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RURAL BANKING:
The Case of Rural and Community Banks in Ghana

AJAI NAIR AND AZEB FISSHA

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ABBREVIATIONS AND ACRONYMS

ADB	Agricultural Development Bank
AfDB	African Development Bank
ARB	Association of Rural and Community Banks
BoG	Bank of Ghana
BSD	Banking Supervision Department
CGAP	Consultative Group to Assist the Poor
CU	Credit union
E-FASS	Electronic Financial Analysis and Surveillance System
FNGO	Financial nongovernmental organization
GCC	Ghana Cooperative Council
GCSCA	Ghana Cooperative *Susu* Collectors Association
GCUA	Ghana Credit Union Association
GDP	Gross domestic product
GHAMFIN	Ghana Microfinance Institutions Network
GLSS	Ghana Living Standards Survey
GoG	Government of Ghana
GTZ	German Technical Cooperation Agency
ICT	Information and communication technology
IFAD	International Fund for Agricultural Development
MASLOC	Microfinance and Small Loan Center
MCC	Millennium Challenge Corporation
MFI	Microfinance institution
MFU	Microfinance Unit
MICR	Magnetic Ink Character Recognition
MIX	Microfinance Information Exchange
MoFEP	Ministry of Finance and Economic Planning
MSI	Microfinance Support Initiative
MTR	Midterm review
NBFI	Nonbank financial institution
NGO	Nongovernmental organization
NPL	Nonperforming loan
OSS	Operating self-sufficiency
PAR	Portfolio at risk
RCB	Rural and community bank
RFID	Rural Finance Inspection Department
RFP	Rural Finance Project
RFSP	Rural Financial Services Project
S&Ls	Savings and loans companies
SME	Small and medium-sized enterprise
SPEED	Support Program for Enterprise Empowerment Development
WU	Western Union

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EXECUTIVE SUMMARY

This case study describes the history and business model of the rural and community bank (RCB) network in Ghana, analyzes its performance, identifies key issues, and makes recommendations on the way forward. The study analyzes the service delivery and financial performance of the RCBs at two levels: the network of all banks and a representative sample of 12 RCBs. It finds that although the service delivery performance of the RCB network has been very good, its financial performance has been mixed.

Before the establishment of RCBs in the late 1970s and the subsequent expansion of other service providers into rural areas, access to institutional credit for farm and nonfarm activities was scarce. The main sources of credit were moneylenders and traders that charged very high interest rates. In many rural communities, secure, safe, and convenient savings and payment facilities hardly existed. Many rural dwellers had to travel long distances to receive payments (such as salary and pension deposits), transfer funds, and cash check payments for their agricultural produce. This situation led the Government of Ghana (GoG) to take several measures to increase access to credit in rural areas. After establishing an agricultural lending requirement for commercial banks and creating a publicly owned agricultural development bank, the GoG facilitated the establishment of RCBs.

The first RCB was established in a farming community in the central region of Ghana in 1976. Rural communities showed tremendous interested in the community ownership and management features of RCBs, and by 1984 the number of RCBs reached 106. The introduction of a check payment system for cocoa farmers (known as the Akuafo Check operation) also spurred the establishment of local banks in many communities. In 1981 about 30 existing RCBs formed an Association of Rural Banks (ARB) to serve as a networking forum. As a network of institutions sharing a common mission, the ARB promoted and represented the RCBs and also provided training services to member RCBs.[2]

The financial performance of many RCBs started to decline, however, for several reasons, including a drought that affected the country in 1983 (leading to high loan default rates), weak governing ability, conflicts within boards of directors, and ineffective management in many RCBs. Several reforms were undertaken to curb the deteriorating situation—exposure to risky sectors (mainly agriculture) was limited, distressed banks were closed, supervision by the central bank was strengthened, and RCB managers and boards of directors were offered training. Nevertheless, RCBs continued to be relevant rural finance service providers, and the GoG has consistently provided support to the RCBs by financing capacity building (in partnership with several donors), restructuring programs, and undertaking regulatory reforms.

By the end of 2008, 127 RCBs were in operation with a total 584 service outlets. RCBs are regulated by Ghana's central bank, the Bank of Ghana, and thereby form part of the country's regulated financial sector. RCBs are the largest providers of formal financial services in rural areas and represent about half of the total banking outlets in Ghana (IFAD 2008).

BUSINESS MODEL

Small asset base. RCBs are relatively small financial institutions with average share capital of GHc 136,526 (US$105,263), average deposits of GHc 2.3 million (US$1.77 million), and average assets of GHc 3.8 million (US$2.4 million). Values of the three indicators, however, vary significantly among RCBs. Out of the total 127 RCBs, 75 percent have assets between GHc 1 million (US$771,010) and GHc 8 million (US$6.1 million), and 20 percent of RCBs have assets of less than GHc 1 million, and 5 percent of RCBs have assets exceeding GHc10 million (US$7.7 million). Similarly, 44 percent of RCBs have share capital of less than GHc 100,000 (US$77,101) and only 6 percent have share capital of more than GHc 250,000 (US$192,753).

Fully owned and governed by local communities. RCBs are fully owned by individual shareholders who are residents of communities in which they operate. Each rural or community bank has a board of directors (BoD) that is responsible for its strategic governance. BoDs are elected by owners/shareholders during annual general meetings. Election criteria are normally based on reputation in the community and professional expertise. Most board members have relevant professional experience, but experience in banking is nevertheless extremely limited. Board members can be reelected more than once. In some of the old RCBs, board members have served as long as 32 years. The average length of service in the sample banks was 11 years. Key responsibilities of BoDs include (1) appraising and approving loan applications as well as ensuring repayment of loans; (2) monitoring the financial performance of the bank; (3) providing strategic guidance to management; and (4) supervising the management.

Professionally managed and staffed. The core management staff of a typical RCB is typically composed of a chief executive officer who is in charge of the daily management of the bank; an internal auditor, responsible for internal control measures, who reports to the BoDs[3]; a finance officer; and credit and project officers (in charge of microfinance operations). Many of the personnel are recruited from local communities. Almost all RCBs have one or more branches, each of which is staffed with a branch manager, an accountant, credit officers, clerks, and cashiers.

Strategic alliance to stay competitive. The ARB Apex Bank was granted a banking license in 2001 and commenced commercial operations in 2002 with significant financial support from the Rural Financial Service Project, which was funded by the World Bank, the International Fund for Agricultural Development, and the African Development Bank. The Apex Bank provides specialized services essential to improving the quality and scope of products offered by RCBs and also performs important supervisory functions delegated by the BoG. Check clearing, specie supply, treasury management, loan fund mobilization, domestic and international money transfers, information and communication technology, training, and inspection and audit are among the main services offered by the Apex Bank. The Apex Bank provides most of the services on a fee basis.

PRODUCTS AND SERVICES

Savings. RCB savings products include regular savings accounts, current accounts, *susu* deposits,[4] and fixed or time deposits. In the sample of 12 RCBs, regular savings deposits account for about 58 percent of the total number of clients and 57 percent of the total deposit balance. These accounts are small in size and short term. The interest rate for regular savings is low and is paid only once a balance reaches a certain amount (usually higher than the balances held by most savers). Many rural clients have access to this type of account; unlike other commercial banks, RCBs do not require a high balance to open an account. *Susu* is the second-largest account type, representing 21 percent of total clients, but its share of total deposits is only 11 percent because of the small size of each account. Fixed and special deposits that offer higher interest rates with a long-term deposit contract represent only about 1 percent of total number of clients.

Credit. The credit products offered by RCBs include microfinance loans, personal loans, salary loans, *susu* loans, and overdraft facilities. In the sample of 12 RCBs, salary loans account for 33 percent of total advances, followed by personal loans (24 percent) and microfinance (20 percent). In terms of the number of borrowers, microfinance accounts for 31 percent of total borrowers followed by personal loans (26 percent) and salary loans (22 percent). RCB loans are used for agriculture, cottage industries, and trading. Microfinance loans are categorized under trading, which accounts for 41 percent of the total sectors financed. Agricultural loans are reported to account for about 9 percent of loans, but this figure is an underestimate given that a significant portion of the loans reported as microfinance and personal loans are actually used for agricultural production.

Money transfer and payments. RCBs offer money transfer and payment services to their clients in collaboration with the ARB Apex Bank. RCBs participate in local and international money transfers through, among others, Western Union, Money Gram, and Vigo. Government agencies use the RCB service outlets for salary and pension deposits. Clearing of checks for cocoa purchases is also an important service provided under the payment category.

PERFORMANCE

Steadily increasing outreach and service delivery. The RCB network reaches about 2.8 million depositors and 680,000 borrowers, making RCBs the largest group of licensed financial service providers in rural areas. RCBs have a market share of 67 percent of depositors and 48 percent of borrowers in rural areas. Clients of RCBs consist mostly of farmers, government employees, and small and micro entrepreneurs. RCBs' increasing outreach to underserved areas has significantly contributed to addressing the credit constraint in rural areas. Between 2000 and 2008, the number of depositors grew at an average annual rate of 14 percent, and the number of borrowers grew at an average annual rate of 27 percent.

Mixed financial performance. The profitability and net worth of the RCB network have steadily increased from 2000 to 2008. Networkwide capital is well above the minimum 10 percent required by the Bank of Ghana. Not all RCBs in the network are solvent, however; in 2008 seven RCBs were insolvent, and the continued operation of poorly performing RCBs is one of the key issues facing the network. The relatively high ratio of nonperforming loans is a major factor affecting financial performance. In the sample RCBs, the proportion of the loan portfolio that was in default for more than 30 days was 16 percent, compared with 3 percent for their global peer group, according to data reported in the *Microbanking Bulletin*. Similarly, in the RCBs, loans in default for more than a year were 3.5 percent, compared with 1.5 percent in the peer group. This indicator is a good proxy for loan losses because most loans that have been in default for more than a year are generally not paid back at all.

LESSONS AND THE WAY FORWARD

The case of rural banking in Ghana points to the following lessons:

- Rural communities have the capacity to create and manage their own financial institutions. In Ghana, rural communities created hundreds of such institutions with very little direct financial support from the government.
- A financial operation that aims to be profitable requires a varied ownership structure, which is lacking in the rural banking system in Ghana. The growth of the network is constrained by the RCBs' location-specific ownership structure, which limits the ability of the institutions' managers and owners to propose mergers and acquisitions to stay profitable and efficient.
- The initial poor performance of RCBs stems from both an unfavorable operating environment and capacity constraints. Factors causing poor operating environments include an absence of clear prudential regulations, both financial and nonfinancial, and excessive directed lending requirements, which limit flexibility in managing risk exposure.
- Although capacity constraints in rural areas limit the scope of operation of local financial institutions to some extent, targeted investments in building the capacity of service providers can have positive payoffs. This finding suggests that initiatives to build local financial institutions should have significant capacity-building components.
- Small local financial institutions often cannot easily procure inputs such as training and specialized technical assistance for product development and setting up of operational systems from the market to be able to produce viable outputs (in terms of service and products) either because the supply of such specialized inputs is constrained or because the institutions do not have the scale to obtain these services individually at a minimum cost. Hence, initiatives to build local financial institutions will also have to support the creation of strategic alliances such as the Apex Bank that can either provide such services or facilitate their cost-effective provision.
- The creation of the Apex Bank also shows the challenges that such an institution faces in ensuring financial sustainability while providing low-cost services. Realistic measures to ensure sustainability should be identified and clarified at the earliest stages to help formulate the business and revenue model for the apex institution.
- Even when a good legal, policy, and regulatory environment is provided, a certain number of institutions will fail. This issue should be addressed upfront by committing the necessary capacity in terms of skills, political autonomy, and financial resources to ensure effective regulation and supervision.
- Donor funding for supervisory activities cannot sustain a supervisory regime in the long run, and mobilization of private funding to supervise services delivered to poor clients is not a feasible option. Government resources are thus fundamental to ensure adequate supervision of services delivered to poor clients, and donor funding should complement direct government resources allocated for supervision.

- Finally, the length, breadth, and scope of the Ghanaian experience offer the potential for carrying out a rigorous impact assessment of rural finance and a cost-benefit analysis of public investment in rural finance. Such a study is beyond the scope of this paper, but the RCB experience offers fertile ground for this research.

In going forward, the study highlights the following issues and recommendations:

- *RCBs.* The challenge for the RCBs is to become more competitive while retaining their mission of providing services to clients in rural areas. Many financial institutions are expanding into the rural financial market in major ways, often targeting clients of the rural banks and their personnel. In this situation, the RCBs should not try to seek protection against this competition. Rather, these competitive market conditions should stimulate the RCBs to innovate and become more efficient in an attempt to strengthen their position in the financial market. Some banks, motivated by their competitors, have undertaken measures to improve their competitiveness and improve their performance. At the network level, the ARB Apex Bank should proactively seek sustainable solutions for weak RCBs with very small capital and deposit bases. Some may have to be merged with another willing RCB or forced into liquidation.
- *Apex Bank.* The Apex Bank was created primarily as a service provider to the RCBs, but it faces challenges in becoming financially self-sufficient and sustainable. It is considering options for generating additional revenue, such as becoming a full-service commercial bank or opening a new banking branch. Such changes should not, however, come at the expense of the mission of the RCB network, which is to increase provision of services in rural areas in a sustainable manner. The Apex Bank could raise revenues by providing additional services currently needed by RCBs, which are willing to pay for these services.
- *BoG.* The Bank of Ghana has delegated some supervisory functions to the Apex Bank, consistent with international good practice. Direct supervision of relatively small institutions, such as RCBs, is not a feasible and financially sustainable option for central banks. The arrangement is weak, however, because of resource, capacity, and structural constraints. The BoG, along with the GoG, needs to immediately address these issues to ensure RCBs' adherence to regulatory standards and thereby protect consumers.
- *GoG.* The Government of Ghana has played a remarkable role in facilitating the creation and growth of the RCB network. In contrast to most countries—where excess regulation and political interference virtually destroyed rural financial institutions, whether development banks or financial cooperatives—Ghana successfully changed many of the regulations that constrained the growth of the RCB network. Some gaps, however, remain unfilled. The GoG should ensure that adequate resources are available for supervising RCBs and compensating them when they are called upon to deliver public programs. It should also consider additional measures to protect consumers, such as deposit insurance and financial literacy programs.

