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A typology of institutional models: Bank Keshavarzi, Iran

BANK KESHAVARZI
THE AGRICULTURAL BANK OF IRAN

From directed credit to sustainable banking under conditions of financial repression

By

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Policy environment:

- 1979 Islamic Revolution
- Financial system centrally controlled
- 1983 Mandatory Islamic banking
- 97% of banking assets held by gov.
- Negative real interest rates
- Incipient liberalization
  - Private banking allowed since 2000
  - Bank restructuring under preparation

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The evolution of BK:

- 1933-78 Prehistory: government-owned credit funds
- 1979-91 Start-up: BK est’d as a gov’t credit fund
  - BK a *handling bank* for government credit
  - 1980s: Close it, merge it, or reform it?
- 1992-97 Transition period:
  - 1992 transformed into a deposit bank
  - Directed and commercial banking
  - Increasing losses, tech’ly bankrupt
- 1998-2004 The new era of reform
- Periodic recapitalizations by government

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Reform initiatives, 1998-2004:

- Customer orientation as a priority
- Increasing autonomy:
  - From directed to managed credit: BK as executing bank
  - Share of commercial operations increasing
- Increasing self-reliance through urban deposit mob'n
- Modernization through IT
- Privatization of subsidiaries and services

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Strategic restructuring since 2000:

- Transformation into a learning organization
- 26 strategic reform plans since 2000
- Participatory approach to strategic reform
  - Developing staff capacity, involving 6000 out of 15,000
- Regular management performance evaluation
- Competitive job postings every 2-3 years
- Converting a hierarchical into a flat organization:
  - With direct access of branches to the head office
  - Decentralization of lending authority

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The bank’s system of incentives:

- Branches are profit centers
- Staff performance incentives:
  - Staff can more than double their regular salaries
- Performance indicators:
  - Savings mobilization
  - Loan collection rate
  - Loan disbursements
- Incentives-driven system of suggestions for improvement

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Achievements during the new era:

- Expansion of branch network from 480 to 1800
- Decrease of directed credit from 80% to 30%
- Deposit market share from 1% (1995) to 6% (2003)
  - Deposits 72% of liabilities (2004)
- Rationalization of all procedures
- Overall staff retraining
- Computerization of branch network
- Incipient portfolio diversification

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Services – over 90 products:

- 21 deposit products
- 15 credit products
- Electronic banking
- Insurance
- Foreign exchange

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Performance indicators (March 2004):

- Total assets: US$ 7.1 billion
  - Real growth: 25% p.a. over preceding 3 years
- Total outreach: 14 million customers
- Deposit accounts:
  - 13.9 million accounts
  - US$ 4.0 billion
  - 69% unremunerated (sight; qard al-Hassan; lottery)
- Loans outstanding: US$ 5.5 billion
  - 95% to the private sector
  - Disbursements 2003-04: 1.5m loans, US$ 3.4 billion

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Loan characteristics:

- Average loan size: $ 2240
- Agriculture & livestock: 75%
- Short-term up to 2 years: 70% of amount
- All loans are Islamic contracts:
  - 80% at fixed rate
  - 17% at flexible profit-sharing rates (*mudarabah*)
  - 3% at an administrative fee only (*qard al-Hassan*)

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Loan security and recovery 2003-04:

- All loans are secured
  - Personal guarantees: 95% of loans, 83% of amount
- Collection through 1500 collection units
- Collection rate 82.5%
  - Late payments due to calculated unwillingness
- Loan loss ratio 2% (after rescheduling)
- Loan rescheduling and interest exemptions:
  - In 6 out of 7 preceding years, decided by parliament
  - Affecting 150,000 to 590,000 persons p.a.

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Profitability:

- 2001-02: Profit-making for the first time
  - accumulated losses wiped out after recapitalization
- Profits during 2002-03 and 2003-04:
  - ROAA (after tax) 1.1% and 1.7%
  - ROAE 15.1% and 22.3%
- Income and expenditures:
  - 91% of income from borrowers
  - 14% of expenditure to depositors

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STRATEGIC CHOICES:

- 1992: Credit fund vs. deposit bank
- 1998: Gov-directed vs. autonomous bank
- 2000: Stable hierarchy vs. continually reforming & restructuring learning organization
- 2005: Retail vs. wholesale banking

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MOST CHALLENGING STRATEGIC CHOICE:

- Mission stability:
  - Continued provision of services to smallholders
- Mission enhancement:
  - Provision of more and better services, retail and wholesale, to a diverse clientele including smallholders
- Mission drift:
  - Abandoning smallholders, moving up-market

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CONCLUSIONS:

- Main threats:
  - Government interference
  - Inflation
  - Interest rate controls, negative real interest rates
- Main opportunities:
  - Incipient liberalization, emphasis on bank self-reliance
  - Improving macroeconomic stability
  - Abundant revenues from oil exports

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Weaknesses of BK:

- Lack of interest/profit rate autonomy
- Low level of portfolio diversification
- Low outreach to women and young adults

Strengths of BK:

- Continual insistence of management on reform
- Emerging *learning organization*
- Evolving full-service bank

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Where is the bank now:

- Despite all the restraining factors
- BK has moved towards profitable universal banking
- upon the initiative of its own board & management
- without donor assistance.

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Recommended next steps :

- Policy dialogue on sustainable Islamic banking
- Wholesaling thru solidarity groups of young adults (*vs. cooperatives in a culture of supply-led banking*)
- Taking the bank to the people:
  - Increasing the number of field staff
  - Appraisal of all household assets and liabilities
  - Repeat loans, graduation to larger-size, longer-term loans
- Exposure in BRI/Indonesia and Centenary RDB/Uganda