

TECHNICAL ASSISTANCE COMPLETION REPORT¹

Division: EAFM

TA No., Country and Name			Amount Approved: \$1,000,000	
4430-PRC: Rural Finance Reforms and Development of Microfinance institutions			Revised Amount: (no revisions)	
Executing Agencies		Source of Funding	Amount Undisbursed:	Amount Utilized:
IMAR Financial Office (Component A) Guizhou Provincial RCC Reform Office (Component B)		Poverty Reduction Cooperation Fund (DfID) of the Government of the United Kingdom	\$76,664	\$923,336
TA Approval Date:	TA Signing Date:	Fielding of First Consultant/s:	TA Completion Date Original: 30 Nov 2005	Actual: 31 Dec 2007
9 Nov 2004	7 Dec 2004	IMAR Feb 2005 Guizhou Apr 2005	Account Closing Date Original: 30 Nov 2005	Actual: 18 April 2008
Description <p>Higher levels of poverty and rural populations; strong government support; the rapid growth of non-agricultural sectors; and the need to reach the poor with suitable financial services have encouraged efforts to reform rural credit cooperatives (RCCs) and support microfinance institutions (MFIs). Based on a study of 158 microfinance (MF) pilots, the People's Bank of China (PBOC) concluded that (i) MFIs should be encouraged in the central and western regions, targeting the poor with income-generating capacity, and nonbanking MFIs should not be allowed to take deposits; (ii) modalities and loan sizes should be made more flexible; (iii) interest rate bands should be widened depending on costs and risks; (iv) tax concessions should be given to MFIs; (v) MFIs could be self-regulated through an association; and (vi) optional minimum investment for MFIs should be around CNY5 million, consisting of CNY1.5 million for operations and training, and CNY3.5 million for loan funds to finance operations for 4,000 low-income households. However, the following concerns needed to be addressed: geographic distance and economic disparity; limited operational scale, poor financial performance, and weak institutional capability; policy constraints, including local government interference; and poor corporate governance. The TA was designed to address key RCC reform issues and the creation of a legal structure for microcredit organizations in the two target provinces.</p>				
Expected Impact, Outcome and Outputs <p>The TA's goal (impact) was to expand affordable and sustainable financial services to the rural sector and the poor in Guizhou Province and Inner Mongolia Autonomous Region (IMAR). Its purpose (outcome) was the establishment in Guizhou Province and IMAR of rural and microfinance systems with prudent administration and supervisory frameworks. It had two components. Component A in IMAR was to (i) assess the performance of RCCs in IMAR and identify and help implement a comprehensive strategy for RCC policy and institutional reforms in IMAR; (ii) prepare pilot RCCs and rural credit cooperative unions (RCCUs) with commercial potential for restructuring into agriculture commercial banks or agriculture commercial cooperative banks; and (iii) establish a conducive policy framework for MF development. Component B in Guizhou was to (i) build the capacity for RCC staff in Guizhou to improve loan operations in the post-restructuring period; (ii) develop Guizhou provincial and related county governments' understanding of, and capacity for support to, MF policy, regulatory, and institutional development; and (iii) develop and implement a competitive bidding process to establish a licensed model MFI in Jiangkou and adjacent counties.</p>				
<p>The TA design was appropriate. During this time, the Government was moving from extensive piloting of alternative financing institutions to determination of more permanent and more effective organizations. Risks had proven to be manageable for microcredit MFIs, and results in poverty reduction were positive. RCC reforms were starting to take hold, and the gaps in capacity building needs and real losses were becoming apparent. By providing significant and flexible resources to two key provinces, engaging the national level regulators, and building in numerous workshops, the TA increased the ongoing dialogue and level of willingness to entertain change. In 2005, this project was designated by OED (now IED) as one of only two TAs to receive a perfect score on the quality of its project framework.</p>				

¹ In preparing any country program or strategy, financing any project, or by making any designation of or reference to a particular territory or geographic area in this document, the Asian Development Bank does not intend to make any judgments as to the legal or other status of any territory or area.