Chapter 1: INTRODUCTION

Rural and community banks (henceforth referred to as rural banks or RCBs) are a network of 127 independent unit banks in Ghana. They are regulated by the Bank of Ghana and thereby form part of the regulated financial sector in Ghana. These banks are the largest providers of formal financial services in rural areas and also represent about half of the total banking outlets in Ghana (IFAD 2008). By the end of 2008, these banks together had 421 branches. Including head offices, there were 548 service delivery locations spread throughout the country. All administrative regions have at least one bank, although most are located in the Ashanti, Western, Eastern, and Central regions (see Annex 1 for map of rural bank locations).[5]

RCBs are relatively small financial institutions with average share capital of GHc 136,526 (US$105,263), average deposits of GHc 2.3 million (US$1.77 million), and average assets of GHc 3.8 million (US$2.4 million). Values of the three indicators, however, vary significantly. Out of the 127 RCBs, 75 percent have assets between GHc 1 million (US$771,010) and GHc 8 million (US$6.1 million), 20 percent have assets of less than GHc 1 million, and 5 percent have assets over GHc 10 million (US$7.7 million). Similarly, 44 percent of RCBs have share capital of less than GHc 100,000 (US$77,101) and only 6 percent have share capital of more than GHc 250,000 (US$192,753).

As a network, RCBs have achieved a remarkable level of service delivery and financial performance. At the end of 2008, they had deposits of GHc 343.9 million (US$265.1 million) from more than 2.8 million clients, and loans and advances of GHc 224.7 million (US$173.2 million) with about 680,000 clients. They delivered 128,875 domestic money transfers worth around GHc 63.3 million (US$48.8 million) in 2007 and 32,392 international money transfers worth GHc 9.3 million (US$7.1 million) in 2008. They also facilitated check transactions worth GHc 993.7 million (US$766.1 million) in 2008. RCBs made a consolidated profit of GHc 15.6 million (US$12.0 million) in 2008 and had a consolidated net worth of GHc 62.3 million (US$48.03 million). Several have excelled in performance, both within the financial sector and in the broader private sector. Some rural banks have figured more than once in Club 100, a group of 100 Ghanaian institutions recognized annually for business excellence.

Several challenges, however, remain. The Bank of Ghana (BoG) rated the performance of 17 of the 127 rural banks in operation as mediocre, based on capital adequacy, and it categorized 5 banks as distressed.[6] Among the banks whose performance is categorized as mediocre, 6 rural banks have negative net worth. The apex bank of the network, which was created primarily to provide services to rural banks, is not yet fully financially self-sufficient and has inadequate resources to effectively perform its functions. The BoG, which is primarily responsible for supervising RCBs, is constrained in effectively performing its supervision role because of political and civil society pressures, resource constraints, and limited delegation of supervisory functions to the Apex Bank.

This paper is based on a review of various published and unpublished documents, interviews with key respondents, and an analysis of data collected from the BoG, the ARB Apex Bank, and a sample of rural banks. The sample rural banks were selected primarily to reflect the proportional representation of different categories of rural banks according to the BoG's performance classification of all 127 banks. Other factors used to select the sample of banks were location (primarily rural or periurban, and agroclimatic zone), size, and age. Annex 2 lists the banks included in the sample. Not all data, however, were available for all the banks included in the sample. In the sample used for a specific analysis, the performance category of banks with missing data is mentioned wherever the results are used.

The performance analysis of the rural banks is primarily presented at the network level (consolidated data for all RCBs) using secondary data available from the ARB Apex Bank, the BoG, and other secondary sources. Whenever the necessary data are not available at the network level, data from the sample banks are used, if available. The analysis includes trends, frequencies, and composition of key indicators and their comparison with data from peer-group institutions.

This paper is organized as follows: Section 2 describes the background of RCBs, including the sociopolitical context, a narrative on the emergence and evolution of RCBs, the structure of the Ghanaian rural financial market, the legal and regulatory environment, and an overview of major donor programs. Section 3 describes the business model of RCBs, including ownership, governance, staffing, products and services, systems, and associative structures. Section 4 analyzes the service delivery and financial performance of RCBs. Section 5 identifies some key issues and discusses options for the way forward. Finally, Section 6 draws some lessons from the RCB experience and discusses its relevance to other countries considering replicating the Ghanaian rural banking system.

Chapter 2: BACKGROUND

2.1 COUNTRY CONTEXT

Ghana covers about 240,000 square kilometers of land in three major ecological zones including the rainforest zone (25 percent of total area), the transitional zone (11 percent), and the savannah zone (64 percent).[7] In 2007 Ghana's population was 23.5 million, growing at an estimated 2 percent a year, down from the 3.4 percent growth recorded in the mid-1990s. Urbanization is concentrated mainly in the southern and central regions, which contain nearly 49 percent of the country's population. Although there are densely settled pockets in the Upper East and Volta regions, more than half of the population lives in the Greater Accra, Eastern, Central, and Ashanti regions.

Real gross domestic product (GDP) growth rose gradually from 4.5 percent in 2002 to an estimated 7.2 percent in 2008, although it is still below the rate needed to achieve Ghana's ambition of becoming a middle-income country by 2015. Inflation fell from 42 percent in 2001 to 13 percent in 2008. Agriculture contributes 40 percent of GDP; industry, 27 percent; and services, 32 percent. Agriculture also contributes about three-quarters of export earnings and provides the main source of livelihood for about 60 percent of the population. Cocoa accounts for about 16 percent of agricultural GDP; cereals and root crops, 65 percent; and forestry, livestock, and fisheries, the remaining 19 percent.

Agricultural growth, which averaged 3.6 percent for the 10-year period from 1997 to 2007, remains the mainstay of strong overall growth performance, accounting for more than half of total growth in this period. The country has an agricultural system that is traditional, rainfed, and dominated by smallholders. Some 2.7 million farms, averaging 1.2 hectares in size, account for 80 percent of agricultural production. The 2006 Ghana Living Standards Survey (GLSS) estimates that the poverty headcount fell from 39.5 percent in 1998 to 28.5 percent in 2006.

2.2 EMERGENCE AND EVOLUTION OF RURAL AND COMMUNITY BANKS (RCBs)

2.2.1 Rural Finance Prior to RCBs

Before the establishment of the first rural bank in 1976, the availability of formal credit in rural communities predominantly made up of small farmers and fishermen was extremely limited. The main sources of credit were moneylenders and traders charging exorbitant interest rates. The Government of Ghana had taken some policy measures to improve access to finance in rural areas. These measures included a requirement that commercial banks lend at least 20 percent of their portfolio for agricultural uses and the establishment of the Agricultural Development Bank (ADB) in 1965 with an exclusive mandate of lending for agriculture and allied industries in rural Ghana. Subsequently, commercial banks and the ADB opened branches in rural areas, with an emphasis on cocoa-growing rural areas. Nevertheless, lending to the rural sector remained low; the commercial banks used their rural branches primarily to make payments to cocoa farmers and collect deposits for lending in urban areas. Other banking services, like credit, were not provided as initially envisioned. Commercial banks demanded higher deposit accounts and stronger collateral requirements to provide loans to rural areas. Many small farmers and fishermen did not have deposit accounts in commercial banks, and the collateral they had available was not satisfactory for commercial lending (Andah and Steel 2003). Mensah (1993) and Ranade (1994) found that the ADB's credit provision and coverage were limited. Only 27 percent of its branches were in rural areas, and lending to smallholder farmers made up only about 15 percent of its total portfolio.

In view of this situation, the Government of Ghana (GoG) considered supporting the establishment of community banks in rural areas that would be dedicated to providing financial services in those areas. It asked the BoG to send a delegation to the Philippines to study the rural banking system there and afterward decided to facilitate the opening of banks in rural farming and fishing communities.

2.2.2 1976–90: Establishment and Growth

The first rural bank was established in 1976 in the Central region of Ghana with paid-up capital of 60,660 old Ghana cedis (old GHc 60,660, or about US$52,000). It was established in Nyakrom, a farming community. Capital contributions were mainly drawn from farmers in the community. A second bank was opened in the following year at Biriwa, a fishing village also in the Central region. By 1980 the number of rural banks had reached 20. Managers and directors of these rural banks founded the Association of Rural Banks (ARB) to promote the exchange of information and to improve the performance of rural banks as a whole. Over the period 1980–84 the number of rural banks rose rapidly and reached 106. This growth was driven by rising interest among rural communities in establishing their own banks and by the introduction of Akuafo Check operations[8] in cocoa-growing areas in 1982.

As the network of rural banks grew, it was essential to provide a code for establishing new rural banks. The BoG developed and issued guidelines for the establishment of rural banks in 1985. The minimum paid-up capital required by BoG was old GHc 1.5 million. Of this, shareholders were to hold 67 percent, and 43 percent was to be contributed by the BoG. The maximum share that could be purchased by an individual shareholder was limited to old GHc 10,000. This limit was intended to allow equal participation of all shareholders from the community and to mitigate the risk that a few shareholders would dominate the governance of the banks.

The rural banks provided mainly savings and credit services and products. With the increase in the number of rural banks, the number of individuals with bank accounts also increased. Salary and pension deposits for civil servants were transferred using rural bank networks. The volume of deposits increased from old GHc 148,000 in 1976 to old GHc 2.3 billion in 1988. With the addition of credit lines, the consolidated loan portfolio grew to around US$4 million, with nearly half of the portfolio in agriculture and 30 percent in cottage industries. The repayment performance of loans worsened, however, with nonperforming loans (NPLs) rising from 5 percent in 1982 to 70 percent in 1986. The capital available in most banks was not sufficient to cover the cost of the bad loans.

Although the 1983 drought and the 1984 bumper yield and price slump contributed to the worsening loan portfolio performance, several other factors also figured in this deterioration. First, the boards of directors of most banks had little experience in or understanding of the banking business. Criteria for selecting directors did not include an individual's competence to lead a banking institution. The main criterion was popularity in the community. Second, because the banks were located in rural areas and had limited resources, they could not attract well-qualified and experienced personnel. Employees of the banks were in most cases selected from their own communities, regardless of qualifications and experience. Training opportunities were rarely available. Third, weak internal controls led to several instances of corruption by management and staff. Fourth, the sector-specific credit quotas and other inappropriate regulatory requirements (concessional interest rates for priority sectors including agriculture) constrained the RCBs' ability to flexibly respond to market signals and risks unique to RCBs. Specifically, RCBs gave many bad loans to meet the 50 percent lending requirement for agriculture imposed by the BoG. Fifth, inadequate resources limited the BoG's capacity to supervise the rapidly rising number of rural banks and to effectively respond to their complex difficulties.

In an attempt to respond to the worsening financial performance of RCBs, the BoG introduced some financial reforms. These reforms included a review of the sector-specific credit quotas[9] and a reduction in agricultural loans, increases in primary and secondary reserve requirements, closure of distressed banks, and a stronger role for the BoG in examination and control of the banks (Andah and Steel 2003). The World Bank–supported Rural Finance Project, approved in 1989, further advanced this attempt. The project aimed to strengthen the rural finance sector, particularly the RCBs, by (1) providing technical assistance for restructuring about 80 RCBs; (2) strengthening the ARB and credit unions; (3) rationalizing the roles of the Rural Banking Department of the BoG and the ARB; (4) improving the rural credit appraisal capacity of RCBs and participating financial institutions; and (5) strengthening the BoG's capacity to supervise rural banks.[10]

2.2.3 1991–2000: Restructuring and Capacity Building

The Rural Finance Project (RFP) started in 1989 and ended in 1994. Initial diagnostics showed that 98 out of 122 banks were capital deficient. In 1992, when the BoG began rating RCBs, 23 out of 123 banks were categorized as satisfactory, and even this number was considered an overestimate. The project offered assistance to rural banks in conducting comprehensive special audits and preparing restructuring programs on the basis of the audit recommendations. Nonperforming loans were assigned to a special collection unit with collection targets, and provisions were made for bad debt. A recapitalization fund equivalent to the value of the nonperforming loans was set up to supplement the loan collection effort. Besides the restructuring program, the project provided capacity-building support to enhance the rural banks' credit administration systems, which had been one of the causes of the large nonperforming portfolio.

The restructuring activities were also accompanied by additional regulatory reforms. The absolute ceiling on shareholding limits by individuals and companies was eliminated and replaced with limits on the percentage of shareholding: individuals were limited to holding 5 percent of total capital and companies were limited to holding 10 percent. Sector-specific allocation of credit was removed for sectors other than agriculture, and the allocation for agriculture was reduced from 50 percent to 20 percent. Concessional interest rates for high-priority sectors[11] were also removed.

The RFP resulted in some positive outcomes. The number of RCBs rated as satisfactory increased to 55 (out of 125); deposits increased from old GHc 4.6 billion in 1989 to old GHc 13.2 billion by 1994; and loans nearly doubled from old GHc 3.7 billion in 1991 to old GHc 6.8 billion in 1994. The recovery rate of the RCB loan portfolio improved to 60 percent. Most RCBs, however, continued to be financially and operationally weak. Of the 134 rural banks in existence at the end of 1998, 23 were classified as distressed and subsequently closed by the BoG. Fifty-six of the remaining 111 RCBs were rated as mediocre (defined as rural banks with capital adequacy between 1 and 6 percent), and only 55 were rated as satisfactory.

At the end of the 1990s, two major policy decisions were made to strengthen supervision of the RCBs: one was to support the establishment of an apex bank, which would provide support services to the RCBs, and the second was to merge the Rural Finance and Inspection Department in the BoG with the Banking Supervision Department (BSD). The merger, accomplished in 1999, was intended to integrate supervision of the RCBs with that of other institutions over which the BoG had supervisory responsibility.

The GoG decided to borrow again from the World Bank and other donors to help establish the Apex Bank and for other activities to strengthen the rural financial sector. The Rural Financial Services Project (RFSP), cofinanced by the World Bank, the International Fund for Agricultural Development (IFAD), and the African Development Bank (AfDB), was approved by the respective boards in 2000. In contrast to the previous piecemeal attempts by these donors, this project coordinated donors in a comprehensive attempt to strengthen the rural financial sector. This project will be discussed in Section 2.5.

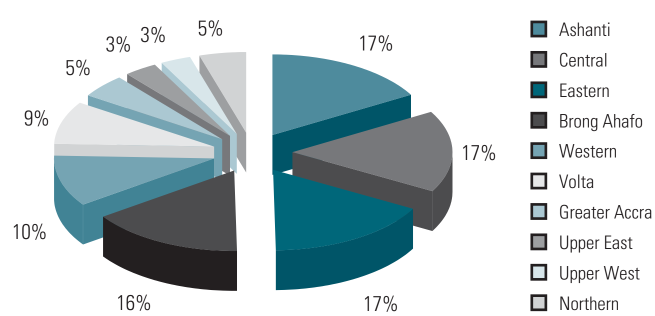
2.2.4 2001–08: Toward Consolidation

The RFSP became effective in 2001, and the ARB Apex Bank created by the rural banks commenced business in 2002 with financial support provided under the RFSP. The establishment of an apex structure for the rural banking system was intended to leverage economies of scale to address constraints faced by the rural banks in check clearing, specie supply, liquidity management, and training.

