

**ACCESS TO FINANCE
INTERNATIONAL CONFERENCE
Brussels, 28 –29 October 2004**

Enhancing Access to Finance: What Needs to be done?

**Presentation by Jan Van Heeswijk
Director General
Regional and Sustainable Development Department
Asian Development Bank
Manila, Philippines**

1. Introduction

Chairman, Distinguished Speakers, Guests and Participants.

Let me first thank the European Savings Banks Group, the World Savings Banks Institute and the World Bank for the opportunity to participate in this important event. I am pleased to be here on behalf of the Asian Development Bank to contribute to the discussion from the perspective of the Asia and Pacific region. It is a critical issue for our organization, which, as many of you know, has an overarching goal of eliminating poverty in the region. And it goes without saying that expanding access to finance for the poor, for farmers, for small and medium enterprise owners and for others is crucial to achieving that goal.

If there is one thing we can all take away from this conference, it is the fact that access to finance is a broad issue with multiple dimensions. It cuts across borders, across sectors and across socio-economic divisions.

As we have heard, inadequate access to finance affects developed as well as developing countries, poor and the lower middle-income families, and operators of small and medium-scale farms and businesses.

2. Access to Finance in Asia Pacific

The situation is no different in Asia and the Pacific. Despite a proliferation of financial institutions in many countries, limited access to quality financial services remains a challenge across the region. I use the term “quality” financial services because in some countries, financial services are accessible – but not of good quality. They may carry high interest rates, or they may be limited in scope so that the needs of individuals and enterprises are met poorly, at a high cost, or not at all.

As you know, the Asia Pacific region boasts a number of flagship rural and microfinance institutions, including banks and NGOs.

For example, in Bangladesh, Grameen Bank operates side by side with two giant NGO microfinance Institutions: Bangladesh Rural Advancement Committee (BRAC) and Association of Social Advancement (ASA). These three institutions together have about 8 million loan accounts in their books.

In Cambodia, ACLEDA Bank and Amret MFI together reach over 200,000 clients, and are the market leaders in finance for the poor.

In Indonesia, a number of very successful rural financial institutions have been in operation for nearly 20 years. For example, Bank Rakyat Indonesia has built an extensive rural finance system. At the end of 2000, its Unit Desas had over 26 million savings accounts and over 2.5 million loan accounts in rural Indonesia.

A state-owned pawning company is also very active in Indonesia's microcredit market. This company — Perum Pegadaian — provides over 15 million loans a year, mostly small loans. People's Credit Banks (BPRs) provide over four million loans a year to rural Indonesians. And, Indonesia's Postal Savings system has close to 8 million savings accounts.

With all these service providers, it would seem at first glance that financial exclusion is not a major issue. But, in reality, the opposite is true – even in countries with relatively mature rural and microfinance markets.

A Household Survey carried out in Indonesia by BRI and the John F. Kennedy School at Harvard University illustrates the point. The survey, conducted in October 200, found that 68% of the households surveyed did not have credit from any formal or informal financial institutions, and 62% of had no savings accounts in formal or informal financial institutions. More surprisingly, 58% of households with viable enterprises did not have loans from financial institutions, and 52% did not have savings in a financial institution.

Many poor households and SME operators in Bangladesh also still suffer from inadequate access to finance, despite the large financial institutions operating there.

In India, there are over 98,000 Primary Agricultural Credit Societies (PACs) with a membership of about 100 million. At the end of 2002, these societies had 44 million borrowers in their books. However, because most of the PACs are not sound financially, their members cannot be deemed to have reliable or permanent access to financial services. The same holds true in respect of the clients of the Rural Credit Cooperatives (RCCs) of the People's Republic of China (PRC).

Looking at the region as a whole, we believe that the entire financial sector – including NGOs, rural branches of commercial banks, agricultural development banks,

rural development banks and cooperatives – reaches no more than 40% of the rural population with microcredit. Even fewer have access to “frills” such as insurance, payment services and money transfers. In most Asian countries, the poorest households rely largely on social safety nets, informal markets and self-finance for their requirements.

