



Technical Assistance Consultant's Report

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People's Republic of China: Rural Finance Reforms and Development of Microfinance Institutions (Component B) (Financed by the Poverty Reduction Cooperation Fund)

FINAL REPORT

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Table of Contents

1.	Background	2
1.1	Overall Objective/Purpose of the Technical Assistance:	2
1.2	Original Scope of Work for the Microfinance Institution Development Specialist (MIDS).....	2
1.3	Original Scope of Work for the Rural Credit Demand Analyst (RCDA).....	3
2.	Contract Variations	3
3.	Project Implementation	4
3.1	Schedule of Inputs	4
3.2	Inception Visit	5
3.3	Training Needs Assessment and International ‘Best-Practice’ Training.....	5
3.4	RCCU Training of Trainer Course in Market Research for New Product Development.....	5
3.5	Demand Study	6
3.6	Tongren Macroeconomic Study	6
3.7	Investor Demand and License Terms & Conditions Consultation	6
3.8	Study Tour to Qinghai, Inner Mongolia and Tianjin.....	6
3.9	Negotiation Terms and Conditions of Licences in Guizhou and Inner Mongolia, and Tender Preparation.....	7
3.10	Finalisation of License Draft License Terms and Conditions	7
3.11	Evaluation of MFI Tenders	7
4.	Lessons Learned.....	8
5.	Conclusions	9

List of Abbreviations

ABC	Agricultural Bank of China
CBRC	China Bank Regulatory Commission
CCB	China Construction Bank
MFI	Microfinance Institution
MIDS	Microfinance Institution Development Specialist
PBC	People’s Bank of China
RCC	Rural Credit Cooperative
RCCU	Rural Credit Cooperative Union
RCDA	Rural Credit Demand Analyst

1. Background

1. Strengthening financial services to the agriculture sector and to rural non-farm activities has become a major policy objective of the Government of the People's Republic of China (PRC). The Government of the People's Republic of China requested ADB during the 2004 country-programming mission to provide technical assistance (TA) for Rural Financial Reforms in Guizhou Province (GP). A Fact-Finding Mission visited Beijing and GP from 30 August – 10 September 2004 to ascertain the objectives and scope of the technical assistance, and after that, a Memorandum of Understanding was reached between ADB and GP.
2. An Inception Visit was conducted from 24 April to 29 April 2005. The mission met with Provincial, Prefecture and County officials from the Govt. of PRC, the People's Bank of China (PBC), and the China Bank Regulatory Commission (CBRC) in Guiyang, Tongren and Jiangkou; and discussed the implementation of the proposed TA.
3. The consulting services were designed to help enhance RCC training effectiveness and the setup of the microfinance model project. The consultants have carried out their terms of reference in support of and in close coordination with; the national and provincial CBRC and People's Bank of China (PBC) the Guizhou provincial government, the provincial RCC Union, and the county governments in the selected target area of Jiangkou county and, surrounding counties.

1.1 Overall Objective/Purpose of the Technical Assistance:

4. **The consulting services provided under the technical assistance served to:**
 - a. build capacity for rural credit cooperative (RCC) staff in Guizhou to improve loan operations in the post-restructuring period;
 - b. develop Guizhou provincial and related county governments' understanding of and capacity for support to microfinance policy, regulatory, and institutional development; and
 - c. develop and implement a competitive bidding process to establish a licensed model microfinance institution (MFI) in Jiangkou and adjacent counties.

1.2 Original Scope of Work for the Microfinance Institution Development Specialist (MIDS)

5. **Detailed tasks for the MIDS were as follows:**
 - a. Based on the desk studies, identify key issues to be addressed in the start-up and operations of the microfinance model, including identification of competition issues, appropriate management and accounting structures, products, and loan delivery and recovery mechanisms;
 - b. Provide training to Guizhou government officials at all levels on international best practices in microfinance and the actual workings of MFIs, including a training and on-site review and analysis of a Guizhou MFI; and
 - c. Help complete the final set of materials for requesting proposals along with the bid analysis instructions to ensure applicability of the MFI program to client needs.
6. **Output/Reporting Requirements were as follows:**
 - d. Inception report 1 week after services start,

- e. Interim progress reports at appropriate stages of TA implementation,
- f. Draft final report before the conclusion of the contract, and
- g. final report 2 weeks after incorporation the EAs' and ADB's comments.