Several key regulatory changes were also undertaken during this period. The secondary liquidity reserve requirement was reduced from 52 to 30 percent in 2006.[12] The capital adequacy ratio was increased from 6 to 10 percent, and the paid-up capital requirement for establishing a rural bank was raised to GHc 150,000 (US$116,135). The BoG delegated part of its supervisory functions to the ARB Apex Bank and launched an electronic reporting system to ensure efficient supervision. Moreover, some rural banks adopted a more commercial business model and introduced innovative products such as microfinance saving and lending techniques (Andah and Steel 2003). Many RCBs started to use new techniques—namely, group savings with credit, group and individual savings with credit, individual savings with group credit, and individual savings with credit (Andah and Steel 2003).

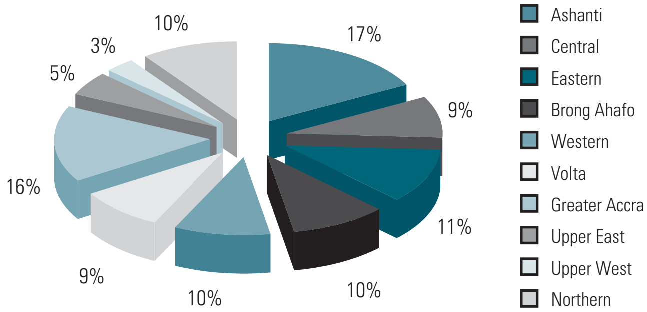
As of 2008, there were 127 RCBs in existence. Of these, one was in the process of being liquidated and six were categorized as distressed. As shown in Figures 2.1 and 2.2, as of 2008 just over three-quarters of the RCBs are distributed in five regions of Ghana, which together were home to 57 percent of the Ghanaian population in 2000. The northern part of the country, which includes the Northern, Upper East, and Upper West regions, has 11 percent of the RCBs but 18 percent of the country's population.

FIGURE 2.1: Regional Distribution of RCBs, 2008



Source: ARB Apex Bank 2008.

FIGURE 2.2: Regional Distribution of Population, 2000



Source: ARB Apex Bank 2008.

BOX 2.1: The Legal, Regulatory, and Tax Framework of Rural and Community Banks

- Licensing requirements
  - Minimum paid-up capital of GHc 150,000
  - Ownership of shares by residents
  - Operation within a radius of about 25 miles
- Prudential requirements
  - Minimum paid-up capital of GHc 150,000
  - Capital adequacy ratio of 10 percent
  - Liquidity reserve ratio of 43 percent
  - Exposure limits of 25 percent for secured loans, 10 percent for unsecured loans, and 2 percent for loans to members of board of directors
- Tax requirements
  - Corporate income tax rate of 8 percent
  - Value-added tax of 15 percent
  - National Health Insurance Scheme tax of 2.5 percent

Source: BoG and ARB Apex Bank.

2.3 REVIEW OF GHANA'S FINANCIAL SECTOR

Ghana's financial sector is composed of banks and nonbank financial institutions (NBFIs). The country has about 23 major banks—including 3 development banks, 4 commercial banks, and 16 universal banks—representing about 90 percent of the total assets of the banking and nonbanking sector. The NBFI subsector includes 36 institutions accounting for 5 percent of the total assets of the financial sector. The NBFIs include 17 savings companies, 13 saving and loans companies, 4 leasing companies, 1 discount house, and 1 mortgage company. Many of these institutions provide services in urban and periurban areas. Their service outlets are largely concentrated around the major urban centers of the Greater Accra, Ashanti, and Eastern regions, with little outreach to rural and remote areas.

In addition to formal financial institutions, informal and semiformal institutions—including 380 credit unions, 80 financial nongovernmental organizations, and 4,000 susu collectors (individuals)—are important financial service providers in Ghana. RCBs and their agencies represent about 5 percent of the total banking assets and account for about half of the total banking outlets in the country, and they are especially significant in rural areas. Formal financial service providers such as commercial banks represent about 40 percent of the money supply in the overall financial sector. The remaining amount is believed to be outside the formal system (IFAD 2008) and mainly in rural areas. Thus, institutions such as RCBs and informal and semiformal service providers play an important role in addressing the lack of access in these areas.

2.4 THE LEGAL, REGULATORY, AND SUPERVISION FRAMEWORK GOVERNING RCBs

Under the Banking Act, the BoG has overall regulatory and supervisory authority in all matters related to banking institutions in Ghana.[13] Rural and community banks are incorporated as limited liability companies[14] and licensed by the BoG within the framework of the Banking Act.

In 2008 there were 127 rural banks licensed and supervised by BoG. The statutory role of the BoG in the operation of rural banks includes the licensing of new banks, supervision, and liquidation. The regulatory framework for rural banks at the end of 2008 is presented in Box 2.1. The capital requirements for all financial institutions in Ghana were increased in 2007. The other local commercial banks were given until 2012 and foreign-owned ones until 2009 to meet the new minimum level of capital (GHc 60 million, or US$46.4 million), but RCBs have not been given a specific date to achieve the minimum capital level of GHc 150,000 (US$116,135). RCBs whose capital falls below the stipulated minimum of GHc 150,000 will not, however, be allowed to pay dividends or open new branches or agencies until they attain the minimum level of capitalization.

RCBs must maintain primary and secondary liquidity reserve requirements to mitigate liquidity risk. As a primary liquidity reserve ratio, rural banks are required to maintain 8 percent of their deposits with the BoG and 5 percent of their deposits with the ARB Apex Bank. As a secondary liquidity reserve, rural banks are required to maintain 30 percent of their deposits as liquid investments such as BoG bonds, ARB certificates of deposits, and Treasury bills. Treasury bills are purchased through the ARB Apex Bank. RCBs that are fully computerized and have achieved the full capital adequacy requirements can be exempted from maintaining the secondary liquidity reserves.

New rural banks have a 10-year tax holiday. During this period, however, they are not allowed to pay dividends and are expected to use the tax savings to strengthen their capital position.

2.4.1 Supervision

The BoG supervises rural banks through its Banking Supervision Department (BSD). The BSD supervises operations of rural banks through on-site and off-site inspection, issuance of administrative directives, and attendance of rural bank annual general meetings. Rural banks are required to submit monthly, quarterly, and annual returns on a variety of financial and nonfinancial indicators (Box 2.2 shows the key returns filed by rural banks). The BoG can penalize rural banks for nonsubmission, incomplete submission, delayed submission, or inaccurate submission of any of these returns.

BOX 2.2: Schedule of Returns Filed by Rural Banks to the BoG

- Weekly
  - Liquidity reserve
- Monthly
  - Statement of assets and liabilities
  - Profit and loss accounts
  - Large exposures (advances and deposits)
  - Capital adequacy ratio
- Quarterly
  - Sectoral distribution of credit
  - Advances subject to adverse classification
  - Aging analysis of loans
- Semiannual
  - Consolidated monthly and quarterly reports
- Annual returns
  - Positions of facilities extended to directors and officers
  - Published audited accounts
  - Consolidated weekly, monthly, quarterly, and semiannual reports

Source: ARB Apex Bank.

The BoG is expected to conduct an on-site examination of rural banks at least once a year. Annual on-site supervision takes about five days in each rural bank. The on-site supervision reviews various aspects of a bank's operations, including books, records, and use of fixed assets. During these visits, BoG supervisors also check physical cash, inspect the cash storage security system, verify compliance with the liquidity reserve ratio, check insurance policies, and examine customer turnaround time. The examination is carried out without prior notice to the rural banks. In the course of the examination, inspectors may also interview staff, clients, and directors as necessary. The output of the examination is a report followed by a directive outlining actions that the bank must implement.

Based on the annual returns filed by rural banks and on-site inspections, BoG categorizes rural banks as satisfactory or mediocre. The key performance indicators used to arrive at this classification are paid-up capital, net worth, the capital adequacy ratio, loans and advances, investments, liquidity, deposits, and total assets. The BoG can revoke the license given to a rural bank if the capital base of the bank is significantly eroded and liabilities exceed assets—unless the shareholders are able to inject additional capital to restore the bank to normal operation within six months of the capital erosion.

Effective supervision of rural banks by the BoG is made difficult by the large number of rural banks spread over a large geographical area. Because of manpower constraints, the BoG has been unable to conduct regular on-site examinations of all rural banks annually. As a result, some poorly performing banks that need these on-site examinations the most do not receive them. Until recently, RCBs were required only to submit paper-based returns, and this situation often meant poor data quality because of missing data or data errors. To improve the quality of supervision and monitoring, the BoG recently introduced an electronic Financial Analysis and Surveillance System (e-FASS) system that requires rural banks to send their periodic returns electronically.

2.4.2 The Apex Bank's Role in Supervision

To help address the challenges of supervising RCBs, a law enacted in 2006[15] allowed the BoG to delegate some of its supervisory functions to the Apex Bank, as follows:

1. maintain primary cash reserves of the rural and community banks in accordance with relevant rules, regulations, and policies;
2. monitor, inspect, examine, and supervise rural and community banks in accordance with relevant rules, regulations, and policies;

3. lend to rural and community banks facing temporary liquidity problems; and
4. provide specie management and specie movement services.

Although the ARB Apex Bank currently performs all the supervisory functions envisaged for it under the 2006 regulations, the BoG continues to carry out both on-site and off-site supervision. The full delegation of powers has been constrained by structural, capacity, and resource constraints. Structurally, since the ARB Apex Bank is owned by the RCBs, its autonomy to supervise its members has been called into question. It also has limited capacity to undertake off-site and on-site supervision, partly because of resource constraints. The Apex Bank neither has access to any funds from the BoG or GoG to perform this task effectively nor can it recover the costs from RCBs because regulations do not require RCBs (or any other banks) to pay for supervision costs.

2.5 RURAL FINANCIAL SERVICES PROJECT AND OTHER MAJOR DONOR-FUNDED PROGRAMS

Several donor-funded programs have supported the rural banks for years. Section 2.1 referred to some of these programs. This section discusses some of the major recent and ongoing programs.

2.5.1 The Rural Financial Services Project (RFSP)

The RFSP (2000–07)—cofinanced by the World Bank, IFAD, and AfDB—had as its overall objective the reduction of rural poverty through the broadening and deepening of financial intermediation in rural areas.[16] The project had four major components: (1) institution building in the informal financial sector; (2) capacity building of rural banks; (3) institution building of the ARB Apex Bank; and (4) institutional support to the BoG's Banking and Supervision Department to enhance oversight of the rural financial sector.

Following a midterm restructuring of the project, the activities financed under components 2 and 3 were either implemented directly or managed by the ARB Apex Bank. Component 3 provided most of the financing to establish office premises for the Apex Bank and for operational expenses, including training of staff in the country and overseas. Component 4 financed the training of BoG staff, procurement of vehicles, and office and information technology equipment to facilitate the supervision of RCB. This component also financed strengthening the microfinance oversight capacity of the Ministry of Finance and Economic Planning.

The rural banks' capacity-building program was aimed at increasing the banks' outreach through staff training and investments in technologies. This component financed a large program of general banking and computer training for RCB directors, managers, and staff, as well as a special capacity-building program in microfinance for 15 RCBs and a special training program for 8 RCBs that were categorized as mediocre at the beginning of the project.[17] Under the rural bank institution-building component, the project also financed the introduction of computers and other office equipment to improve the operational effectiveness of the banks.

Through the training program in general banking, more than 8,000 RCB staff members were trained in a variety of topics, such as customer care, treasury and credit management, anti–money laundering, internal controls, and check clearing. The demand for and use of training provided under RFSP is particularly remarkable because cost subsidies for training were incrementally reduced and eliminated by 2005. Until 2003 the RCBs enjoyed a 50 percent subsidy on the cost of training, and in 2004 the subsidy was reduced to 25 percent. In 2005 it was removed completely, and the RCBs also pay 20 percent of the cost to the Apex Bank as an administrative fee. The special microfinance training program, the Microfinance Support Initiative, trained 79 staff in RCBs that participated in this program, helped them prepare strategic plans for microfinance, and provided handholding services as these strategic plans were implemented. Training programs on product design, internal controls, portfolio analysis, and governance were also conducted. In addition, strategic business plans and training manuals were developed. The special restructuring program helped the selected banks prepare restructured plans and upgrade the skills of their board members, managers, and staff.

The project also financed full computerization of 4 rural banks and partial computerization of 13 others. Initially, the project envisioned providing all rural banks, on a full cost recovery basis, with four computers each, a photocopy machine, and wireless equipment. During implementation, however, it became clear that providing hardware alone, without additional support for networking and training, did not support the intended objective of increasing the operational efficiency of the rural banks. Project leaders thus decided to instead support full computerization of at least one branch in a selected number of banks. Even this was found to be suboptimal, however, and it was decided that at least one RCB would be fully computerized—that is, networked computers would be installed in the head office and all branches.

Currently, four banks are fully computerized. In these banks, all operations in the head office and the branches are computerized, and the branches are connected to the head office through a wide-area network. Two banks have local area network connections within their head offices and some branches, and 11 have at least one branch with a local area network.

The overall quality of service delivery and financial performance of the rural banks improved significantly over the period of project implementation. Key improvements in service delivery include (1) 16 percent and 28 percent average annual increases in the number of depositors and borrowers, respectively; (2) 23 percent and 32 percent average annual increases in RCB deposits and loans, respectively (in real terms after adjusting for inflation); (3) a 61 percent average annual increase in domestic money transfers (in real terms after adjusting for inflation); (4) a reduction in check clearing from 2–3 weeks to 3–5 days; (5) approval of advances to salaried workers from 14 days to 3 days; and (6) improved turnaround time for withdrawals from more than 20 minutes to 9 minutes. In terms of financial performance, the number of banks classified as unsatisfactory by the BoG based on capital adequacy declined from 28 RCBs (of 105) in 2001 to 16 RCBs (of 127) in 2007. The percentage of nonperforming loans fell from around 20 percent at the start of the project to 12 percent at the end of the project.

The project also resulted in several activity or component-level benefits to RCBs. Initial results of an assessment of the impact of the various training programs on RCB performance, conducted in parallel to this study, finds that the general banking training program had a positive and significant impact on both service delivery and financial performance.[18] The quantitative impact of the training provided under the Microfinance Support Initiative or special training for mediocre banks, however, could not be identified because this dataset was much smaller. Nevertheless, descriptive data on the Microfinance Support Initiative does show that the participating banks also increased the number of their microfinance clients and microfinance portfolios by 13 percent and 25 percent respectively, while also being profitable. Twelve out of 15 banks supported under the initiative increased their microfinance portfolios in 2007 over 2006, and six of the banks increased their portfolios by more than 100 percent.