Neither the causes of this problem nor its solutions are readily apparent. Some people tend to believe that access to finance is related to proximity to service providers: hence, if service outlets can be made available in close proximity to the potential clients the problem could be resolved. But the experience of poor families living in the midst of huge cities, sometime within a radius of say one or two kilometers from many banks, quickly shatters that myth.

3. Multi-dimensional approach needed

This is clearly a complex problem with many dimensions. That is not to say, however, that nothing can be done. On the contrary, it is our view that much can be done – by government, the private sector, the donor community and civil society – to improve access and thereby improve the standard of living – not only in Asia and Pacific, but around the world. Given the limited time remaining, I will focus primarily on the public and private sectors.

Needed Public Sector Efforts

First and foremost, the public sector must create an enabling policy environment. In a number of countries, a non-conducive policy environment has been a primary reason that the situation has not improved over time.

For example, countries that imposed ceilings on interest rates continue to have poorer outreach than those that did not do so or those that removed such ceilings early on. India's microfinance industry suffered from interest rate ceilings for many years. Although the Indian market has begun to respond to the more liberal and conducive environment of recent years, it has a lot of catching up to do.

In both India and PRC, access to credit for the rural population has increased because of government subsidies and inappropriate interventions. In both cases, however, transaction costs are high and few rural households have permanent access, reliable access or access to quality services.

And, during a period where countries such as Bangladesh, Cambodia and the Philippines were making progress in microfinance under liberal interest rate regimes, heavy interest rate subsidies in PRC undermined the development of a dynamic microfinance sector – a sector that can provide quality services.

Profit-oriented financial institutions often have good reasons not to provide credit to certain segments of the market. For example, SMEs' lack of suitable collateral is

often a problem for banks, as they either do not have the capacity for cash-flow-based lending, or are required to make full provisions for unsecured loans. These fundamental issues need to be addressed through appropriate actions.

Policy environment is also important to encourage competition in the financial markets. Competition in the low end of the markets, as well as in broader financial markets, will encourage financial service providers to become more efficient and provide quality products and services at minimal transaction costs.

Financial infrastructure must also be improved. This is a lesson that most governments and funding agencies learned from the failed small farmer credit development efforts in the 1970s and 1980s. Credit disbursements were pushed without due attention to the financial infrastructure development. The result was poorly performing financial institutions, increasing non-performing loans and many other financial and operational problems.

One can still find the results of such approaches in China's Rural Credit Cooperatives (RCCs). Although about 35,000 RCCs are serving many rural clients with deposit and lending services, they are not sustainable without continued government subsidies. They are institutionally weak and have no capacity to scale up services on their own. Lack of appropriate and adequate supervision and regulation explains part of the dismal picture of RCCs. The government of PRC has recognized these weaknesses and is now trying to reform RCCs.

Public sector efforts are needed to reform and revitalize many state-owned alternative financial institutions (AFIs). AFIs include post office savings banks, state-owned pawnshops, non-postal savings banks and state-owned agricultural and rural development banks. They are characterized by their commitment to serve the households that conventional financial institutions will not serve. We know in many countries in our region, AFIs play a significant role in the financial sector. But in most countries, with few exceptions, they are in bad shape financially and operationally and they rely on huge state-subsidies for their continuation. The funding community, as well as governments, has to recognize both the role and the potential of AFIs in improving access to finance, and make more serious and concerted efforts to reform these institutions and improve their sustainability, outreach and quality of services.

Empirical evidence from the region indicates that such reforms are possible. For example, ADB is working with the governments of Lao PDR, Viet Nam, Pakistan, Sri Lanka and Nepal to improve AFIs in their respective countries. While this is a risky task, the potential social and economic returns are high. We believe that the human resources and the extensive branch networks of AFIs can be leveraged to scale up outreach plans and offer access to more families, farms and businesses. However, we also recognize that a strong commitment and a "willingness-to-reform" from the political leadership is a pre-requisite for success.

