

Before the late 1970s, rural dwellers in Ghana had almost no access to institutional credit for farm and nonfarm activities, and in many rural communities, secure, safe, and convenient savings and payment facilities hardly existed. In response to this situation, the Government of Ghana took several measures to increase access to credit in rural areas, including facilitating the establishment of rural and community banks (RCBs). This brief discusses the history of RCBs, their business model, their services, and their financial performance. It then draws some lessons relevant for others involved in or planning similar initiatives.

As a network, RCBs are the largest providers of formal financial services in Ghana's rural areas. By the end of 2008, Ghana had 127 RCBs with a total 584 service outlets, representing about half of the total banking outlets in the country. The RCB network reaches about 2.8 million depositors and 680,000 borrowers. Although the service delivery performance of the RCB network has been strong, its financial performance has been mixed. The profitability and net worth of the network have grown, but the financial performance of some members has been poor, and a small number are insolvent.

The creation and evolution of the RCBs

The first RCB was established in a farming community in the Central region of Ghana in 1976. Several others were established in rapid succession, and by 1984 the number of RCBs reached 106. By the early 1980s, however, the financial performance of many RCBs started to decline for several reasons, including a 1983 drought, weak governing ability, conflicts within boards of directors, and ineffective management in many RCBs.

The Bank of Ghana, the Ghanaian central bank, undertook several reforms to curb the deteriorating situation. Exposure to risky sectors (mainly agriculture) was limited, distressed banks were closed, supervision was strengthened, and RCB managers and boards of directors were offered training. Between 1989 and 1994 the Government of Ghana, with the support of the World Bank, also implemented the Rural Finance Project, aimed at providing targeted support to the RCBs. The project contributed to an improvement in RCB performance.

Nevertheless, several RCBs remained weak, and in 1998, the Bank of Ghana liquidated 23 RCBs. The Government of Ghana, with the support of the World Bank and other donors, implemented a follow-up project—the Rural Financial Services Project—between 2001 and 2007 to help further strengthen the RCBs. This project provided extensive training to RCBs and supported the establishment and strengthening of the Association of Rural Banks (ARB) Apex Bank, as a bank to the RCBs. (The Association of Rural Banks had been established in the early 1980s as a networking forum for RCBs and later started providing training to member RCBs.)

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), although values of the three indicators vary significantly among RCBs.

Community ownership and governance. RCBs are fully owned by shareholders who are residents of communities in which they operate. Each rural or community bank has a board of directors that is responsible for its strategic governance. Boards are elected by owners/shareholders during annual general meetings. Election criteria are normally based on reputation in the community and professional expertise, but experience in banking is extremely limited.

Professional management and staff. The core management staff of a typical RCB is 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; a finance officer; and credit and project officers. Many of the personnel are recruited from local communities.

Strategic alliance. Since 2002 the ARB Apex Bank has provided specialized services essential to improving the quality and scope of products offered by RCBs, and it performs important supervisory functions delegated by the Bank of Ghana. Among the main services offered by the Apex Bank are check clearing, specie supply, treasury management, loan fund mobilization, and domestic and international money transfers. The Apex Bank provides most of these services on a fee basis.

Legal and regulatory framework. RCBs are incorporated as limited liability companies and licensed by the Bank of Ghana within the framework of the Banking Act. The minimum level of capital required by RCBs is GHc 150,000 (US\$116,135). RCBs whose capital falls below this minimum are not allowed to pay dividends or open new branches or agencies until they attain the minimum level of capitalization.

Products and services

Savings. RCB savings products include savings accounts, current accounts, susu deposits (small savings collected daily from clients by individual collectors going door to door), and fixed or time deposits. In a 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. 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 long-term deposit contracts represent only about 1 percent of total clients.

Credit. The credit products offered by RCBs include microfinance loans, personal loans, salary loans, susu loans, and overdraft facilities. In a sample of 12 RCBs, salary loans amount to 33 percent of total advances, followed by personal loans (24 percent) and microfinance (20 percent). In terms of 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.

Money transfers and payments. RCBs participate in local and international money transfers, and 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. Between 2000 and 2008 the number of depositors in RCBs grew at an average annual rate of 14 percent, and the number of borrowers grew at an average annual rate of 27 percent. 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. Clients of RCBs consist mostly of farmers, government employees, and small and micro-entrepreneurs.

Mixed financial performance. The profitability and net worth of the RCB network steadily increased from 2000 to 2008. Network-wide capital is well above the minimum 10 percent required by the Bank of Ghana. In 2008, however, seven RCBs were insolvent, and the continued operation of poorly performing RCBs is a key issue facing the network. The relatively high ratio of nonperforming loans is another major factor affecting financial performance. In the sample RCBs, for example, the proportion of the loan portfolio that was in default for more than 30 days was 16 percent, compared with 3 percent for banks in their global peer group.

Lessons on rural banking

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

- Although community-based financial institutions such as the RCBs can play a key role in increasing access to financial services in rural areas, their small size can also make it challenging for them to become financially sustainable and compete with other financial institutions that enter the rural financial market. To be successful, they should be able to respond dynamically to changes in the business environment. These responses may include building linkages, being open to mergers, and bringing in external investors, if necessary.

- Small local financial institutions often cannot easily procure needed technical support (such as training and specialized technical assistance for product development and setting up of operational systems) from the market. Hence, initiatives to build local financial institutions must support the creation of strategic alliances that can either provide such services or facilitate their cost-effective provision. Apex institutions can play a crucial role in providing technical and financial services to small financial institutions.
- Apex institutions may find it difficult to achieve financial sustainability by providing services to members alone. Such institutions may have to also provide services to the public, including general commercial banking services. Care must be taken, however, to ensure that the business model adopted does not compromise the original mission—in this case, to increase sustainable provision of financial services in rural areas.
- The regulator needs to have the necessary skills, political autonomy, and financial resources to effectively regulate and supervise a large number of small financial institutions that are geographically dispersed. Often the central bank does not have the skills to undertake this task directly, and alternative models of supervision may have to be adopted. Even in the best circumstances, however, a certain number of institutions will fail, and the regulatory system needs to have the capacity to respond quickly to protect depositors and to prevent failure from lowering confidence in other institutions. Donor funding cannot sustain a supervisory regime in the long run, and recovery of all supervision costs through fees from the supervised institutions may not be a feasible option. Under these circumstances, adequate government funding for supervision would be critical for ensuring sustainable service delivery. ■

For further reading: A. Nair and A. Fissaha, “Rural Banking: The Case of the Rural and Community Banks in Ghana,” Agriculture and Rural Development Discussion Paper No. 48 (Washington, DC: World Bank, 2010).

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