Too few RCBs have been fully computerized (only four), and for these banks only one to three full years of post-computerization data are available—too small a database to allow for an rigorous impact assessment of computerization.[19] Anecdotal benefits reported, however, include (1) enhanced effectiveness of oversight by BoG; (2) reduced staff overtime costs; (3) improved customer service (on average, turnaround time for customer services was reduced from 15 minutes to 3 minutes); (4) improved internal controls; (5) automated ledger balancing; and (6) better monitoring of loan portfolios (World Bank 2008). The computerization program is also reported to ease implementation of the electronic Financial Analysis Surveillance system (e-FASS) introduced by the BoG for reporting of prudential returns. Since 2008 all rural banks have been required to submit returns using e-FASS.

Finally, the project played a key role in the establishment of the Apex Bank, which in turn was instrumental in managing the capacity-building program for the RCBs, in introducing the MICR (magnetic ink character recognition) checks that improved the acceptance of RCB checks, developing the domestic money transfer product, and providing improved investment options for RCBs through its brokerage services.

2.5.2 Support Program for Enterprise Empowerment and Development (SPEED)

SPEED is an ongoing project, started in 2004, and is cofunded by the Danish government and GTZ, the German technical support agency. The project facilitates the development of the financial market and business development services for micro, small, and medium enterprises of Ghana.[20] The project focuses on the northern and more rural regions of Ghana and has three major components: funding, technical assistance, and business development services.

The funding facility provides refinancing funds to rural banks to on-lend to small and medium enterprises at their own risk. The fund is disbursed through the Apex Bank. Three types of products are provided: (1) developmental loans with technical assistance, up to a maximum of GHc 100,000; (2) a revolving fund of GHc 100, 000–300,000; and (3) terminal loans of GHc 300, 000–500,000. The technical assistance component of SPEED Ghana provides capacity-building support through training for rural financial institutions, including rural banks. Rural banks are the major beneficiaries of this component because of their proximity to rural areas. The training provided covers internal controls, risk and treasury management, and market research.

This facility has also facilitated bank-to-bank learning and experience-sharing forums. The business development services component supports business associations and nongovernmental organizations with a focus on the tourism and wood products sectors and helps build their capacity to deliver relevant services to their members on a commercially sustainable basis. SPEED has assisted about 18 rural banks through its funding facility.

2.5.3 Ghana Rural Banks Computerization and Interconnectivity Project (GRBCIP)

GRBCIP is financed by the Millennium Challenge Corporation (MCC) and will provide support for computerizing RCBs and savings and loans institutions.[21] The program is being built on the RCB computerization program initiated by the RFSP. About 30 RCBs are expected to participate every year. Additionally, the program will establish a refinancing facility to be provided to RCBs based on specific eligibility criteria.

2.5.4 Rural and Agricultural Finance Program (RAFiP)

The focus of the RAFiP is on the rural banking sector (RCBs and the ARB Apex Bank). It is designed to strengthen institutional performance, outreach, and client orientation in all segments of the rural financial system. It also seeks to integrate rural financial institutions more closely with each other and with the financial system as a whole and link them to support systems (particularly related to technical issues and risk management of agricultural value chains). The specific objective is to improve the rural and agricultural population's access to sustainable financial services through enhanced outreach, sustainability, and linkages. The program has the following components and activities:

1. **Strengthening the rural financial system through capacity-building activities.** The program improves the ability of apex organizations at the meso level to support the retail institutions and become self-sufficient. The primary focus will be on developing and rolling out products that make financial services more accessible to clients. RAFiP will also support strategic planning, upgrading management information systems, use of data benchmarking, and rating or other measures to attract external funding.
2. **Product development and innovation.** Support for product development and innovation will improve the ability of rural MFIs to serve more clients in different niches and levels of agricultural value chains. This component will build product development capability in the Apex Bank.
3. **Linkages and technical support.** Support will be provided to technical service providers (TSPs) including training and consulting services to rural financial institutions, technical assistance to agricultural producers and value chains, and business development to micro, small, and medium-sized enterprises.
4. **Regulation, policy, supervision, and monitoring.** The program will provide support for the implementation of financial, private, and agricultural sector strategies. The primary focus will be on regulation and supervision of the rural banking network. Apex organizations will also receive support to strengthen sectorwide performance monitoring and benchmarking capabilities. The program will support the engagement and training of banking inspection staff by the ARB Apex Bank.
5. **Knowledge development and dissemination.** Knowledge development and dissemination services will be provided to apex organizations.

Chapter 3: BUSINESS MODEL

3.1 OWNERSHIP AND GOVERNANCE

Rural banks are incorporated as limited companies under the Companies Code of 1963 (Act 179) of Ghana and are required to be owned by shareholders from the local community in which they operate. At first, the BoG owned up to 43 percent of shares in rural banks as preference shares. This practice was stopped in the 1990s. In the early years of RCBs, the shareholding levels for an individual and a corporate body were capped at 10 percent and 30 percent, respectively. These levels have been revised to 30 percent for an individual and 50 percent for a corporate body. An identifiable group can also own 40 percent shares in a bank.

The governance structure of an RCB comprises a board of directors that represents shareholders within the bank and supervises the management of the bank. Boards of directors are elected by the shareholders from the communities where the banks are located. Election of board members takes place during annual general meetings (AGMs). Directors are elected on the basis of their reputation in the community and professional qualifications. The individuals nominated by the shareholders are validated by the BoG before assignment is effective. The board elects a chairperson and a vice chairperson from among the directors. In many cases, the chief executive[22] of the bank serves as the secretary of the board. A board member is elected for a three-year term but can be reelected for an unlimited number of terms by the shareholders. At every AGM, one-third of the board members need to retire but are eligible for reelection, in accordance with the Companies Code of Ghana.[23] However, a sample analysis of 10 BoDs of RCBs showed that the average number of years spent as a board member is 11; the maximum was 32 and the minimum was 1 year.

The minimum size of a BoD is five, and the maximum is 11. Although the number of directors with voting rights cannot exceed the maximum allowed size, additional individuals can participate as coopted members. Based on a sample analysis of 10 RCBs, only 9 percent of the directors are women. The sample analysis also showed that a limited number of directors have experience in banking.

The board of a rural bank has three to five supervisory subcommittees covering the main aspects of managing and operating the bank. Members of the supervisory subcommittees are elected from the board based on specialization and interest. The following are the main subcommittees and their respective responsibilities:

- **Loans subcommittee:** ensures that loan approvals are in accordance with the operating policy of the bank and that loans disbursed are recovered; reviews and approves loan applications; and follows up with delinquent clients and legal cases.
- **Finance and audit subcommittee:** monitors the financial performance of the bank; assesses the liquidity position of the bank and makes decisions on advances; monitors the bank's investments; reviews the operational budget; ensures that accounts are prepared for audit; ensures that prudential returns are prepared and submitted; ensures provision for bad and doubtful loans; and ensures that policies and manuals are updated and implemented.
- **Disciplinary subcommittee:** manages conflict among the staff and takes disciplinary action in case of misconduct.

The boards typically meet once a month. During this meeting the board approves loans above the approval threshold of the RCB management (above GHc 2,000, or US$1,542); reviews monthly reports from the internal auditor; examines portfolio quality; follows up on previous meeting actions; reviews reports from supervisory subcommittees of the board; and undertakes strategic decisions and guidance for management. The minutes of the meetings are recorded and submitted to the BoG for monitoring and information purposes.

Shareholder services—such as share registries that are essential to attract investors—are weak in rural banks. Share registries of many rural banks are not up to date despite support provided for this purpose under RFSP. Until recently many rural banks operated a system of equal voting rights for each shareholder regardless of the number of shares owned, thus creating no incentive for shareholders to increase their shareholding. This situation has been changed to voting rights based on the number of shares.

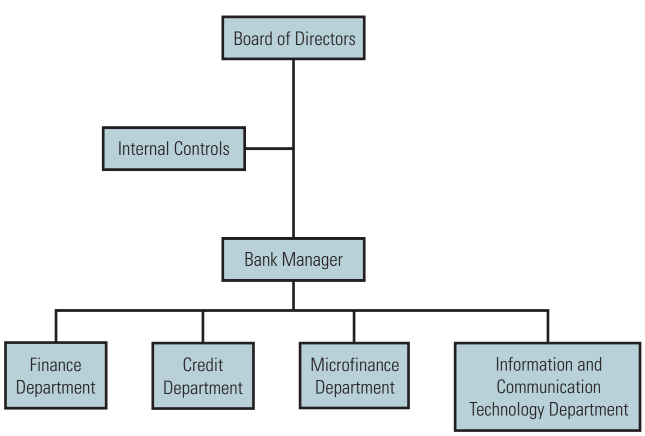
Governance of rural banks is constrained by their difficulty in attracting and retaining qualified directors, even though these positions are generally considered prestigious. The opportunity cost for professionals with the necessary knowledge and skills to serve effectively as board members of financial institutions is often higher than what most rural banks can afford to pay as sitting fees or honoraria. In addition, the amount of time directors are expected to spend attending board meetings, subcommittee meetings, and other ad hoc engagements is typically higher than that in other organizations.

3.2 STAFFING

Figure 3.1 shows the typical organizational structure of a rural bank. The management staff is headed by a chief executive officer (typically called a supervising manager or general manager), who reports to the Board of Directors. The core management staff of RCBs includes an internal auditor supported by assistant accountants; a finance officer; a credit head supported by credit officers and project officers in charge of the microfinance portfolio; and a system administrator, if a bank is computerized. Some larger banks have additional departments, such as research and business development support units. At the branch level, the structure typically includes a branch manager, an accountant, credit officers, clerks and cashiers, and support staffs. Rural banks that provide *susu* products have *susu* supervisors and *susu* collectors at the branch levels.

The total number of staff in all RCBs reached 5,703 in 2008. The number of staff members varies, however, by the level of outreach. RCBs with a larger number of clients have larger staffs. Nearly half of the professional staffs are microfinance credit officers, and of these about 26 percent are women. The client–credit officer ratio is 208.

FIGURE 3.1: Organizational Structure of a Rural and Community Bank



Source: Authors' analysis based on organizational diagram of 12 RCBs.

3.3 SERVICES

As financial intermediaries, rural banks provide primary services consisting of savings, loans, and payments. Several products are offered within each of these categories. Given the community-owned nature of these institutions, they also generally support community development services. As financial institutions actively supported by the government, RCBs offer special products and services for specific target groups on behalf of government- and donor-financed programs, such as Microfinance and Small Loan Center (MASLOC), the Social Investment Fund, the Community -Based Rural Development Project, and the Millennium Development Authority.

The rural banks use a variety of techniques to promote their services and products, including traditional outreach by bank staff and use of electronic and print media. For example, some banks use local FM radio to promote their products (particularly microfinance) and broadcast information about services available. This approach has been successful in reaching many clients in remote parts of the operational area. Several social occasions such as funerals have been used to disseminate important information such as repayment reminders.

3.1.1 Deposits

Rural banks offer all the general savings products such as the regular savings accounts, current accounts, and time deposits. Typically, the largest share of the deposit portfolio in a rural bank is held in the savings account. Interest rates offered on these accounts are typically very low, however, and often negative when inflation is taken into account. In 2008 in the sample banks, interest rates on savings deposits varied from 5 to 16 percent, while inflation ranged between 11 and 18 percent. Further, interest on savings accounts is often provided only when the savings balances are more than a specified amount. Unlike in most commercial banks, however, rural banks do not require high minimum balances to maintain a savings account and do not charge a high ledger fee.

BOX 3.1: *Susu* Collector: Rural Banks' Frontline Deposit Mobilization

Rose Opoku Mensah is a *susu* collector who just graduated from school and joined the bank. She has been working for the bank as a *susu* collector for one year. She has about 599 clients in five towns. She covers four towns and visits about 300 individuals in a day. Rose either walks between towns or uses public transportation to travel to towns and villages.

Source: Author interviews.

A unique deposit offered by rural banks is their *susu* deposits. These deposits are daily or weekly savings deposits that are collected by *susu* collectors, who are either rural bank employees or agents paid on a commission basis. This deposit and deposit collection technology builds on the traditional system of *susu* collectors in Ghana. *Susu* collectors mobilize daily deposits by visiting individuals at their houses and business premises. A *susu* collector has a schedule and an agreed savings plan with a client and collects the amount of deposit according to the agreed plan. One *susu* collector visits up to 300 clients per day (Box 3.1). Most of the *susu* collectors are men, whereas a majority of the participants are women. Safety is an area of concern since the women physically carry money with them. Typically, no interest is paid on *susu* deposits, and depositors pay a fee for the service.

Banks use different savings mobilization methodologies. Many banks use the s*usu* approach. Some banks use deposit mobilization centers, which operate in the market on market days. Some rural banks also offer special deposit products that target specific target groups such as small traders and fishmongers, or purposes such as children's education (Box 3.2).

Figure 3.2 shows that among the sample banks (12), regular savings is the largest type of savings product used, both in terms of number of clients (58 percent) and balances (57 percent).[24] As expected, *susu* deposit accounts have a larger share of the number of accounts (21 percent) but a lower share of the total deposit balance (11 percent).

Another indicator of the primary deposit clientele of the rural banks is the percentage of deposits accounts that are below GHc 100 (US$77.1). In the sample banks, 90 percent of all accounts have balances between GHc 10 (US$7.1) and 100 (US$77.1), with only 10 percent of accounts larger than GHc 100. Not surprisingly, the top 10 percent of accounts, by size, hold 81 percent of the deposits whereas the 90 percent of smaller accounts hold only 19 percent of the deposits. Although these small accounts make up only about one-fifth of the deposit base of the rural banks, these deposits are more likely to be stable and are hence important to the banks.

BOX 3.2: Major Rural Bank Credit Products

Microfinance loans. These loans are provided to groups of individuals to finance small and micro income-generating activities. For some banks, the group is the borrower, whereas for others, each member of the group is a borrower. In both cases, the group is jointly liable for the loan. The size of a microfinance loan ranges between GHc 50 and GHc 1,000; most loans are between GHc 100 and GHc 500. The term of a microfinance loan is four to six months, and the interest rate ranges between 30 and 36 percent.

***Susu* loans.** These loans are provided to individuals following a three-month *susu* deposit. The size and term of *susu* loans are similar to those of microfinance loans, but *susu* loans are provided to individuals whereas microfinance loans are group loans.