Reforms do not necessarily mean privatization of AFIs, at least at the initial stages. Unit Desas of Bank Rakyat Indonesia, which I referred to earlier, were reformed in the early 1980s under a public ownership structure. The unwavering commitment of the Ministry of Finance to make this effort a success was the key factor behind the Unit Desa reform. Private sector participation in BRI was allowed only recently through an IPO. Until that time, the Unit Desa system operated sustainably under public ownership.

Mongolia's formerly state-owned Agricultural Bank was also transformed from a money losing and poorly functioning institution into a profit making and professionally managed institution under public ownership before it was privatized. The government of Mongolia provided external management to put the bank on a sustainable footing. The bank retained full management authority, free from political or other interference. This was a key factor in its success. After the institution was turned around, it was privatized and purchased by a H.S. Securities of Japan.

The important lesson to learn from this experience is that neither privatization nor foreign ownership led to a contraction of services to rural clients. On the contrary, under the foreign private ownership, this bank's branch network, deposit, lending and other financial services have expanded at a remarkable rate. Between 2000 and 2004, the bank increased its number of offices from 269 to 379 and its number of employees from 803 to 1,833. Today, one out of every two Mongolian households use the services of this bank. About 90% of all loans are made in rural areas. The bank's total loan portfolio is \$49 million and its 377,424 deposit accounts carry a deposit volume of \$75 million. The bank also processes over 15,000 domestic money transfers per month. In the context of Mongolia these are not trivial achievements

Needed Private Sector Efforts

So that is the public sector side of the equation. What should the private sector do?

From our perspective, established financial institutions in the private sector should begin to look at the hitherto unserved and under-served market segments as an important source of potential profits, and develop new business models to serve those segments profitably. Specifically, these institutions could:

- Make available funds for dedicated microfinance institutions to expand their growth;
- Establish alliances and partnerships with NGO microfinance institutions and postal savings institutions to expand the services to poor households;
- Introduce new poor-friendly, information and communication technology (ICT) to serve the poor;
- Provide poor-friendly products and services leveraging their financial and organizational resources; and
- Downscale their operations to serve an increasing segment of the small farm community and SMEs. For example, they can provide innovative insurance

products for farmers to reduce the risks associated with farming and improve the creditworthiness of small farmers.

In short, there are ample opportunities for downscaling and rebalancing the services of the established large-scale private sector financial institutions, if they begin to look at these market segments through a different lens.

Some private sector banks are beginning to just do this. For example, India's largest private sector bank—ICICI Bank— is now providing funds to over 25 MFIs to expand their operations. ICICI is also piloting a remote-area and poor-friendly, low-cost ATM machine to serve poor households in remote areas. The bank has merged with a state-level regional bank to expand its services to rural areas in Andhra Pradesh in India, and it is also involved in a pilot weather insurance project for small farmers.

Thus, ICICI Bank is leveraging its financial and human resources to introduce innovations and expand the services to hitherto un-served and under-served clients. ICICI has developed a very clear strategy to serve the bottom of the pyramid market, not as its corporate social responsibility but as a profitable activity. With this, ICICI Bank has moved from what is described as best practice to "next practice." This is good for the banks, good for its clients, and good for the Indian economy.

4. Concluding remarks

Ladies and gentlemen, I would like to conclude my remarks today by making two additional points.

First, much of what I have discussed today has relied on “best guesstimates” of the situation in Asia and Pacific. I know that many fellow panelists and speakers, and undoubtedly many participants are aware that reliable estimates on financial exclusion in all developing countries are badly needed. Such estimates are vital for designing effective solutions. And, they can serve as a catalyst for action among both domestic and international policymakers.

Second, we must understand that access to finance is not purely a financial sector issue; hence, financial sector measures alone can resolve it. Access to finance has social and other non-financial dimensions. Poor and low-income households suffer from multiple, often inter-locking, disadvantages. Because of this, many other measures are also needed to address this issue effectively, such as improvements to education, rural infrastructure, primary health care and other vital services.

Broader access to finance can play a major role in achieving ADB’s vision of a poverty-free Asia and Pacific. By making this a priority issue and working systematically towards solutions, the public sector, private sector, civil society and the funding community can contribute to achieving that vision for the world.

Thank you.