Rehabilitation of Rural Finance Institutions:
Lessons from Benin and the African Experience

Most attempts to develop financial markets and rural credit institutions in Africa have performed poorly, not satisfying the demand for savings and credit services in the rural areas. In many cases, however, the institutions continue to exist and could be revived, enlarged, or made more efficient if suitable programs to help them can be worked out. This note reviews the strategies and measures that can be used to rehabilitate rural finance institutions, based on the successful rehabilitation program in Benin and some other cases in Africa. Rehabilitation of a rundown rural finance institution takes several years, but it can be organized in phases, first concentrating on emergency measures to save the institution from bankruptcy, and then planning and implementing the actions for a longer term recovery process.

Emergency Policies And Measures

Emergency measures may have to be taken to save the rural finance institution from bankruptcy and to provide a sound starting point for the rehabilitated institution. The emergency measures can include some or all of the following actions:

(i) Drastic restructuring at the top. The measures required may include closing down the central unit for the rural finance network, or drastically reorganizing its top management, and seeking alternative arrangements for the national-level functions.

(ii) Obtaining financing for the emergency program. To gain the financing needed for the initial costs from donors, the government must demonstrate commitment to change by removing controls over rural finance agencies and permitting the future network to act like other private sector agencies.

(iii) Providing a guarantee for deposits and additional liquidity. Deposits may have been frozen when the apex finance institution for the rural finance network was closed or restructured. Enough funds must be released to enable the institutions to refund
members’ deposits if requested and to continue lending at least on a small scale.

(iv) Establishing an independent unit to coordinate the emergency measures. A competent body must be created to supervise the initial financial and institutional measures being taken to reform the rural finance network. This interim unit should report to a local monitoring committee of representatives of the government, donors, and the field network being rehabilitated.

(v) Providing technical assistance. Accounting and other assistance may be needed to help liquidate the apex unit or update its accounts, and undertake financial audits of all field units.

(vi) Financing a pilot credit operation. The proposed new credit and savings policies and practices to be used during the main rehabilitation program should be tested in selected areas or regions.

Delay in taking the necessary actions is often detrimental. This was observed in the studies on bank restructuring in Africa, where, for instance, the earlier managers were often retained too long after the rehabilitation had been initiated. Exceptions in this respect were Benin and Ghana.

Rehabilitation Project

A project to rehabilitate a rural finance network (savings and credit cooperatives, rural banks, agricultural development banks, and NGO-initiated schemes) should cover three key areas: institutional development, financial rehabilitation, and revision of the credit regulations.

(i) Institutional rehabilitation. Institutional rehabilitation is typically needed to correct past management mistakes and strengthen the overall management and administrative procedures in the organizations involved. The overall goal is to make them independent and viable rural financial intermediaries. The program should include:

- Development of appropriate participation and ownership by local people. In the case of a cooperative network, a genuinely "mutalist" (cooperative) approach is needed. Such mutualist, vertical organizations have been built, for instance, in Kenya and Uganda. In other types of rural finance institutions, the arrangements can be different. The government may need to issue new statutes that make explicit the autonomy of rural finance institutions and guide their administration and financial operations.

- Restructuring of the organization at all levels. If the emergency phase includes liquidation of the previous apex organization, a new one must be established to lead the activities at the national level. Similarly, arrangements must be made at the regional level to provide support services to the local units. Unprofitable regional and local units may need to be closed down or merged with others, at least temporarily. All staff may need to be technically separated;
only the staff needed in the restructured setup should be rehired on the basis of performance reviews.

- **Development of management information and control mechanism.** Better budgeting, accounting, financial information systems, and a permanent internal audit system need to be established, and annual audit reviews be carried out by a reputable firm (a good example in this respect is Kenya in the 1970s, where one of the first actions in restarting the cooperative credit and savings schemes was to develop and document good systems for these functions); and

- **Development of human resources.** Designing and implementing a training program in accounting, credit management, internal audits, and administration for the staff, Boards of Directors, and members.

(ii) **Financial rehabilitation.** The merger of unprofitable units and the staff reductions would improve the financial position of the savings and credit network. Other financial rehabilitation measures can include:

- **Reconstitution of members’ equity and savings depleted by accumulated losses.** Actions can include: cancellation of claims on the network for outstanding debts to the liquidated apex organization; cancellation of unpaid back taxes to the government; partial financing of the deposits frozen during the interim project period; and external financing of the remaining past losses.

- **Development and implementation of adequate administrative, budgeting, accounting, and financial control procedures.** As a first step, an external firm could be recruited to implement a rigorous procedure of annual audits and inspection of all remaining units.

- **Improvement of operational profitability.** The interest margins may have to be increased (to be decided by the new Boards), deposit accounts may have to be opened for the liquidity reserves of the local units in commercial banks giving the highest returns, and an initial deposit from the government and donors can be provided to help finance the costs and increase the capital base.

