Second, financial services and products need to be diversified. Prudent cash flow management will ensure reliable payments for depositors. Deposits and revenues

from the majority of POSBs are currently channeled to fund government deficits, although such investments do not generate much income. Cross-subsidization through regular postal products is becoming increasingly difficult due to competition from private courier, parcel, and Internet service providers, especially in urban and peri-urban areas. In rural areas, informal systems such as self-help groups compete with POSBs in mobilizing deposits.

The majority of POSBs are not suited for retail lending due to weak governance structure and lack of skilled staff. They can, however, provide other

types of services. For instance, they can partner with MFIs to offer some microfinance products such as deposit services, fund transfers, and payment services in a cost-efficient way. They can function as agents for collecting information and as collection windows for loan installments for banks and MFIs. POSBs can be equipped with automatic teller machines (ATMs) and smart cards for MFIs. In high-risk areas, POSBs can help transfer MFI funds from their branches to headquarters. These auxiliary services can generate fees and commissions for POSBs to become self-sustainable. On the other hand, the MFIs can expand financial services to unbanked areas and offer more financial products at a lower cost.

Since postal staff are often underutilized, they may help provide new services to increase capacity utilization of post offices. Costs may increase in terms of salaries since financial services may require more skills than mere mail delivery and sorting. Staff will, therefore, need training to provide financial services effectively.

POSBs may find better clients than the government in channeling their investments to obtain higher revenues, as several MFIs are now searching for funding sources. POSBs may channel some locally mobilized funds to finance promising local MFIs for their on-lending activities. Some of the locally mobilized funds may be earmarked for a centrally based apex that can intermediate nationwide.

All options for the efficient use of deposits mobilized by POSBs need to be identified. To handle such types of intermediation, POSBs may require skills to evaluate creditworthiness of MFIs for funding. At the macro level, this may also require changes in ownership structures and formulation of legal and regulatory guidelines—all these involve costs. The fees and revenues collected from some auxiliary services can be used for developing the local POSB office and staff. Some initial subsidies from the government can also be used in building capacity of the postal banks.

Before tapping POSBs as microfinance providers, several issues

need to be resolved: Is there a demand for postal bank services? Is it worth restructuring POSBs to improve financial services to the poor efficiently? What impact will this have on existing financial arrangements? How can they complement existing financial

institutions and enhance cost effectiveness in providing quality services? What time frame is required for such changes?

There are several experiments underway and there is ample room for learning from one another. The

Universal Postal Union and World Savings Bank Institute are facilitating information flows among POSBs and advocating standardization and transparency of operations. The potential role of POSBs as financial agents need to be explored before strongly advocating their use. ■

NEWS HIGHLIGHTS

Regional Technical Assistance for Rural Finance in Central Asia Approved

The Asian Development Bank (ADB) approved in December 2002 a \$600,000 regional technical assistance (RETA) to help promote viable and sustainable rural financial systems in the Central Asian republics (CARs).

The RETA will support a regional study, which will provide an overview and analysis of rural financial activities, including issues relating to the development of sound rural financial markets in each CAR.

The findings and recommendations of the RETA will be discussed with stakeholders at the national and regional levels. These will help prepare efficient approaches to building viable and sustainable rural financial systems in these countries. The RETA will be implemented, starting in April 2003.

Technical Assistance to Develop Microfinance for the Kyrgyz Republic

The Asian Development Bank (ADB) will help the Kyrgyz Republic improve its microfinance institutions through a technical assistance of \$550,000, approved in December 2002. The grant will help strengthen the capacity of the National Bank of the Kyrgyz Republic (NBKR) to regulate and supervise microfinance institutions, and of the Financial Company for the Support and Development of Savings and Credit Unions (FCCU) to supervise and regulate savings and credit unions.

The technical assistance is expected to contribute to developing a sound and viable financial system that can provide a range of financial services on a sustainable basis. The technical assistance will help formulate new regulations for supervising microfinance institutions and assist in the Government's efforts in improving the institutional capacity of NBKR and FCCU. The implementation of the technical assistance commenced in February 2003. ■

BOOK REVIEW

Nimal Sanderatne. September 2002. *Leading Issues in Rural Finance*. Postgraduate Institute of Agriculture, University of Peradeniya: Sri Lanka.

Rural and agricultural finance has re-emerged as a development topic of great interest for many funding agencies and policy makers. Unfortunately, recent proposals for changing policy and creating new agricultural development banks suggest that the supporters have forgotten the key lessons learned from the dismal performance of most agricultural credit programs implemented in the 1960s to 1980s under the directed credit paradigm. This book once again reminds us of those lessons.

Professor Sanderatne is a recognized rural finance authority in Asia with both academic and policy experience, and this book reflects a lifetime of research and analysis of the key issues. It contains 13 chapters. Three chapters in the first section cover the functions, fea-

tures, and evolution of rural financial markets. In two chapters in section two, the author straightforwardly tackles the contentious issues concerning the role of informal finance with empirical data presented for Sri Lanka. Section three discusses rural savings mobilization.

Section four on institutional finance covers important topics related to institutional lending in rural areas. Five chapters deal with the evolution of institutional credit in Sri Lanka, the problem of loan recovery, interest rate policies, an analysis of the factors that explain small farmer loan defaults, and political economy issues that contribute to defaults. Taken together, these chapters provide abundant evidence of how the old paradigm of subsidized farm credit failed to develop sustainable rural finance in the country despite successive programs, policies, institutions, and guarantees.

The last chapter ends on a more positive note by reviewing key aspects of out-

reach and sustainability of microfinance and identifies strengths and limitations of the new financial system paradigm.

Readers of this book will be reminded about how this prominent figure in the field helped compile the evidence and arguments, pointing to the failures of the directed credit paradigm in Asia. His work contributed to the base of understanding used to design the more promising approaches used today in successful microfinance programs. This material needs to be reread by everyone who suggests quick and easy solutions to the challenges of rural finance. ■

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