



Workshop Report Bishkek and Osh 2006-12-06

Two workshops were organized in Kyrgyzstan aimed at disseminating the findings of a report on “Expanding Finance in Rural Areas” and a survey carried out on 200 farm households and 30 agro-processing companies commissioned by the EBRD Group for Small businesses (GSB).

The first workshop was held on 5 December 2006 in Bishkek and targeted senior government officials, senior bank managers and donor representatives. It was mainly geared at sharing experience and information on rural and agricultural lending, on-going and planned initiatives to support agricultural and agribusiness development and exploring the most appropriate ways for deepening financial services in rural areas, identifying major constraints and impediments, and at discussing options to foster synergies and removing constraints.

The second workshop was held in Osh on 7 December 2006 and assembled the operational and middle level management staff of commercial banks and other financial institutions already involved in agricultural finance. The objectives of the workshop were to share experience on agricultural finance, familiarise relevant staff with new strategies and options to deepen their outreach to rural clients, and discuss the concrete actions and support requirements for achieving a wider coverage of the food production and processing sectors.

The main conclusions reached by the workshop participants were:

1. **Expanding agricultural and rural finance:** Participants, on the basis of their experience, the reports presented, and the exchange of information at the workshop, were convinced that a further expansion would be both desirable and feasible. The participants noted with satisfaction that the repayment rates of agricultural loans has shown the same excellent performance as all other loans: only 0.3% of the number and 1.5% of the value of agricultural loans were in arrears for more than 30 days, compared with 0.7% of the number and 0.8% of the value of all loans granted by the seven banks participating under the Kyrgyz Micro and Small Enterprise Finance Facility (KMSFF). In addition to the well-known major crops and commodities, such as meat, wheat, cotton, tobacco and sugar beet, there are a number of niche markets, which are worth being explored further. Participants noted further that the demand for credit, seen from all different angles, is high, and far from being met at present by the financial sector. Reference was made to the low penetration of financial services in the country, as visible in a share of total financial sector loans in GDP, which stood at below 13% by the end of 2005. This compares with about 17% in the case of Tajikistan (2005), and almost 40% in the case of Mongolia (2006). The market size would amount to at least USD 150 million, which is about three times the current agricultural portfolio of the entire industry. The need for expansion of commercial banks was even the more felt as the state-

owned agricultural development bank had stopped lending some months ago, which left a big vacuum.

2. **Supply chain finance:** Supply chain finance was recommended as a strategy to pursue two goals at the same time, i.e. to substantially expand credit volumes and reduce some of the risks inherent in agricultural finance. Other advantages of the supply chain approach were that technical training of farmers could be much easier arranged for, and that price fluctuations could be better balanced. Under this approach, commercial banks would provide mainly working capital loans to the suppliers, producers, processors and marketing agencies on the basis of the expected sales contracts. Sales contracts, cession of payments and domiciliation of accounts would serve as collateral substitutes and replace the conventional forms of security. Additional investments in equipment and machinery would then be made on the basis of classical collateral arrangements. The participants noted that there are several agencies, projects and donor organisations that already provide technical assistance to value chain operators, which have already achieved some good results in terms of organising producers and processors, market expansion and quality standards. However, most of these initiatives had limited impact due to their inability to facilitate access to credit for supply chain businesses. A further expansion of these promising results would – among others – require: (i) a closer networking of all actors intervening; (ii) training and exposure of banks in value chain finance approaches; and (iii) negotiating concrete arrangements for selected value/supply chains. Participants were further convinced that the traditional agribusinesses in Kyrgyzstan needed some technical assistance to improve their management abilities, in particular as regards organising ties with producers and marketing of produce. Participants also noted that mediation between producers and processors was a key challenge, and that some processors had achieved excellent results in terms of securing constant supplies by farmers by facilitating their participation in the share capital of the processing business.
3. **Financing of equipment and machinery:** Another important challenge for the development of agriculture in the Kyrgyz Republic is the replacement of the obsolete equipment and machinery. Although the share of term finance in the financial sector has been slowly increasing over time, and the average duration of loans granted under the KMSFF grown, the value of term loans for the substitution of agricultural machinery is still at low levels. At the same time, the demand for term finance is quite high. Given the liquidity constraints of banks and their current liability structure, with a preponderance of short-term deposits, there is a need to reflect further on ways and means to increase the offer of term finance for rural development. Reference was made to the joint FAO and GTZ publication “Financing Agricultural Term Investments”, which can be downloaded from: http://www.fao.org/ag/ags/subjects/en/ruralfinance/pdf/Afr7_E.pdf
4. **Training:** The supply/value chain approach is rather new in Kyrgyzstan, although there have been isolated and single efforts to establish these. While commercial banks are familiar with the financing of individual clients, they are less familiar with the totality of issues involved in financing associations, groups, cooperatives or agribusinesses, in particular where this would involve more complex arrangements and the financing of both requirements of producers