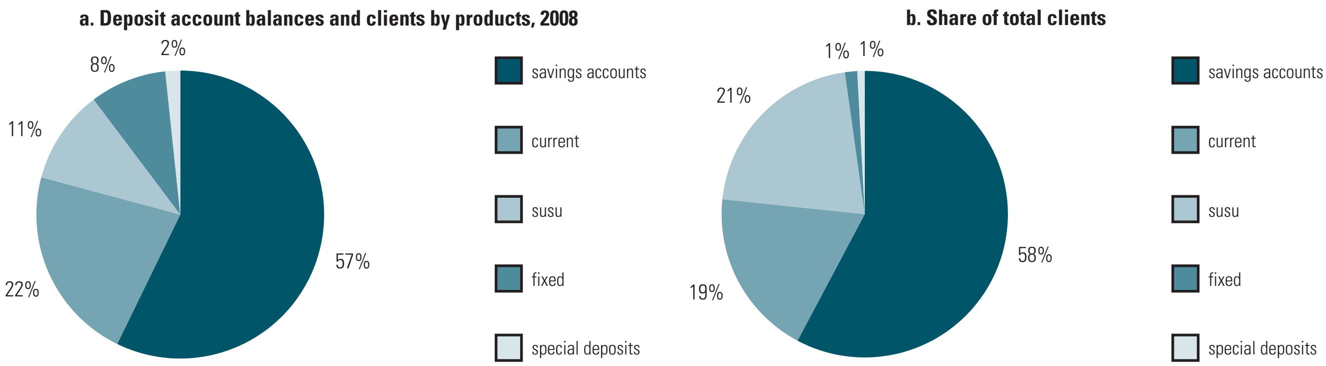
Salary loans. These loans, provided to salaried individuals, are secured by the individual's salary, which is paid through the bank. The bank automatically deducts the loan repayment installment from the salary payments. Salary loans are used for consumption and investment, as well as social purposes. The size of the loan is determined by the salary of the borrower. The maximum term of a salary loan is 48 months, and the interest rate ranges between 30 and 33 percent.

Commercial loans. These loans are provided to companies and individual entrepreneurs for working capital or fixed capital. The maximum loan size is GHc 100,000, the maximum term is 36 months, and the interest rate ranges between 28 and 35 percent.

Source: Various RCBs.

In five of the sample banks, more than 20 percent of clients are *susu* clients; in three banks this proportion is less than 20 percent, and in four banks there are no *susu* operations. In Nzemamale rural bank, the bank with the highest proportion of *susu* clients, 63 percent of its clients are *susu* clients, although they hold only 6 percent of the total balances. In Upper Manya Kro rural bank, however, the share of *susu* in

FIGURE 3.2: Deposit Account Balances and Clients by Products, 2008



Source: Authors' analysis based on 12 sample RCBs (2008).

clientele and deposit balances is more even, at 31 percent and 28 percent, respectively.

The smaller size of deposit accounts and the concentration of a large number of deposit clients around these small-sized accounts may imply that the rural banks are increasing the depth of outreach by serving poor clients. The *susu* products and savings mobilization instruments are particularly well suited to the savings needs of poor clients.

3.3.2 Loans

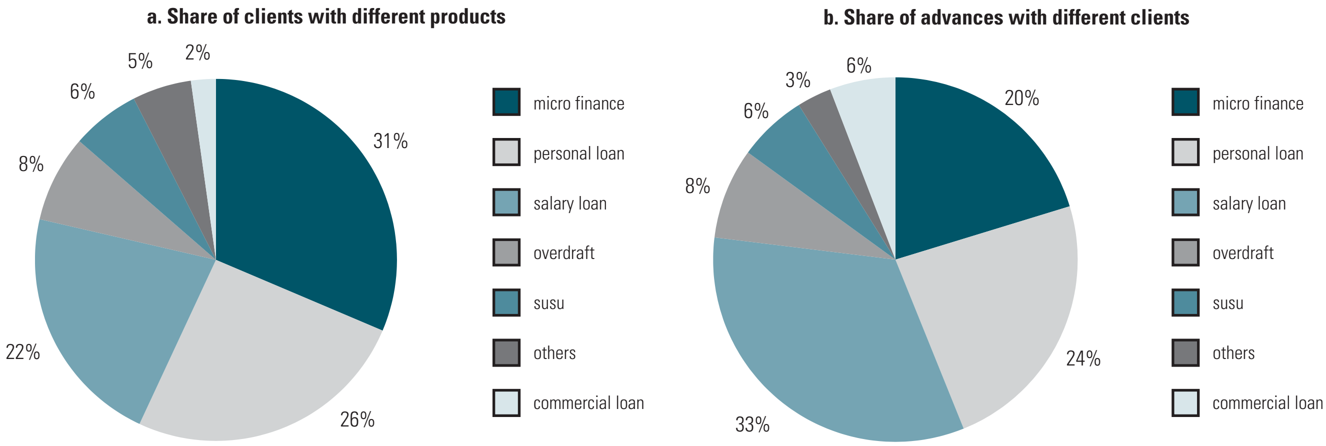
The major credit products offered by the rural banks include microfinance loans, personal loans, commercial loans, salary loans, susu loans, overdrafts, and others. Box 3.2 describes some of the major credit products provided by rural banks. Microfinance loans and *susu* loans are the two special loan products that most directly benefit the low-income population. A significant portion of the salary loans, however, would also be considered microloans in the Ghanaian context. Consequently, the microcredit portfolio of rural banks is larger than the sum of the microfinance and *susu* loan portfolios shown in the loan classifications reported by the RCBs.

Most banks are using a "credit with education"[25] approach adapted from Freedom from Hunger[26] to deliver microfinance credit products. In this approach, banks educate and sensitize members of microfinance groups for about six weeks before disbursing the loan. First, members of microfinance groups participate in a financial education program on basic bookkeeping and preparation of business proposals for credit. Then, credit officers assess the readiness of the group members before releasing funds. This methodology is intended to reduce credit risk caused by clients' inability to manage and use loans in a productive way that allows for repayment. The training is provided by microfinance officers, and some RCBs outsource training to NGOs. The training typically includes education on savings; the purpose of group formation; group management; good business practices; and bookkeeping. In addition to the financial education, clients also receive education on health and nutrition. The group is required to collect compulsory savings during the six-week training period to cultivate the habit of saving and managing funds. Following the satisfactory completion of the training and compulsory savings, the group is eligible to obtain formal credit from the bank. The bank requires 10–20 percent of the compulsory savings as collateral and a group guarantee of the loan.

Figure 3.3 gives the share of clients and credit portfolio in nine sample banks in 2008. Out of the total advances, salary loans are the highest, with 33 percent of the total advances, followed by personal loans (24 percent) and microfinance (20 percent). In terms of size of clients, microfinance loans have the most borrowers (31 percent) followed by personal loans (26 percent) and salary loans (22 percent).

In six (out of nine) of sample banks, more than 20 percent of clients are microfinance clients. Only one bank has no microfinance product. In three banks—Borimanga, Upper Manya Kro, and Ahafo Ano Premier—about half of clients

FIGURE 3.3: Loan Portfolio by Clients and Types of Products, 2008

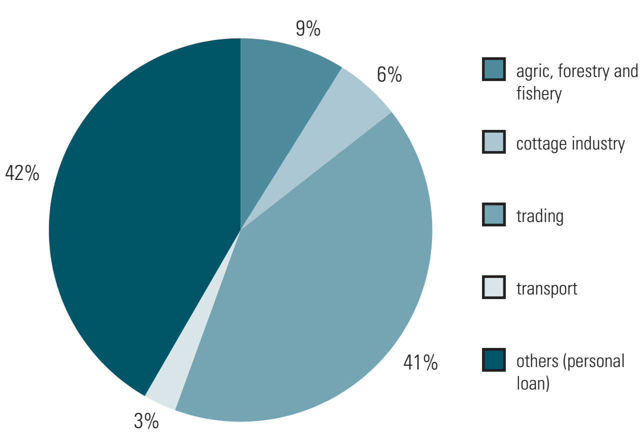


Source: Authors' analysis based on 9 sample RCBs (2008).

are microfinance clients, and more than half of the loan portfolio is in microfinance. The *susu* loan product is much less popular. Only one bank, Kintampo, has a significant share of *susu* loans; 29 percent of its clients and 33 percent of its loan portfolio are in *susu* loans.

Loans can also be categorized by sector: agriculture, cottage industry, trading, transport, and other. Figure 3.4, based on data from 11 sample RCBs, shows that the two largest categories are trading and other (42 percent and 41 percent, respectively). Salary loans are typically included

FIGURE 3.4: Distribution of Loans across Major Sectors, 2008



Source: Authors' analysis based on 11 sample RCBs (2008).

in the "other" category, and microfinance in the trading category. The proportion of loans reported as being in agriculture (9 percent) is an underestimate because a significant portion of microfinance and personal loans are used for agriculture.[27]

3.3.3 Money Transfers

Rural banks offer both domestic and international money transfer payments. Both these services are managed across the network by the ARB Apex Bank. Domestic transfer payments are offered through Apex Link, a domestic transfer system, set in place in 2003. Both inward and outward money transfer services are available at all 455 outlets of the rural bank network. Apex Link also allows for money transfer to and from other commercial banks and selected nonbanks in Ghana. International money transfers are offered through partnership agreements between the ARB Apex Bank and several major international money transfer companies such as Western Union, Vigo, and Money Gram. In 2008, rural banks facilitated 128,875 domestic money transfers worth about GHc 63.3 million (US$48.8 million) and 32,392 international money transfers worth GHc 9.3 million (US$7.1 million).

Both the domestic and international money transfer services are provided by rural banks through a fee-sharing agreement with the Apex Bank. The Apex Bank is responsible for negotiating the fee-sharing arrangements with the external institutions—banks within Ghana for domestic transfers and international money transfer companies.

3.3.4 Payment

Payment services are a key service provided by rural banks. Rural banks provide this service through the Apex Bank, which is a member of the national clearinghouse. The introduction of MICR checks in 2002 gave rural banks' checks the same legitimacy as checks issued by other financial organizations. Before the introduction of MICR checks guaranteed by the Apex Bank, many institutions and commercial establishments refused to accept rural bank checks. With the introduction of the check-clearing system in 2002, the number of checks for clearing grew by an average of 43 percent a year.

Because of their location and network of branches, rural banks are used by the central and local governments and private companies to make salary and pension payments to their employees in rural areas. The salary payment system in particular enabled the rural banks to consolidate their salary loan products that are closely tied with the salary transfers. Licensed buying companies (LBCs) also use rural banks to pay cocoa-producing farmers in their catchment areas. In 2008, rural banks facilitated GHc 68.8 million (US$56 million) in payments to cocoa farmers and earned about GHc 2.75 million (US$2.1 million) in commissions.

3.3.5 Social Investments

Many rural banks support social development activities in the communities where they operate as part of their social responsibility to their communities. Activities generally supported include financing of infrastructure such as school buildings, community libraries, and community roads, as well as scholarships for girls and medical students. These activities also help RCBs gain acceptance in their communities as a locally owned financial institution rooted in the community.

3.4 SYSTEMS

3.4.1 Lending Technology and Credit-Risk Management

Appropriate lending technology and credit risk management are among the most important factors in the sustainability of a lending institution. The tasks involve identifying creditworthy borrowers, appraising and approving loan applications in a timely manner, managing credit portfolios so that revenue is maximized and delinquencies minimized, and taking appropriate action in case of delinquency. This management has generally been a weak area in rural banks, with the result that the percentage of nonperforming loans has generally been higher than that in other financial institutions in the rural financial sector in Ghana.

As in other lending institutons, lending in rural banks is typically guided by credit manuals and credit policies approved by the boards. Some banks follow standardized credit appraisal procedures such as the one described in Box 3.3. Loans are assessed by credit officers and project officers. The assessment techniques vary by product. For individual loans, the creditworthiness of the borrower is assessed on the basis of the individual's character, the purpose of the loan, and the credit history of the individual with the bank. The level at which credit decisions are made also varies from bank to bank and has changed over time. In some banks, all credit decisions are made by credit committees in the head office or by the board. In others, smaller loans are approved by branch-level credit committees. Until late 2008, loans equivalent to and greater than GHc 2000 (US$1,542) were required to be submitted for review and approval by the BoG. Loans to members of boards of directors, regardless of their size, are appraised and approved by BoG. With this exception, boards of directors can approve all loans amounts less than 25 percent of the net worth of the bank. Loan amounts

BOX 3.3: Credit Appraisal System in the Atwima Kwanwoma Rural Bank

The Atwima Kwanwoma Rural Bank, a large rural bank, is located close to Kumasi, the second-largest city in Ghana.

The bank uses a credit appraisal system that it calls CAMPRI, which stands for Character, Ability, Margin, Purpose, Repayment capacity, and Insurance. "Ability" stands for managerial ability and understanding of the market. "Margin" stands for profit margin in the activity being financed. "Repayment capacity" is assessed based on existing cash flows. "Insurance" refers to security for the loan and consists primarily of cash security of 20–33 percent and one to three guarantors. No assets are taken as collateral.

The bank requires that no more than 60 percent of the existing cash flow surplus is needed for loan repayment. Although interest rates on loans are fixed, credit committees can decide to give discounts for clients considered to be highly creditworthy.

Source: Authors' discussion with staff.

greater than 25 percent of the net worth of the bank must be approved by BoG.

RCBs also use group lending and guarantees by salaried individuals to reduce credit risk. The use of insurance, asset collateral, and other financial risk management tools is not common in the rural banks. Microfinance groups have monthly savings that are separate from the group loan account that will be used to repay the loan in case of default. Additionally, the banks hold a certain percentage of all loans as security. For microfinance loans, individual savings of group members are used as security.

Boards of RCBs are increasingly involved in cases of delinquency, and this has reportedly improved loan recovery. In cases of delinquency, the bank management usually notifies the board. The board and the credit officer follow up with the client. Board members may also visit the client at his or her household or business. If a loan is delinquent for three months, a demand notice is sent to the client and the case is transferred to the bank's lawyer. In some cases, village chiefs are also involved in persuading the borrower to repay the loan. In case of lending to individuals via a group, the group chairperson, the treasurer, and other group members work together to recover the loan from the individual. In some cases, groups have paid the amount due from their group savings.

3.4.2 Internal Controls or Operational Risk Management

RCBs have operational manuals that stipulate managerial and administrative policies and procedures. All banks are required to have internal auditors, who are responsible for internal controls.[28] Internal auditors are expected to be autonomous from the management and report to the audit committee of the board. The internal auditor is responsible for

- instituting internal control measures within a bank;
- ensuring that transactions of the bank are undertaken according to the general regulations and operational manual of the bank;
- examining records to ascertain their originality and minimize fraud;
- ensuring that risks are identified, prioritized, and reported;
- monitoring the credit cycle from appraisal to disbursement, ensuring the integrity of the process, and advising management on any change required; and,
- investigating and reporting on any irregularity in financial management.