1.3 Original Scope of Work for the Rural Credit Demand Analyst (RCDA)

- a. Locate and analyze village household data for Jiangkou and all adjoining counties on financial circumstances, based on the 60-household detailed household survey data in Jiangkou county, but may include field surveys;
- b. Extrapolate numbers of client households likely to access financial services in each county, and types of financial services they desire, as baseline technical assistance (TA) data;
- c. Based on RCC county data and other client data to be accessed through PBC, determine the level of client demand already supplied and justify the assumptions;
- d. Determine the level of effective client demand as yet unmet, particularly for low income and poverty households, comment on likely mechanisms for meeting this demand, and approximate funds that are needed to address this gap; and
- e. Present these findings to the Guizhou government and ADB to facilitate selection of an effective catchment area for the MFI model.

2. Contract Variations

- 7. Two contract variation proposals were submitted for each of the contracts of Robert Hickson and He Guangwen, during the course of the technical assistance based upon agreed modifications to project implementation.
- 8. The first contract variation proposal for Robert Hickson requested an additional one month input to allow the conduct of a qualitative component to the market research to be conducted in Tongren prefecture. Two additional return trips from Australia to China and the provision of 90 person days for translation services were also approved.
- 9. The first contract variation proposal for He Guangwen requested an additional 1 ½ months input and an additional \$6,000 costs for the conduct of the demand study in 4 counties of Tongren prefecture. In addition, the ADB transferred the budget for RCC training onto the contract for He Guangwen, so that it could be administered by Microfinance Services Pty Ltd. Both contract variation proposals were approved by the ADB.
- 10. The second contract variation proposal for Robert Hickson requested an additional 2.5 months input and an additional 4 return economy airfares. This additional input was to allow for Dr Hickson to continue his support to the preparation of the license terms and conditions and preparation of bidding documents which now also included Inner Mongolia; conduct a “microfinance market research and product development” Training of Trainer course for the RCCU; and to assist in the evaluation of tenders. The original project budget had included an additional 2 months for unidentified international consultant inputs and a budget for a Bidding Specialist whose terms of reference Dr Hickson fulfilled.
- 11. The second contract variation proposal for He Guangwen requested an additional 2.5 months input to allow him to expand the demand study to include the remaining 6 counties of Tongren prefecture.

3. Project Implementation

12. Project implementation was undertaken by four consultants, Robert Hickson – International Microfinance Institution Development Specialist (MIDS), Kate Druschel - International Microfinance Regulatory Specialist (MRS), Du Xiaoshan – Domestic Microfinance Applied Research Specialist (MARS), and He Guangwen - Rural Credit Demand Analyst (RCDA).
13. Two domestic consulting positions remained unfilled. These were the Financial Institutions Training (FITS) Specialist and the Bidding Specialist (BS). The FITS position tasks were instead subcontracted out to the Microfinance Training Centre in Beijing and, being unable to find an appropriate bidding specialist consultant, these tasks were undertaken by Robert Hickson with the assistance of a contracted Chinese legal firm.

3.1 Schedule of Inputs

14. Table 1 below provides a list of the major tasks undertaken by the consultants together with the approximate dates that these inputs took place.

Table 1 Consultant Inputs and Dates

Major Activity	Consultant(s)	Dates
Inception Visit	Hickson, He and Du	23 to 30 April 2005
Training Needs Assessment	He	8 to 26 May 2005
Best Practice workshop	Hickson and Druschel	9 to 13 May (office-based preparation of 'best-practice' training materials) 31 May to 5 June 2005 (in-country)
Qualitative Demand Study	Hickson	6 June to 24 June 2005
Tongren Macroeconomic Study	He	6 to 22 June 2005
Quantitative Demand Study Part 1	He (and Hickson)	28 June to 9 August 2005
Investor Demand and License Terms & Conditions Consultation	Hickson	14 August to 8 September 2005
Development and Delivery of RCC Training of Trainer Courses	He	22 August to 30 September 2005
Quantitative Demand Study Part 2	He	4 October to 25 November 2005
Development and Delivery of RCC Training of Trainer Course in Market Research and Product Development	Hickson	4 October to 16 October
Study Tour to Qinghai, Inner Mongolia and Tianjin and Microfinance license negotiations	Hickson and Du	16 October to 7 November 2005
Monitor Retail Level RCC Training Delivery	He	17 to 28 October 2005
Tender Preparation and License Negotiations – Inner Mongolia	Hickson and He	15 to 28 November 2005
Finalisation of License Draft License Terms and Conditions	Hickson and Du	31 December to 8 January 2006
Tender Preparation and License Negotiations – Guiyang	Hickson and Du	19 to 27 January 2006
Evaluation of MFI Tenders	Hickson and Du	23 to 28 May 2006