(farmers) and processors. Bank representatives expressed their interest in obtaining further training in those fields. The FAO offered to prepare and run specific training courses in short modules, which could comprise (i) value chain finance systems and approaches, including the loan appraisal mechanisms; (ii) loan appraisal systems and approaches related to the provision of term finance, in particular for agricultural purposes; and (iii) financing of intermediary organisations, such as farmer groups or associations and cooperatives. Such training could be provided on the basis of a clear demand by the financial sector and geared to solve concrete problems and overcome practical constraints. The duration should be about 2.5-3.0 days for each of these modules. Bank staff involved in loan appraisal further pointed at the need for concise information about the different types of farm businesses, e.g. through so-called 'tech-cards', which contained all relevant information about inputs, production, yields, profitability and marketing. Reference was made to the "Rural Finance Learning Centre" of the FAO, which aims to assist organisations in developing countries to build their capacity to deliver improved financial services which meet the needs of rural households and businesses. See: <http://www.ruralfinance.org>

5. **Networking:** Banks have very little knowledge about agribusinesses and the cooperative sector. Participants noted that no informal or formal networking existed between the major players involved in promoting agriculture and rural development, and expressed their desire that such be established in order to provide and accelerate the flow of information about relevant issues, in particular about the promising actors in supply chains, the services offered by the financial sector, and the integration of international technical assistance and domestic finance. Joint workshops for processors and the financial sector were also proposed by some participants in order to overcome the lack of mutual knowledge and appreciation.
6. **Collateral:** Two regulations in the Kyrgyz Republic have facilitated the expansion of micro and small loans. These are that loans below USD 1000 can be granted without any collateral, and that a mortgage has to be sought only for loans above USD 2000. Over and above this, the commercial banks participating under and the KMSFF have adopted very flexible collateral arrangements and accept nearly all sorts of assets as collateral. However, despite the obvious progress that has been achieved, many farmers complained that the collateral requirements are still excessive (up to 200% of the loan value) and that the methods of computing the value of assets pledged would not be transparent. This has again been confirmed by the farm household survey undertaken under the study. Given the excellent loan portfolio quality of the KMSFF loans, and that the repayment rates of agricultural loans are practically the same as other loans, it would be very useful if the threshold for non-collateralised loans could be raised further to USD 2000. This would enable the banks to speed up their loan appraisal further, and lead to lower transaction costs for both the borrower and the lender. A further reduction of operational charges in the case of micro and small loans is very desirable, as the current levels of transaction costs in Kyrgyzstan are fairly high in international standards, and would provide an incentive to cut down interest rates in line with overall market trends. The adoption of this recommendation would require the approval of the National Bank of the Kyrgyz Republic (NBKR), and commercial bank representatives requested that this specific aspect be brought to the

attention of decision makers in the NBKR. Several participants further pointed at the possibility to expand financial services for equipment financing by offering leasing facilities, which would reduce the collateral requirements.

7. **Outreach:** Under the KMSFF, substantial progress has been achieved in terms of increasing the outreach to clients. As at the end of November 2006, a total of 26 863 loans were outstanding, of which a vast majority as express loans without collateral (82%). Over and above the approach to further increase outreach by adopting a supply chain approach and to lend to intermediaries such as farmer associations and cooperatives, bank outreach could be substantially enhanced by running mobile banking services. This service has been in the pipeline of several commercial banks, but implementation has been suspended in the meantime. Participants pointed at the potential to mobilise deposits and grant loans through such mobile units. Bank representatives further pointed at the need to increase the radius for branch operations, and to provide adequate mobility for branch staff for the required monitoring of clients.
8. **Savings mobilisation:** The mobilisation of deposits is one of the weakest aspects of the Kyrgyz financial sector. As at the end of 2005, total savings in the financial sector were equivalent to 13% of GDP, which is very low compared to international standards applicable to the 'transitional' and developing economies. The major constraints identified included: (i) lack of public confidence into the banking sector, as many depositors had lost money when banks collapsed; (ii) the absence of a deposit insurance mechanism or a reliable safeguard system that would compensate depositors in case their deposits would be lost in a failing bank; (iii) absence of suitable banking products linked to the interest of the different segments of the society in saving money for future use; and (iv) absence of a clear mandate for branch staff to mobilise deposits as cross-selling activity in addition to other duties and tasks to be performed. The workshop concluded that a further expansion of bank lending depended to a large extent on their ability to mobilise domestic deposits, which are a more dependable source than external loans, and which in most cases would also be a cheaper source of funds. Higher investments into public advertisement campaigns, awareness raising and training of staff on the need and techniques of mobilising deposits, specific targets to branch staff to mobilise deposits in addition to granting and recovering of loans, and a thorough analysis of the perceptions of clients about the transparency and trustworthiness of a bank would be some of the most immediate and urgent activities undertaken in the best interests of banks. On the side of bank products, linking loans with prior savings activities, as done in many parts of the world, including the credit unions, could be one option to be pursued by the banks. The model of granting short term loans on the basis of a short term savings plan, as proposed in the report on Kyrgyzstan (Annex 1 of the Report) could offer a concrete point of departure for rural areas.