- **Provision of operational support.** The project may have to finance a part of the first year’s operating costs in support of the efforts by the local units working toward financial autonomy.

- **Decision on responsibility for foreign exchange risk.** For rural finance institutions oriented toward small farmers who are not exporting directly, the government should take the foreign exchange risk, at least until the rural finance institution has reached full financial sustainability (possibly against a fee charged to the benefiting organization, as was done, for instance, for the National Agricultural Bank in Tunisia.).

(iii) **Revision of credit regulations.** Typical examples of the new policies and practices that may be needed are as follows:

- **Cautious provision of credit.** The project should emphasize the mobilization of savings to
satisfy the demand for credit in the medium to long term. In the short term, demand for credit is likely to exceed the savings, and arrangements should be made to provide additional funds from different donors, including the World Bank’s International Development Association (IDA), for a small line of credit. During the initial phase of the rehabilitation, credits should be granted cautiously, perhaps limited to about 50 percent of member deposits, and tied to agreed-upon performance criteria.

- **Development of uniform credit conditions, with some flexibility for local views.** It may be advisable to permit local committees to make credit decisions, but new policies and conditions for credit operations should be developed in a participatory manner through extensive meetings between the various members and Boards of the network and the project preparation teams. The conditions for credit can be allowed to vary in different regions, but acceptable rules for the qualifications of the borrowers, minimum deposits required from borrowers, collateral required, and the type of credit to be granted should be included in the conditions.

- **Improvement of security and viability of the local units.** It may be appropriate to help establish and operate an insurance fund to cover possible losses resulting from natural hazards or special programs. Another fund or window should be established to provide more general support to local units that are too new to be profitable or have run into temporary difficulties (such funds exist in Benin and Kenya).

- **Recovery of old loans.** The rehabilitation program should include a special program or unit to recover old loans that were left unpaid before the rehabilitation started. This is important not only to improve the capital base of the network but to emphasize that the law is following up on delinquent debtors.

**Consolidation and Follow-up Programs or Projects**

Some of the measures just described may take several years to be fully institutionalized. Even more time-consuming is the need to expand the outreach of the network as soon as the major problems have been resolved. Consolidation of the rehabilitation efforts and expansion of outreach require continued financial support from outside the rural finance institutions themselves, because their own finances cannot carry the extra costs. The measures needed can include the following:

(i) **Strengthening the agencies and building capacity.** External assistance funds should be used primarily to strengthen the national apex organization, to pay for new computerized management information and accounting systems at all levels, for staff training, and for short-term technical assistance when needed.

(ii) **Updating or improving policies and objectives.** The government and other stakeholders should agree at appraisal of the follow-on project on the possible changes needed in lending and loan recovery policies and objectives; the policy relating to the ratio of loans to savings (this can usually be increased from the level permitted during the first phase); the objectives for financial performance of the units at all levels of the
network; the measures to improve the network’s financial autonomy, including the use of annual profits and procedures to determine the distribution of external assistance; and the policies and objectives for opening and closing local units.

(iii) Supervising and monitoring. The supervision and control mechanisms should be reviewed at this stage and the stakeholders should agree on their relaxation or strengthening as necessary (a need for reliable and comprehensive supervision by members and by higher units in the vertical organization has been noted in many countries, such as Madagascar). Also, the list of key monitorable indicators should be reviewed and focused on key measures for which reliable data exist.

Conditions for Successful Rehabilitation

The costs of undertaking a rehabilitation program may not always be justified. In addition to long-term commitments as described above, rehabilitation is more likely to be successful if the following conditions are present:

- Favorable financial-sector climate;
- Real demand for rural financial services;
- Understanding of local conditions and analysis of past problems;
- Prospects for financial self-sufficiency;
- Competent program planning and supervision; and
- Appropriate technical methods.

Ideally, the country that is planning to rehabilitate its rural institutions should have a strategy for rural finance. This was the case in Indonesia, where the building of rural finance institutions has succeeded. A strategy would allow the limited resources to be directed toward the most promising agencies, still creating adequate competition. However, the preparation of such a strategy, with all the phases of work by technicians and decisions by the stakeholders, often takes a long time. If the agency considered for rehabilitation is promising enough, it would be appropriate to start rehabilitation on the basis of an analysis preceding the emergency program, and prepare a strategy during the second phase.

This note and a longer paper were prepared by Turto Turtiainen, Rural Finance consultant, following a mid-term review mission, led by Ousmane Sissoko in May 1998, of the Benin Second Cooperative Savings and Loan Rehabilitation project. The full paper also contains criteria for selecting candidates for external assistance and recommended approaches for donor support, as well as a list of references for work done on the topic. For a copy of the complete paper, please e-mail TTurtiain@aol.com or Koro Ouattara at Kouattara@worldbank.org.