At the beginning of every year, internal auditors prepare an audit plan. The plan consists of full inspection activities; snap checks; follow-ups on previous recommendations; special investigations in case of staff problems; and other duties assigned by the board. A full inspection looks at all operations of an agency, including cash accounts, current accounts, savings accounts, cocoa purchase accounts, interagency operations, and others. Additionally, sample credit applications are reviewed. The internal auditor assesses whether the bank is properly following credit appraisal procedures and whether the quality of the assessment process meets the bank's requirements. Loan disbursement processes are also examined against the required operational procedures. The process includes checking whether the proper interest rate has been applied. A schedule is prepared for each agency, and inspection visits are made without prior notification to the agency. The internal control departments of many rural banks have reportedly been strengthened following incidents of fraud such as those discussed in Box 3.4.

BOX 3.4: Examples of Fraud Detected through Internal Controls

Case 1: In Bank N, fraud related to *susu* deposits was detected during inspection by the internal auditor. *Susu* collectors were not recording the correct amount collected, and the deposits were misappropriated by the collectors. Significant mismatches between the amounts recorded in the *susu* passbook and the amount recorded in the bank ledger were identified. Following this discovery, the bank recruited *susu* monitors to supervise and monitor *susu* collectors and daily *susu* transaction balances. As a result of this measure, instances of fraud related to *susu* deposits have declined.

Case 2: Bank NM did not have an internal control department until a major embezzlement involving the cashier took place. The bank lost about GHc 20,000. The cashier was suppressing deposits without recording the balance in the internal ledger at the time of deposit. It was noted that the cashier had served on the same schedule without any leave for more than two years. This pattern was not detected until the cashier was away from work one day and a client came to the bank to withdraw savings. Following this incident, the bank required that staff should take annual leave as stipulated in the operational manual, and other security measures were strengthened.

Source: Authors based on interviews with rural bank managers.

3.5 ASSOCIATIVE STRUCTURES

3.5.1 The Association of Rural Banks (ARB)

In 1981 the 30 existing rural banks formed the ARB, with the support of the BoG, to serve as a forum for rural banks. The association has nine regional chapters. Initially, the ARB's functions were primarily to provide training to different target groups. This role has been mostly taken over by the Apex Bank since its formation, however. The ARB continues to be responsible for providing Code of Conduct training for rural bank directors. The ARB played a key role in the formation of the Apex Bank. Although it was initially proposed that the ARB should cease to exist once the Apex Bank was formed, it was later decided that the ARB should continue to function, focusing primarily on advocacy with the government and conflict resolution among its members.

3.5.2 The ARB Apex Bank

The Apex Bank emerged as a result of the rural banks' felt need for an institution that could provide financial, managerial, and technical support. It was first recommended by a study commissioned jointly by the World Bank, the BoG, and the ARB in 1996. The study recommended setting up an institution similar to the Rabobank in the Netherlands. A subsequent feasibility study conducted in 1998 concluded that an apex bank could be financially viable, and the ARB Apex Bank was incorporated in 2000 as a public limited liability company with rural banks as shareholders. It was licensed in 2001 and started operations in July 2002.

The Apex Bank currently operates from its head office in Accra and through its six branch offices spread across Ghana. The first managing director, Emmanuel K. Kwapong, came from the commercial banking sector with more than 30 years of experience in Barclays Bank and served in this role for six years. Eric Osei-Bonsu, who took over as managing director, had been president of the ARB. As of 2007, the Apex Bank had a staff of 149. The Apex Bank board, consisting of 13 members, is currently headed by Dr. Samuel Dufu. The board comprises nine representatives from the regional chapters; one each from the ARB, the BoG, and the MoFEP; and the managing director of the Apex Bank.

The Apex Bank provides the following services to the rural banks:

1. **Check clearing:** The Apex Bank offers check-clearing services to the rural banks through the 11 clearing centers it operates across Ghana. As discussed in Section 3.3.4, this service played a critical role in making rural banks' checks as acceptable as checks from other financial institutions. The bank is currently in the process of facilitating participation of the rural banks in the automated clearinghouse with a computerized system that uses scanned check images. This system replaces the earlier system of manual check clearing.
2. **Specie supply:** Although the Apex Bank was initially fully responsible for the physical supply of specie to the rural banks, it has now moved to providing this service on a need basis. Most rural banks now use their own bullion vehicles to obtain cash from the Apex Bank branches. The role of the Apex Bank is now primarily to maintain adequate specie supply in collaboration with the BoG and, if necessary, to provide loans to the RCBs to purchase bullion vans.
3. **Treasury management:** The Apex Bank provides brokerage services to the RCBs to purchase and rediscount Treasury bills and bonds, purchase Apex certificates of deposit, and pay interest on clearing account balances.
4. **Loan fund mobilization:** The Apex Bank also facilitates RCBs' access to funds from donor projects such as SPEED and other government-led interventions like the Agricultural Credit and the Poverty Alleviation Loan, the Community-Based Rural Development Project (CBRDP), and the Ghana Energy Development and Access Project (GEDP).
5. **Domestic and international money transfers:** The Apex Bank operates Apex Link, the manual domestic fund transfer platform, which allows money transfers across Ghana through the RCB network. The bank is currently planning to move Apex Link to an electronic platform. In 2008 the Apex Bank entered an agreement with Western Union to provide international money transfer services through RCBs and its own branches. Since then it has added VIGO as a partner and plans to add other remittance companies.
6. **Information and communication technology (ICT):** The Apex bank's ICT department provides installation and support services for RCB computerization. It supported the full computerization of 4 RCBs and partial computerization of 13 RCBs and provides ongoing maintenance and troubleshooting services to these banks. The Apex Bank will also coordinate the implementation of GRBCIP, the US$20.3 million RCB computerization project being funded by the Millennium Challenge Corporation.

7. **Training**: As mentioned in Section 2.5.1, the Apex Bank provided or managed training that was financed by the RFSP. It continues to provide training services to RCBs.
8. **Inspection and audit:** Given the lack of funding for this activity from either the government or the BoG, the Apex Bank currently restricts this service to "marginal" banks and to special assignments.

A key challenge facing the Apex Bank is becoming financially self-sustainable. Its profitability steadily decreased between 2003 and 2006 because of narrowing income margins,[29] but the bank reversed this trend in 2007 and 2008. In 2008, the bank made a profit of GHc 1.2 million (US$925,212), an increase of nearly 100 percent over the profit in 2007. The bank benefited from a tax holiday that expired in 2009, however, and its after-tax profits are thus bound to decline.

Chapter 4: PERFORMANCE

4.1 SERVICE DELIVERY

Table 4.1 shows the outreach of rural banks and other financial service providers operating in the low-income segment. Rural banks have the largest market share in client outreach (67 percent of depositors and 48 percent of borrowers) as well as deposit and loan balances (60 percent of deposit balances and 57 percent loan balances). The cases in Box 4.1 provide profiles of a cross-section of rural bank clients.

4.1.1 Deposits and Loans

Rural banks cater primarily to the low-income and middle-income segments of the population. The rural banks serve primarily smaller clients because of several factors, including local ownership, regulation, and capacity. Most clients of the banks are teachers, government employees, pensioners, and small and micro entrepreneurs. Some banks, however, do have relatively large clients that obtain part of their financial service needs from rural banks.

The total outreach of the rural banks has steadily increased in recent years. As shown in Figure 4.1, outreach increased from 1.1 million depositors and 139,000 borrowers in 2000 to 2.8 million depositors and 680,000 borrowers in 2008. These figures represent average annual growth rates of 14 percent in depositors and 27 percent in borrowers.

TABLE 4.1: Client Outreach by Different Financial Institutions, 2004–07 (in thousands)

INSTITUTIONS	2004	2005	2006	2007
RCBs	119	120	122	125
Savings and loans	10	12	11	14
Credit unions	261	273	279	322
Financial NGOs	29	29	20	40
Susu collectors	911	1,016	1,000	1,259

Source: GHAMFIN 2007

BOX 4.1: Profiles of a Range of Clients

Case 1: Asumdwe Kuw is a microfinance group with 34 members, mostly women. A group of members contacted the RCB in their community to seek support in forming a group and in obtaining credit for their micro businesses. The bank trained the group for six weeks and formed a group eligible to obtain credit. Before joining the bank, the members explained that they had no access to formal credit. Most of them depended on family networks and moneylenders. Some had saved with savings and loans but could not get loans because of the size of their savings. Now they are able to receive loans for their businesses against small savings. Categories of businesses include small shops, snacks, and charcoal trading. The maximum loan per member is 100 GHc. Repayment is collected every Friday during a meeting organized by the group and attended by the bank's credit officer. The group is primarily responsible for ensuring timely repayment of loans by members. Members of the group also have *susu* accounts with the bank and receive *susu* loans.

Case 2: Tisungta Ba farming group has about 24 members. Out of these, one of them is a woman. Individuals in the group are involved in small-scale farming activities. They grow maize, groundnuts, and soybeans. The group has a treasurer, a chairman, and a secretary. Members of the Tisungta Ba started borrowing from the bank to finance production and marketing of their produce five years ago. Before joining the bank, the group members had supported each other through free labor on each other's farms. At that time, the sale of animals was one of the sources of funds for their agriculture activities. Presently, the group has received two cycles of loans. Each member received about 50 GHc with a repayment period of six months and a 28 percent annual interest rate. The group has been repaying within the stipulated repayment schedule. The source of repayment funds is not always agriculture. During times of bad weather or lower

(Continued)

BOX 4.1: (*Continued*)

prices for agriculture produce, the farmers repay from other income-generating activities.

Case 3: Collins Parker rears grasscutters (a small animal used for meat) in a small village in Brong Ahafo. He also manages another small business operated from his household. He received a loan from his community bank to support grasscutter rearing. The loan will be repaid within two years. This schedule was drafted to match the production period of the grasscutter, a feature Collins likes. He has now started repaying the loan.

Case 4: Shaibu Muniru is an entrepreneur in Walewale district. He manages a limited liability company that includes (1) a beverage distributor, (2) a gas agency, (3) an FM radio station, (4) a construction company, and (5) an exporter of nontraditional products. One of the owners of the company is a founding member of the rural bank in that district. The company uses the bank's overdraft facility. Shaibu reports that the amount of the overdraft facility is way below the demand of the business. Additionally, the term of the bank's loans is too short for the company to use the credit products. Yet this company is one of the bank's biggest clients.

Source: Authors' interviews with clients.

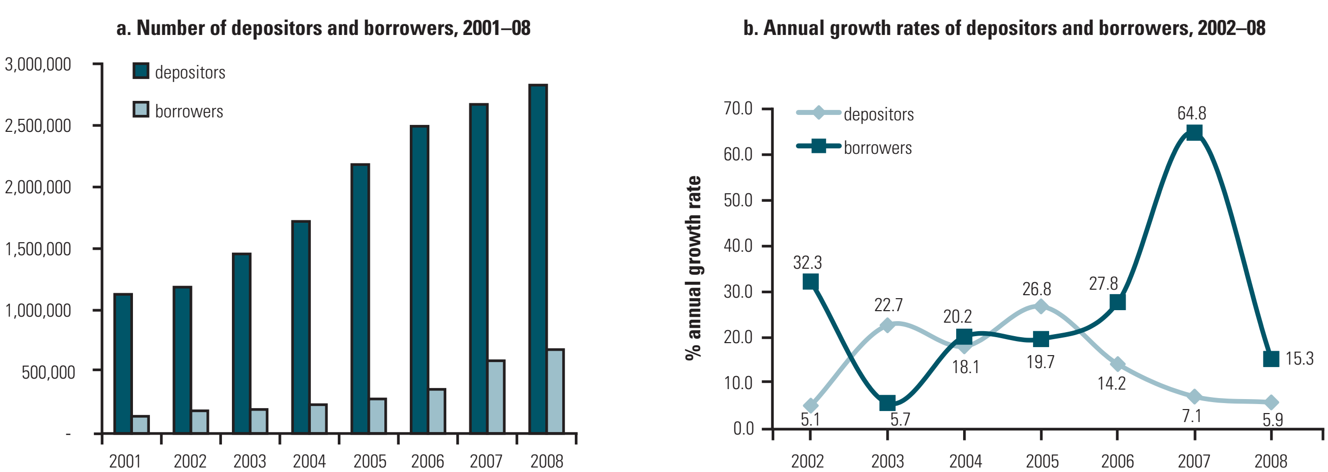
The significant growth of rural bank outreach among depositors and borrowers demonstrates the ability of the rural banks to provide services to an increasing number of clients. Most important, increasing numbers of borrowers address the problem of credit constraint in rural areas. As Figure 4.1B shows, however, annual growth rates, though always positive, fluctuated significantly. The growth rate of borrowers shows a generally increasing trend over the period 2003–07, the period over which RFSP was implemented. In contrast, the rate of growth of depositors seemed to taper off starting in 2005.

During the same eight-year period, the total amount of deposits, adjusted for inflation, grew from GHc 17.3 million (US$5.8 million) to GHc 100.6 million (US$77.5 million), and total advances grew from GHc 7.1 million (US$2.4 million) to GHc 72.8 million (US$56.1 million). These figures represent real average annual growth rates of 4 percent for deposits and 11 percent for loans. Figure 4.2 shows the growth of inflation-adjusted deposit and loan balances in RCBs. Both deposit and loan balances show a positive growth trend, but loan balances grew at a much faster rate, showing the success of RCBs in increasing lending. Although this increase became necessary because of the falling interest rates on Treasury bills during this period, the significant efforts taken under the RFSP to increase lending also likely contributed to this growth. Nevertheless, as Figure 4.3 illustrates, the year-to-year growth in both deposits and loan balances continues to fluctuate sharply, suggesting that the RCBs go through periods of rapid increase and sharp decrease in deposit mobilization and loan disbursements.

4.1.2 Money Transfers and Payments

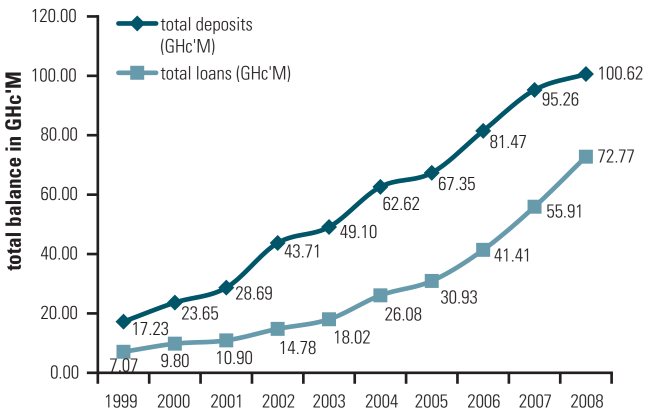
Between 2003 when Apex Link was introduced and 2008, the number of domestic transfer transactions consistently increased, rising from 10,158 to a peak of 128, 875 in 2008. The

FIGURE 4.1: Outreach Overview of All RCBs, 2001–08



Source: ARB Apex Bank 2008.