Delivery of Inputs and Conduct of Activities

The TA was originally planned for November 2004 - November 2005 but was extended for 25 more months through December 2007 due to significant additional outputs requested by the Government and delivered under the TA. Five international consultants for 17.4 person-months and nine national consultants for 24 months provided services in agricultural banking, MF development, RCC accounting and management, MF licensing, and MF institutional development. Thirteen consultants were recruited in a very timely manner and commenced work in the field three months after the TA was signed. The consultants were recruited separately but the TA project officer solicited high quality consultants and worked closely with them, thus creating good teamwork and substantial and cooperative engagement with the Government. The PERs have been completed showing satisfactory performance, which is the overall rating of the consultant inputs. The TA was intensively supervised with 12 missions over 3 years.

The initial studies undertaken, multiple workshops with both provinces participating in information sharing, and the quality of consultant inputs enabled Government officials to learn quickly and have a clearer vision of additional opportunities. No revisions were effected in the planned work but significant additional activities were undertaken. Judicious use of consulting resources enabled the TA to more than double international consulting inputs and for the project officer to be responsive to the significant additional requests. Additional outputs specific to each component are listed below. An unplanned major conference to share results nationwide in April 2007 and the development of a detailed publication in Chinese and English were added to the overall TA outputs at the request of the PBOC. ADB's performance was highly satisfactory.

For Component A in IMAR, the EA performed highly satisfactorily, using initial results to enable further development than expected. A detailed study assessing the environment for both RCCs and MF was completed in early June 2005. One of the more important findings of the report was that the regulators had not sufficiently detached from operations of state-owned enterprise banks and RCCs. As a result, the institutional autonomy was lower, as was the willingness to disclose weaknesses. This high-quality report increased interest in both having a potential investor assess an RCCU to determine appropriate options for converting an RCCU to a bank, and in carefully proceeding with RCC reforms with better data. The TA added an assessment for restructuring from a key international investor in cooperative banks, Rabobank. This was used as the basis for reform for the initial RCCU with 11 RCCs. In addition, IMAR also conducted a bid process and issued an MCC license for the Dongshang area, requiring additional consulting time to develop demand and supply studies as well as undertake the bid process and evaluation.

For Component B in Guizhou, the EA was also highly successful, participating strongly and responsively, and effectively using and contributing to inputs. The RCC training needs assessment was completed and, based on this, an initial training on credit analysis was provided and a training-of-trainers program established for the RCCU training center. A client demand assessment was completed, and actual and potential suppliers of rural finance were documented. The investigation process for developing the bids for MF licenses illuminated the weaknesses in the policy environment, including problems investors perceived with restrictions on interest rates, funding, geographic location, sector and loan size, as well as with the licensing time horizon (originally planned for one year). These were addressed through consultations on how to both improve the general regulatory environment, and create specific incentives in the bidding process. Workshops were held with various stakeholder groups to educate them on (i) the research processes undertaken by the consultants; (ii) the findings; (iii) the implications of the findings; and (iv) how such information can be used and studies replicated by others. Guizhou's bidding process for an MCC license was carefully designed and successful in finding bidders, evaluating bids, and issuing a license.

Training and workshops were intensive during this TA. In October 2005, the project held a Microfinance Training Workshop for senior officials of the PBOC and executing agencies. In December 2005, IMAR officials of the Finance Bureau and RCCs were taken on a study tour to France, the Netherlands, and Germany to better understand the conversion process of rural credit cooperatives into cooperative banks, and how the movements are supervised. In January 2006, a workshop was held for PBOC Guiyang to discuss options and arrangements for tendering for MCC licenses. In June 2006, PBOC officials went to Bangladesh, Indonesia and the Philippines to better understand options for microfinance and rural finance institutions and regulation. In October 2006, IMAR hosted a workshop for all five pilot MCC areas to share their experiences with key stakeholders from all over PRC. In April 2007, a major conference was held in Beijing on rural finance, findings of the TA, and how the results can be used to improve rural finance in the PRC. The measurable results of the multiple information sharing engagements are in the additional outcomes: improvements in RCC reform; granting of powers to continue innovation to these two provinces by national financial regulators; and a much wider scope for MFI pilots over the last three years.

Evaluation of Outputs and Achievement of Outcome

The TA's first steps, which involved detailed assessments of the business and policy environment for rural finance and reports of the findings, helped key stakeholders understand more comprehensively how the market was governed and was functioning. By taking these reports and discussing them in groups, better consensus was formed on what was occurring in each market and what needed to be changed.

