ICR Review

Operations Evaluation Department

Report Number : ICRR10682

1. Project Data :		Date Posted :	08/21/2000	
PROJ ID:	P001677 OEDID: C2513		Appraisal	Actual
Project Name :	Rural Financial Services	Project Costs (US$M)	36.7	32
Country:	Malawi	Loan/Credit (US$M)	25.0	24.8
Sector, Major Sect .:	Agricultural Credit, Agriculture	Cofinancing (US$M)	none	none
L/C Number:	C2513			
		Board Approval (FY)		93
Partners involved :	none	Closing Date	12/31/1996	12/31/1999
Prepared by :	Reviewed by :	Group Manager :	Group:	
Nalini B. Kumar	Ridley Nelson	Ridley Nelson	OEDST	

2. Project Objectives and Components

a. Objectives

The project had two objectives. The principal objective was to improve the access of the rural sector to financial services on a sustainable basis. The strategy was to corporatize and convert the Smallholder Agricultural Credit Administration (SACA) into a limited liability finance company, the Malawi Rural Finance Company (MRFC) for eventual privatization and conversion to a privately owned rural bank. The other objective was to improve the policy and institutional framework for financial intermediation by supporting the development of linkages between the formal and informal financial sectors and through strengthening related non-financial institutions serving the rural sector.

b. Components

The project had three components: (i) an institution building component to corporatize and convert SACA into MRFC, to use various institutions including the Development of Malawi Traders Trust (DEMATT) to assist in preparing investment proposals for agricultural, small and micro enterprises and provide related training and advisory services; (ii) a line of credit component to finance the short term loan requirements of farm and non farm rural activities provided under a subsidiary loan agreement between the Reserve Bank of Malawi and MRFC; (iii) a pilot component to support innovative approaches to providing financial services to rural women entrepreneurs.

c. Comments on Project Cost, Financing and Dates

As appraised total project cost was US $ 36.7 million of which the IDA share was US $ 25 million (68 percent) and the domestic contribution (Government, MRFC, sub-borrowers) was to be US $ 11.7 million. Actual project cost was US $ 32 million of which the IDA contribution was US $ 24.8 million (77.5 percent) and the domestic contribution was US $ 7.2 million. The project was appraised in June/July 1992, approved in June 1993, and became effective in September 1994. The project was extended thrice from its original closing date in December 1996, and closed in December 1999.

3. Achievement of Relevant Objectives :

As designed the project was extremely ambitious. Although the basic objectives (improving access of the rural sector to financial services on a sustainable basis and improvements in the policy and institutional framework for rural finance) remain essentially valid, the project design was unrealistic in expecting full privatization of the new entity, MRFC, in three years. The original project design was deficient as well in expecting a private entity to be able to lead the wider process of public policy development. In the light of the economic and political changes, and the collapse of SACA in 1992/93, the original project design was deemed irrelevant to the country circumstances, and although no formal changes were made to project objectives, the ICR maintains that the project was significantly modified. The ICR, however, does not indicate what the revised objectives were. As implemented, the project helped restore the smallholder farmer credit system, through MRFC, during the mid 1990s and supported the development of burley tobacco production. It helped stimulate the emergence of the private Intermediate Buyer system in tobacco marketing. As noted, however, the objective of making MRFC into a private bank was unrealistic, especially given its important developmental role in the rural economy. While MRFC is being operated on commercial principles and is autonomous, it is government owned. There are concerns about its viability and sustainability. There has also been little impact on overall policy and institutional linkages for the rural finance sector.

4. Significant Outcomes /Impacts:

(i) A number of farmers benefited from MRFC seasonal loans; (ii) Smallholder burley tobacco production was put on a sure footing as MRFC provided the essential start up working capital . Surveys and other evidence point to the beneficial effects of MRFC loans on smallholder client's income and savings ; (iii) A smallholder farmer credit system was re-established which has facilitated growth of export oriented smallholder farmers; (iv) The credit system was successfully de-linked from agricultural extension services.