FIGURE 4.2: Real Deposits and Loans of All RCBs, 1999–2008

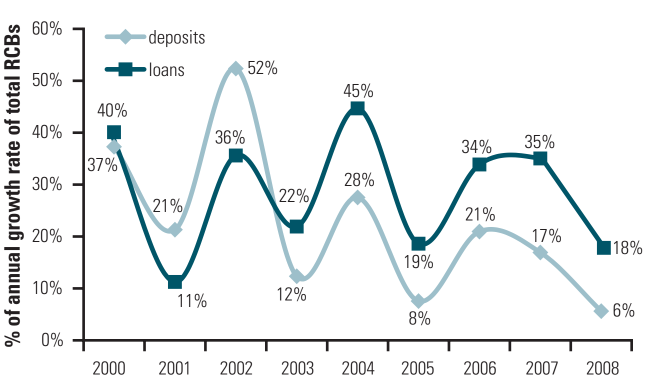


Source: Authors' estimates based on ARB Apex Bank (2008).

average annual growth from 2003 to 2008 was 46 percent. The transaction value rose from in 2003 GHc 2.7 million (US$2.2 million) to GHc 63.3 million (US$48.8 million) by 2008. In real terms, the average annual real growth of domestic transfers over the past four years was 53 percent. Because international money transfers managed by the Apex Bank started only in 2008, growth performance cannot be analyzed for this service. Nevertheless, this service achieved a significant number of transactions and value within the first year. In 2008 the Apex Bank facilitated international money transfers worth GHc 9.3 million (US$7.1 million) in 32,392 transactions just through one provider.

The number and value of checks cleared have also increased significantly since the Apex Bank started providing this service to the RCBs. Between 2002 and 2007, the value of checks delivered increased from GHc 43.66 million (US$36.3 million) to GHc 384.90 million (US$386.7 million), and the value of checks received increased from GHc 17.97 million (US$14.39 million) to GHc 295.67 million (US$236.83 million),

FIGURE 4.3: Annual Growth of Real Deposits and Loans of All RCBs, 1999–2008



Source: Authors' estimates based on ARB Apex Bank (2008).

representing average annual real growth rates of 69 percent and 95 percent, respectively.

4.2 FINANCIAL PERFORMANCE

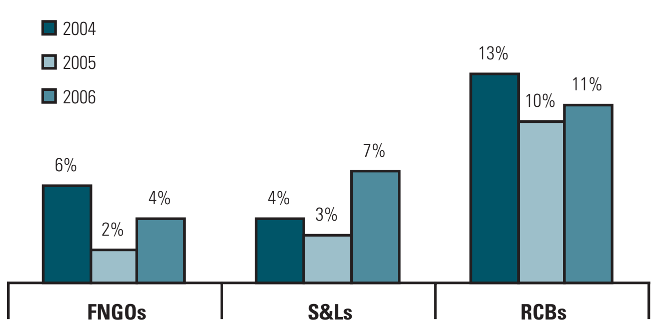
4.2.1 Asset Quality

The extent of nonperforming loans in a financial institution's loan portfolio is often considered the best leading indicator of the institution's financial performance. A low ratio of nonperforming loans to the total outstanding loan portfolio is often correlated with low financial expenses and higher profitability. A low nonperforming loan portfolio also necessitates a lower spread for the financial institution between the interest it pays on its deposits and the interest it charges on its loans, thereby benefiting its customers.

Although networkwide data are not available on this indicator, sample studies suggest that this is one of the weakest areas of RCB performance. Among the sample RCBs used in this study, the average portfolio at risk (PAR) > 30 days[30] is much higher than the average ratio for their *Microbanking Bulletin* (MBB) peer group (16 percent compared with 3 percent). The PAR > 365 days, which is a good proxy for the loan loss rate because loans that are delinquent for more than a year have little chance of being repaid, is more than double that of their MBB peer group (3.5 percent compared with 1.5 percent).

Figure 4.4, based on a separate sample analysis of 24 RCBs by GHAMFIN (2007), also shows that RCBs have higher ratios of nonperforming loans than do savings and loans and financial NGOs in Ghana. The large margin between these two ratios for RCBs, in contrast to the MBB peer group ratios, also suggests that loan losses are not as large an issue as delayed payments. Nevertheless, the higher loan loss rate

FIGURE 4.4: PAR > 30 Days of All RCBs with Comparators



Source: GHAMFIN 2007.

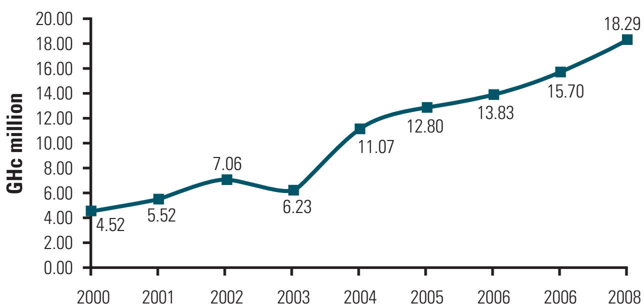
means that RCBs must recover these losses by charging higher interest rates on their loans.

4.2.2 Solvency

Adequacy of capital is intrinsically critical for banks because of the nature of the business they undertake. The primary business of banks is financial intermediation—that is, using money provided by depositors to make loans to borrowers. Lending is inherently risky because the loans may not be paid back, resulting in financial losses to the bank. Hence, banks are expected to have adequate capital to remain solvent even if some of the loans may result in significant losses. The BoG requires RCBs to maintain a 10 percent capital adequacy ratio.

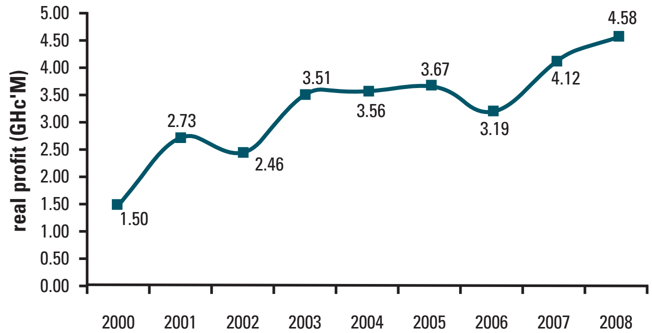
As Figure 4.5 shows, the inflation-adjusted net worth (capital) of the RCB network has steadily increased in the period 2000–08 and is well above the minimum required 10 percent.

FIGURE 4.5: Real Net Worth, All RCBs, 2000



Source: Authors' estimates based on ARB Apex Bank (2008).

FIGURE 4.6: Real Annual Profits of All RCBs, 2000–08



Source: Authors' estimates based on ARB Apex Bank (2008).

Not all RCBs in the network, however, are solvent. In 2008 seven RCBs were insolvent, five of which negative net worth in excess of 10 percent. The number of RCBs with very low capital or negative net worth decreased rapidly from 26 in 2001 to 16 in 2003, but this number has remained fairly steady since then.

4.2.3 Profitability

Profitability is key to any business because it allows the business to expand and provide more and a broader range of services to a larger number of people. Figure 4.6 shows that as a network, RCBs have demonstrated an increasing trend in annual profits, with significant decreases only in two out of the past nine years. As with solvency status, however, not all RCBs are profitable. In 2008 five RCBs made losses. Among the sample banks, one RCB became profitable in 2008 after several years of making losses.

Chapter 5: LESSONS, KEY ISSUES, AND WAY FORWARD

As a network, RCBs have shown commendable performance in both service delivery and financial performance over the past decade. Both depositors and deposits have been growing, though at a slower pace in recent years. The growth in the number of borrowers and in lending has been remarkable and demonstrates that rural banks are steadily transforming themselves into financial intermediaries that are able to successfully transform deposits into loans. This development marks a significant turnaround from being institutions that primarily collected rural deposits and invested them in Treasury bills. The rapid growth in domestic money transfer services and significant uptake of the international money transfer services introduced in 2008 suggest that RCBs are emerging as full-service financial intermediaries.

In addition, as a network, RCBs are operationally and financially self-sufficient. They have operational and financial self-sufficiency ratios that are comparable with those of other similar institutions in Ghana (savings and loans) and exceed median values for MFIs in the mature MFI peer group of institutions reporting to the Microfinance Information Exchange (MIX) database. The net worth of RCBs has also shown an upward trend over the past decade.

Within the network, however, the performance of a significant number of RCBs continues to be weak. Although the number of such RCBs has decreased over the past decade because of turnarounds or liquidation, they still constitute about 15 percent of all RCBs in operation. The key issue though is not the weak performance of this group per se[31]; it is the inability of the regulatory system to identify these failing institutions at an early stage and facilitate a process that leads either to a cost-effective liquidation, a turnaround, or a merger with a stronger institution.

Lessons drawn from the experiences of Ghanaian rural banks can be summarized in the following points:

- Rural communities have the capacity to create their own profitable financial institutions. In Ghana rural communities created hundreds of such institutions with very little direct financial support by the government.
- Both poor operating environments and capacity constraints can adversely affect performance. Factors constituting poor operating environments include absence of clear prudential regulations, both financial (such as capital adequacy) and nonfinancial (such as qualifications of directors), and excessive directed lending requirements leading to concentration of lending.
- Although capacity constraints in rural areas do affect the performance and limit the scope of operation of local financial institutions, the Ghanaian experience also shows that targeted investments in building capacity can have positive payoffs. This finding suggests that initiatives to build local financial institutions need to have significant capacity-building components.
- The requirement of location-specific ownership of RCBs is a key factor constraining the growth and consolidation of the network. This requirement prevents the institutions' managers and owners from merging to take advantage of economies of scale and from attracting external investors from the financial markets.
- Local financial institutions themselves often cannot self-provide or obtain several services (such as specialized training, product development, market research) they need from the market, either because they are not available or because the institutions do not have the scale to obtain these services. Hence, initiatives to build local financial institutions will have to support the creation of associations or federations that can either provide such services or facilitate their cost-effective provision.
- These institutions, however, such as the ARB Apex Bank, can face capacity challenges in management and service provision. These challenges would then dictate the business and revenue model for the institution.

- Even if a good legal, policy, and regulatory environment are provided, failures of a certain number of institutions should be expected. This issue should be addressed up front, however, by ensuring that the regulatory system has the necessary capacity in terms of skills, political autonomy, and financial resources.
- Donor funding for supervisory activities cannot sustain a supervisory regime in the long run, and mobilization of private funding to supervise services delivered to poor clients is not a feasible option. Government resources are thus fundamental to ensure adequate supervision of services delivered to poor clients. Governments can shift some of the resources used from directed and subsidized credit to subsidizing supervision of financial institutions serving poor clients.
- Finally, the length, breadth, and scope of the Ghanaian experience offers the potential for carrying out a rigorous impact assessment of rural finance and a cost-benefit analysis of public investment in rural finance.[32] Although such a study is beyond the scope of this paper, the RCB experience offers fertile ground for this type of study.

5.1 RCBs: BECOMING COMPETITIVE, RETAINING MISSION

The challenge for RCBs is to become more competitive while retaining their mission of providing services to a broad range of clients in rural areas. The analysis of their performance suggests that although they have succeeded to a large extent in providing deposit and payment services, they have succeeded less in providing credit services. Since 2002, however, their performance in credit services has rapidly improved. Domestic money transfer services has been an area where RCBs have been highly successful, registering a 50 percent real growth rate over the past five years. The rise in international money transfers since the service was introduced network wide in 2008 has also been strong.

With increased competition from commercial banks, S&Ls, CUs, and FNGOs, it is imperative for RCBs to become more competitive. The BoG has made it clear that it will not protect RCBs from competition. Some commercial banks have entered the rural financial markets in major way, often targeting clients of the rural banks and their personnel. S&Ls, CUs, and FNGOs have also expanded their outreach significantly. Interactions with managers of the sample RCBs, however, seem to show that RCBs are more concerned with competition from commercial banks rather than the other categories of institutions. This complacency appears misplaced given that the latter group of institutions is the one that primarily shares the market niche to which RCBs cater.

Several RCBs are already undertaking measures to increase their competitiveness. These measures include an increased focus on microfinance services (primarily *susu* deposits and microfinance group loans, but also *susu* loans and other types of small-value loans); participation in international money transfer services; and computerization of bank operations. Some of the frontrunners are trying to use technology to improve services. For example, the Kakum Rural Bank is piloting a mobile banking operation to allow clients to check their balances via mobile text message or SMS. This bank is also establishing an automated teller machine in one of its branches and planning to introduce a smart card for *susu* products.

A second option being considered by RCBs is the possibility of mergers and acquisitions to allow economies of scale in the face of strong competition. The Apex Bank appears to be supportive of this option, including the option of merging all RCBs under the ARB Apex Bank into one bank and transforming individual RCBs and their branches into Apex Bank branches. Another option is a regional-level consolidation. Unsurprisingly, however, the latter option does not seem to have much support among the RCBs because of their unique ownership and governance structures.

It is clear that to become more competitive, RCBs need to change at two levels. First, at the individual RCB level, RCBs need to improve their service delivery and financial performance. To succeed in this endeavor, however, many RCBs would need significant high-quality support from the Apex Bank, even though they may have the financial capacity to pay for these services. Second, at the network level, a sustainable solution needs to be found for the RCBs categorized as distressed or weak by BoG. Some may have to be merged with another willing RCB or forced into liquidation. Others may need external support for which they do not have the capacity to pay. Support for these banks would need to be subsidized, but they may have the potential to emerge as profitable financial service providers.

5.2 THE APEX BANK: TRANSFORMING INTO A SUSTAINABLE SERVICE PROVIDER

The Apex Bank was created primarily as a service provider to the RCBs. Its strategic goal has been to "achieve financial sustainability based on a service model" by improving the quality and scope of the products and services it offers to RCBs and any other financial institution outside the network. The Apex Bank also envisions increasing its capital base from existing shareholders—the member RCBs, the BoG,[33] and investors outside the network. The service provider model is getting another look, however, primarily because of the challenges the Apex Bank is facing in becoming fully self-sufficient under this model and because of the option of mergers for RCBs discussed in the previous section.

In 2008 the bank introduced full cost recovery for all its services, including banking and nonbanking services. The Apex Bank is also considering the option of converting into a full-service commercial bank and or opening a banking branch. This option could provide the opportunity to bring in larger revenues to maintain sustainability, but it could be perceived as a threat by the RCBs.