In July 2005, a major report discussing the sector, rural finance environment and reforms, the situation of selected RCCs, reviews of MF pilots, and options for both microfinance growth and for deepening RCC reforms were presented to a wide array of stakeholders. Its recommendations on services, system structure and regulation, corporate governance, non-performing loans and risk management, and microfinance services were also provided. The work on RCCs validated what most had suspected – that the financials and capacity of staff was weaker than had been reported, and thus much more work on training and financial restructuring would be needed for the RCC reform. Additional steps were then taken to enable the reform process to proceed sensibly. Further training on RCC options was conducted and agreement on RCC reform implementation forged in a workshop in December 2005.

The bidding process for the two MCC licenses was productive in a number of ways. First, it was seen as a market discovery process for authorities in making policy choices. Second, the bidding invitation documents showed potential investors (i) the local governments' long term commitment to MCCs; and (ii) flexibility in loan interest rate ceilings, geographic coverage, loan size limits, and sector requirements. Third, the process was transparent and decisions rapid. By June 2006, the license of Jiangkou County, Guizhou was issued after the evaluation of two domestic proposals and, in August of that year, the agency opened for business. In Dongsheng County, IMAR's two international and 11 national proposals were received, a license was issued and the licensee started operations in September 2006. By having activities in two areas, there was a virtuous spiral of information sharing and competition which doubled the results and extended the competition (and information-sharing) to all five of the PBOC-designated areas. Other provinces immediately picked up the methodology and began using it for licensing MCCs.

The numerous seminars, workshops, training events, and other opportunities for dialogue, discussions, and capacity-building on an ongoing basis were found to be very productive in stimulating reform. The interactions markedly increased learning and exposure for larger groups of government officials on options for reforms, as well as showing the Government the perceptions of outsiders about the local financial markets. The TA consultants were able to provide a wider range of options for reform and licensing and test them among various interest groups. The project teams used the development of information for both RCC reforms and bid development as a market discovery process to both facilitate improvements at the national level by the China Banking Regulatory Commission (CBRC) and PBOC in the licensing and regulations, and to educate local governments. PBOC added IMAR to the list of four areas for pilot MCCs. Partially as a result of the extensive research and learning under this TA, CBRC issued a set of principles to expand access to finance in rural areas in December 2006. However, collaboration with PBOC on application of the new principles to MCCs, and actual implementation of the principles is a longer-term issue.

Final reports² from various consultants were produced under the TA.

Overall Assessment and Rating

The project was highly successful. It not only produced the expected results but extended the bidding process directly to another province and, by extension of information, to at least three other provinces. The policy reforms went to a national level during the TA and now continue to influence the national rural finance reform agenda. The Government in 2006 designated this project as one of the ten top donor projects in the country for the year.

Major Lessons

In cases where ADB is financing innovations in financial markets in middle income countries such as the PRC, four elements seem to be important to success: (i) domestic high-level ownership of the change process and a willingness to follow it through; (ii) a structured approach which at each step develops thinking and then shares it with a fairly large body of stakeholders, so they understand and buy into each step of the change; (iii) sufficient financial and staff resources and time to respond to changes in direction, additional information requirements, or to continue along a productive track; and (iv) flexibility to extend a TA that is working well. However, this type of approach also requires intensive TA supervision and significant TA resources, including higher than usual international consultant levels for PRC TAs.

Recommendations and Follow-Up Actions

As has been requested by CBRC and PBOC, follow-on work to deepen rural financial product innovation, data on rural finance flows, and ongoing improvements in institutional development should continue to be supported by ADB.

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² PRC: Macroeconomics and Financial Development in Tongren Prefecture and Its Counties; PRC: Market Research for Microfinance in Jiangkou County; PRC: Financial Demand Study of Farm Households in Tongren/Guizhou of PRC; PRC: Financial Demand Study of Farm Households in Tongren/Guizhou of PRC—Survey in Wanshan, Songtao, Yanhe, Dejiang and Yinjiang; and PRC: A Report on the Demand for Credit from Microenterprises in Erdos, Inner Mongolia Autonomous Region.