5. Significant Shortcomings (including non-compliance with safeguard policies):
(i) There has been little improvement in the overall policy and institutional environment for the rural finance sector, with subsidized credit schemes posing a potentially serious threat to MRFC operations; (ii) the long run sustainability of MRFC is not assured given its current portfolio quality, an eroding (real) asset base, and lack of sustainable source of funding; (iii) effective local saving services were not developed and MRFC was not successful in creating a diversified risk profile in its lending operations; (iv) Although the project provided funds for the preparation of investment proposals by DEMATT no investment proposals for agricultural, small and micro enterprises were prepared.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Marginally Unsatisfactory	The ICR text rates outcome as satisfactory with the qualification that this assessment needs to be reviewed in twelve months time. The ES rates outcome as marginally unsatisfactory because despite substantial short term development results and the resurrection of the small holder credit system through MRFC after the collapse of SACA, the long-run impacts are not assured given serious concerns about the viability and sustainability of MRFC. An important element in the development of a rural financial system is a sound policy and institutional framework, to which little attention was paid.
Institutional Dev .:	Substantial	Modest	The ES rates Institutional Development as modest for three reasons: (i) Policy and planning for rural financial services within the Government remains weak; (ii) Effective operation of MRFC is not assured and is contingent on several decisions yet to be taken; (iii) MRFC has not developed effective local saving services and has not been able to develop a diversified risk profile in its lending operations.
Sustainability :	Likely	Uncertain	The ES rates sustainability as uncertain for three reasons: (i) financial viability of MRFC is questionable and its economic viability is yet to be established (i.e., the benefit-cost analysis of the subsidies implicit in MRFC's operation) ; (ii) the long term survival of MRFC is contingent on a number of important and difficult conditions (both with respect to operations - costs and increase in outreach - and policy environment) in the coming months and it is not clear whether these conditions will be successfully met considering the past experience which required strong project support; (iii) government commitment to serious reforms in the rural financial system appears to be low. (iv) The delay in the

			Options Study raises concerns about the institutional development arrangements after project closing.
Bank Performance :	Satisfactory	Unsatisfactory	The ICR rates Bank performance as satisfactory but qualifies it as marginally so. The ES rates Bank performance to unsatisfactory for several reasons: (i) While we do not question the difficult management decision to go ahead despite uncertainties, the project was not ready for implementation and should have been re-appraised as suggested in the ICR; (ii) though supervision was thorough in many respects, yet an important decision on a fundamental issue was not taken in a timely manner. This was the failure to take steps to restructure the project when it became evident that MRFC could not be made a private bank; (iii) Sufficient attention was not given to sustainability concerns. Little thought was given to the fact that MRFC was a registered company and not a financial institution and could not be supervised by the Reserve Bank of Malawi. As a result the withdrawal of direct Bank supervision on project closure has left a vacuum and the future supervision of the MRFC as a financial institution is unclear. (iv) An inherent contradiction in project design was not given sufficient attention. A unit of MRFC was given the responsibility of leading a wider process of policy development for rural finance. This was a public role and was inconsistent with the activities of a Company that was working its way towards a private sector status. During project implementation, this issue remained unaddressed.
Borrower Perf .:	Satisfactory	Unsatisfactory	The ICR rates Borrower performance as satisfactory but qualifies it as marginally so. The ES rates Borrower Performance as unsatisfactory for a number of reasons: (i) deficient and unrealistic project design; (ii) Government was slow in meeting the conditions of effectiveness; (iii) Weak political commitment of the government to support MRFC to become a viable rural financial institution; (iv) Several other credit/finance schemes were implemented during the project implementation period with different terms and conditions which had a negative impact on MRFC; (v) failure to adhere to time bound action plans for examining and working towards future strategic options for MRFC;
Quality of ICR :		Satisfactory	

7. Lessons of Broad Applicability :

The lessons provided by the ICR are relevant and have important implications for provision of future Bank assistance in rural finance. Three lessons from the ICR are repeated here. (i) Support to rural and agricultural finance institutions requires a relatively long term commitment on the part of donor organizations. (ii)

Agricultural/rural finance should not generally form the basis for stand alone projects . Agricultural finance is intimately tied up with broader developments in agricultural market development and the regulation of agricultural markets. (iii) In an agriculture based economy, rural and agricultural credit will always certainly be highly politicized . Managing political relationships is therefore critical to credit and institutional sustainability .

This ES adds the following further lessons: (i) A realistic assessment of borrower capacity to implement and of ownership is crucial in setting project objectives. In this case the objective of a commercially run rural financial intermediary was ambitious given the relatively weak state of the economy, the human resource base of the implementing agency and the weak political commitment of the Government to support MRFC to become a viable rural financial institution. (ii) In the case of the Bank, effective and timely action and decision making is equally if not more important than simply close supervision. In the case of the Malawi Rural Financial Services Project, when it became evident that the private rural bank solution was unrealistic, prompt action should have been taken to restructure the project and adjust the objective so that realistic, clear and achievable objectives could be pursued .

8. Audit Recommended? ● Yes ○ No

Why? To verify the sustainability of the project, as the ICR notes that long term sustainability is dependent on the actions and decisions to be taken over the twelve months following project closing .

9. Comments on Quality of ICR :

The ICR is satisfactory in discussing the evolving design and implementation issues . Although it mentions the impact of inflation, it does not indicate what the interest rates or profits were in real terms, nor does it provide relevant details concerning MRFC's portfolio quality.