It is clear that the Apex Bank needs to become financially self-sustaining sooner rather than later. This step should not come, however, at the expense of the mission of the RCB network, which is to increase provision of services in rural areas in a sustainable manner. Discussions with the RCB managers and analysis of data reveal that there is a definite need, demand, and benefit for the services provided by the Apex Bank because it is costly (and in some cases unaffordable) for individual RCBs to procure highly complex specialized services on their own.

The discussions and analysis also suggest that RCBs need other services that are not available from the market at a reasonable cost. Examples category include (1) shareholder registry management and shareholder education, (2) internal audit services—most rural banks are too small to attract good internal audit staff, (3) product development services—few organizations in Ghana can provide this much-needed service to RCBs at a reasonable cost, (4) strategic advisory services, including risk management, (5) technological upgrades besides computerization, and (6) loan syndication services. Provision of these services and others to the member RCBs can generate additional revenue for the Apex Bank, significantly contributing to the financial sustainability of its service provider role.

RCBs often lose their best commercial customers to commercial banks because they are unable to provide loans of the size required by a growing commercial establishment. The Apex Bank could potentially provide loan syndication service, under which it can facilitate lending to these customers by more than one RCB. Another example of a value-added service provided by an apex institution is the automatic teller machine (ATM) network operated by Cooperative Bank in Kenya, which allows its member cooperatives to offer the service of nationwide cash withdrawal to their members. A value-added technology service that the Apex Bank could offer consists of queuing management systems that can help reduce customer wait times and improve staff productivity.

Finally, for the Apex Bank to become sustainable, its role in supervising RCBs needs to be clarified and the costs involved need to be fully covered. The options for doing so are related to the future structure of the RCB network, discussed in the previous section, and the roles of the BoG and GoG, discussed in the following sections. The current system in which the Apex Bank subsidizes the costs of supervising the RCBs from the meager resources it generates from the services it provides is not sustainable.

5.3 THE BoG: TOWARD EFFECTIVE DELEGATED SUPERVISION

Weak supervision of the rural banks continues to be an issue. The BoG has been unable to take effective action on rural banks that do not meet prudential requirements. It is also not able to carry out tasks such as liquidation in a timely manner because of political pressure to allow even "distressed" RCBs to operate at the risk of causing financial losses to shareholders and depositors of the affected bank.

Global experience suggests that directly supervising relatively small financial institutions, such as rural community banks in Ghana, is not an efficient option for central banks because of the high transaction cost of the function. One sustainable option is to delegate most of the supervision tasks to an external entity while retaining key tasks such as licensing and liquidation. The delegated or indirect supervision approach is practiced in many countries, including Brazil, Canada, France, Germany, Mali, Niger, and Peru. Experience from these countries suggests that an indirect supervisory regime for small financial institutions such as financial cooperatives and community banks ensures supervision and monitoring of financial institutions according to their special needs, ownership, and governance structure, while keeping transaction costs reasonable.

Lessons from delegated supervision models, however, underscore that the independence of the delegated supervisor from control by the supervised units and a strong commitment by the ultimate supervisory authority are critical to make the delegated supervisory model work. The effectiveness of the current supervisory arrangement involving the BoG and the Apex Bank is weak because of the structural, capacity, and resource constraints discussed earlier. The Apex Bank has no sanctioning powers, and even if it had such powers, their effectiveness would likely be limited because the Apex Bank is owned by the RCBs. If the current arrangements are to be continued, the Apex Bank department that performs the supervisory role will at least have to be effectively "ring fenced" from the service provider part of the bank. This solution can also help address capacity constraints by attracting the necessary human resources, particularly if a way is found to sustainably fund the supervision activities.

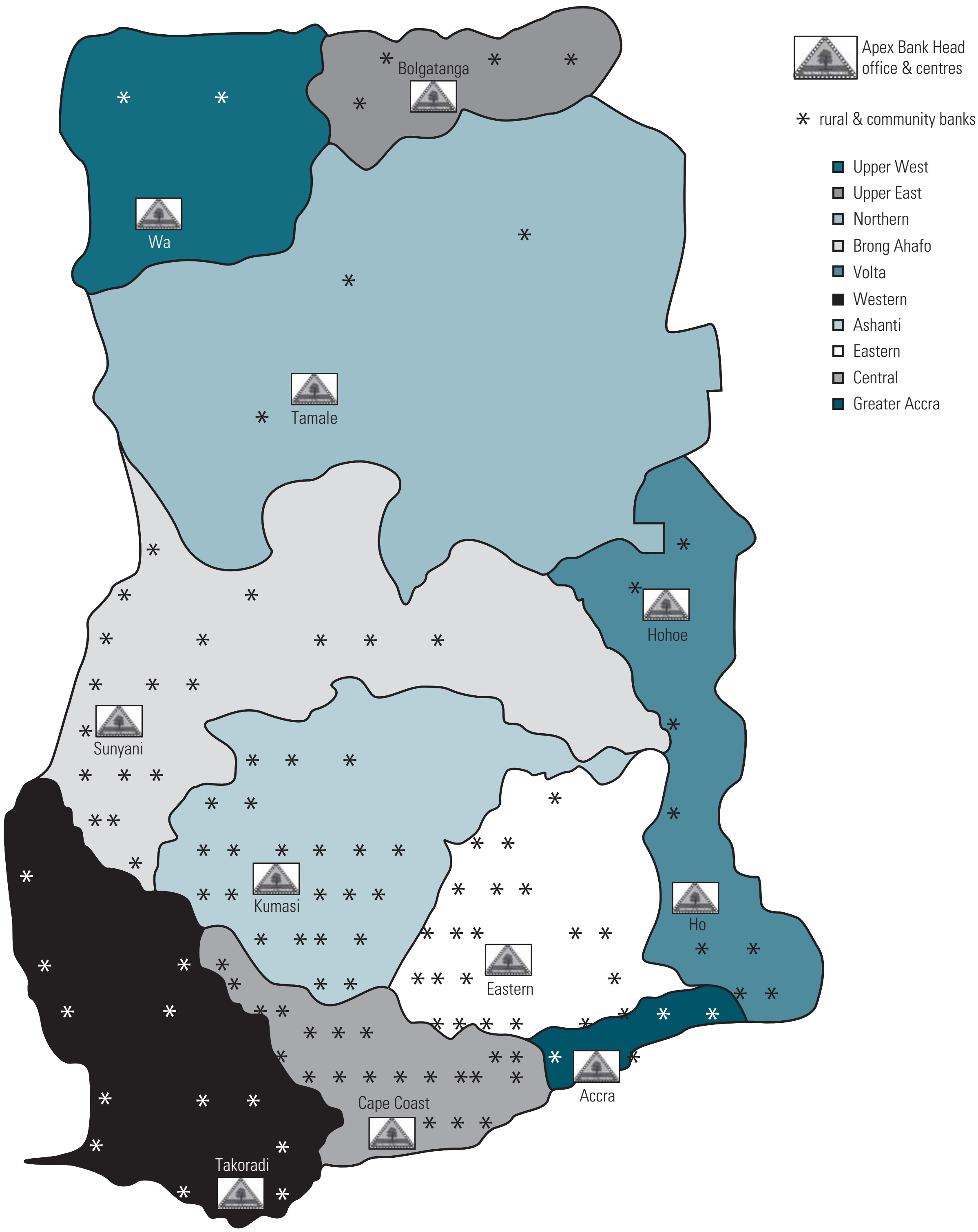
5.4 THE GoG: INCENTIVIZING SERVICE DELIVERY TO THE POOR

The Government of Ghana has generally played a remarkable role in facilitating the establishment of and growth of the RCB network. In contrast to most countries, where excess regulation and political interference virtually destroyed rural financial institutions—whether development banks or financial cooperatives—Ghana successfully changed over time many of the regulations that constrained the growth of the RCB network. Nevertheless, the government should consider undertaking some additional measures to further strengthen the RCB network and to enhance access to financial services in rural areas, particularly for low-income households and small businesses.

The major measures needed include ensuring that there are adequate resources for supervising the RCBs and fully compensating RCBs when they are called upon to deliver services for the government. Because commercial banks do not pay for being supervised, it is not reasonable to expect that RCBs should do so. Although the share of supervision costs devoted to RCBs is disproportionately higher than their share of assets in the banking system, the positive externalities that result from wider access to financial services in rural areas justify devoting these resources. Rural and community banks provide essential services in many remote, underserved areas of the country that would otherwise have no formal access. Subsidizing the initial stages of the delegated supervisory regime will be necessary until the system evolves enough to be able to finance inspection from its own sources.

Lastly, the government can create additional mechanisms for consumer protection. An explicit deposit insurance mechanism can be useful if accompanied by stronger regulatory sanctions on poorly performing banks. A "salvage operation" mechanism suggested by Cuevas and Fischer (2006) can also be created to finance the reforming, closing, and merging of RCBs to prevent the loss of public deposits. Finally, the government can devote additional resources to improving financial literacy in rural areas. This measure would both increase demand for financial services and reduce the implicit cost RCBs incur when delivering services to a less financially literate clientele.

Annex 1: MAP OF GHANA WITH RCB AND APEX BANK LOCATIONS



Annex 2: SAMPLE FRAMEWORK OF 12 RCBs

RURAL BANKS		KEY INDICATORS				
		COMPUTERIZATION	OPERATIONAL AREA	OFFICES	AGE	PERFORMANCE
1	Ahafo Anao	Partially computerized	Periurban	4	20	Mediocre
2	Atwima	Fully computerized	Periurban	6	20	Satisfactory
3	Boriamango	Manual	Rural	1	5	Satisfactory
4	Kakum	Fully computerized	Periurban	10	25	Satisfactory
5	Kintampo	Partially computerized	Rural	3	25	Strong
6	Nsoatreman	Manual	Rural	1	13	Fair
7	Nyakrom	Partially computerized	Periurban	6	33	Fair
8	Nzemamale	Manual	Rural	3	20	Fair
9	Odotobri	Partially computerized	Periurban	5	20	Mediocre
10	Upper Manya Kro	Manual	Periurban	3	20	Satisfactory
11	Wamfie	Manual	Periurban	5	20	Satisfactory
12	West Mamprusi	Manual	Rural	1	12	Satisfactory

Annex 3: TIMELINE OF EVENTS RELEVANT TO RCBs

Year	Events
1976	First RCB established
1981	Association of Rural Banks (ARB) founded
1982	Akuafo Check system introduced
1985	Operational manual for RCBs established Temporary ban on opening new RCBs
1989	Rural Finance Project started
1991	Liberalization of the financial market through financial sector adjustment program
1996	Reserve requirement increased to 62%
1998	Maximum number of RCBs reaches 133
1999	23 distressed banks liquidated
2000	Rural Finance Services Project started
2001	ARB Apex Bank licensed
2007	Currency redenomination launched
2008	Rural Financial Services Project closed 18 RCBs qualified for Ghana Club 100

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ENDNOTES

1 At a later stage the ARB evolved into a strategic alliance between RCBs, and the ARB Apex Bank was formed in 2002.

2 Not all RCBs have internal auditors.

3 *Susu* deposits are small savings collected daily from clients by individual collectors going door to door. *Susu* collectors have long operated outside the formal system in Ghana. Recently RCBs as well as other commercial banks have started to link up with *susu* collectors to mobilize deposits from the public. RCBs hire *susu* collectors as part-time agents or employ them as regular bank staff to manage this special product. A *susu* option in a bank provides *susu* depositors a secure place for saving and access to loans using small deposits. Interest rate earnings on *susu* deposits, however, are insignificant.

4 Ghana has 10 administrative regions.

5 Banks with less than 10 percent capital (net worth as a percentage of adjusted assets) are rated as mediocre, and those with negative capital are rated as distressed.

6 This section is drawn primarily from Program Design Report, Rural and Agricultural Finance Programme, (IFAD 2008, updated with data from the World Bank's World Development Indicator database.

7 Under this system any buyer of cocoa is required to pay farmers by check instead of with cash. Farmers wanted rural community banks in their own areas to reduce the cost of traveling longer distances to cash checks.

8 RCBs were required to lend about 50 percent of their total loans and advances to agriculture, 30 percent to cottage industries, and 25 percent to other activities.

9 When the project ended, expenditures on the project were US$28.4 million. Of the US$20 million contribution from the International Development Association, US$15 million was a credit line for rural banks and $5 million went to an institution-building component.

10 High-priority sectors include agriculture, export trade, and manufacturing.

11 At the same time, the secondary reserve requirement was eliminated for commercial banks.

12 As stipulated in the Bank of Ghana Act 2002 (Act 612), Banking Act 2004, and Banking (Amendment) Act 2007.

13 Under the Companies Code of Ghana 1963 (Act 179).

14 As per the ARB Apex Bank Limited Regulations, 2006 (L.I. 1825).

15 This section draws primarily on World Bank (2009).

16 The last component was intended to support 22 banks that were rated as mediocre at the beginning of the project. Because of budgetary constraints, however, only 8 could be provided with additional support under the special restructuring program. All 22 banks received training under the general banking training program.

17 This assessment is still ongoing. The analysis controlled for regional, time, and inflation effects.

18 Among the four fully computerized banks, one bank completed this process in 2005, two in 2006, and one in 2008.

19 www.speedghana.org.

20 Millennium Challenge Compact with Ghana, Executive Summary, August 2006.

21 Supervising managers of RCBs, as they are called in some RCBs.

22 Sec. 298 of the Ghana Companies Code of 1963, Act 179.

23 The number of accounts is used as a proxy for the number of clients using a particular type of product.

24 It is currently called "Credit and Savings with Education."

25 Freedom from Hunger is a registered nongovernmental, nonprofit organization with a vision of a world without poverty.

26 Based on authors' discussion with clients and credit officers.

27 Some RCBs do not have internal auditors because they are unable to attract and pay for qualified internal auditors.

28 The "narrowing income margins" that led to the steady decrease in profitability were due in large part to declining Treasury bill rates, as early profits were based heavily on investment of initial funds in high-return Treasury bills.

29 PAR > 30 days refers to the value of all loans outstanding that are more than 30 days past due.

30 Failure of a certain percentage of financial institutions is to be expected in any market economy. Even before the onset of the financial crisis in 2008 leading to a wave of new bank

failures, some banks failed every year in the United States. In the seven-year period from 2000 to 2007, 30 banks failed (www.fdic.gov, accessed on August 24, 2009).

[31] Pande and Burgess (2005) is a good example.

[32] The Apex Bank envisions obtaining a universal banking license for low-risk products and preference shares and getting a regulatory capital in the form of grant from BoG (ARB Apex 2008).

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