3.2 Inception Visit

15. The implementation of the project began on the 23rd of April with an inception visit led by Betty Wilkinson. During this mission visits were made to Beijing and Guizhou province. Following the inception visit an Inception Report was prepared by Robert Hickson detailing the planned implementation strategy for the technical assistance, and providing revised budget estimations. The inception report was submitted to the ADB and approved in April 2005.

3.3 Training Needs Assessment and International ‘Best-Practice’ Training

16. The RCDA undertook a training needs assessment study of the RCC and RCCU to identify key human resource weaknesses and institutional strengthening requirements. The RCDA provided his training needs recommendations in a Training Needs Assessment Report. Following further consultation with the RCCU a number of additional training courses were agreed upon. The final agreed training program is shown in Table 2 below.

Table 2 RCCU Training Programme

Course Title	Trainer
Assessment and Analysis of Investment Projects	He Guangwen
Assessment and analysis of investment project	He Guangwen
Basic Financial Skills Training	He Guangwen
Specialised Financial Skills Training	He Guangwen
International ‘Best-Practice’ Training	
Understanding Causes and Costs of Delinquency	Microfinance Training Centre
Effective Interest Rates	Microfinance Training Centre
Financial Analysis for Financial Institutions	Microfinance Training Centre
Introduction to Market Research for New Product Development	Robert Hickson
Risk Management in Microfinance	Robert Hickson and Kate Druschel
International Best Practice in Microfinance	Robert Hickson and Kate Druschel
International Models used in Microfinance	Robert Hickson and Kate Druschel

17. At the conclusion of the ‘best-practice’ workshop the RCCU requested that the Market Research for New-Product Development course be provided to the RCCU as a trainer of trainer course such that the RCCs could continue to offer this at Prefecture level.

3.4 RCCU Training of Trainer Course in Market Research for New Product Development

18. The RCCs are currently undergoing restructuring in an attempt to improve their financial viability. The commercial imperative is for these RCCs to become more market responsive in the products and services they offer to their market. Consequently, the RCCU decided that market research for new product development should be taught throughout Guizhou province.
19. Consequently, the Microfinance Institution Development Specialist provided ‘training of trainer’ training to RCCU trainers in market research for new product development in October 2005. This market led approach to new-product development was quite challenging to many of the participants as, until now, product development within the RCC has been done mostly at the national level with product designs being passed down to RCCs throughout the nation.

Nevertheless, the majority of participants recognise the importance of changing to a demand driven, rather than a supply driven, approach.

3.5 Demand Study

20. The demand study was split into two components; a qualitative study and a quantitative study. Robert Hickson and He Guangwen respectively undertook primary responsibility for these studies. The quantitative study initially covered only 4 counties within Tongren prefecture but following discussion with the AGB project officer Ying Qian it was determined that this study should extend to all 10 counties within Tongren prefecture. Both studies indicated a high level of unmet demand for financial services within Jiangkou and most of the other counties in Tongren prefecture. Furthermore, the quantitative study indicated that a large percentage of households demanding credit services appeared well positioned to service the levels of debt demanded.
21. The qualitative study indicated widespread dissatisfaction with existing financial services, particularly those provided by the RCCs. Amongst other things the study noted a strong unsatisfied demand for personal financial services (consumption lending and savings services), in addition to business financing.

3.6 Tongren Macroeconomic Study

22. As part of his analysis of demand for financial services in Tongren prefecture, the RCDA undertook a detailed macroeconomic study of the sub-region. This study provided valuable economic data for the prefecture and highlighted specific counties which were experiencing high levels of economic growth.

3.7 Investor Demand and License Terms & Conditions Consultation

23. While not in the original terms of reference for the TA, during the implementation it became apparent that consultation was required with potential microfinance investors. This consultation was undertaken by Robert Hickson and Kate Druschel and involved interviews with approximately 10 international institutions that provide debt and equity investments in microfinance. These consultations allowed an assessment of the level of interest within the international community with respect to microfinance investments in Guizhou and Inner Mongolia Autonomous Region¹.
24. The analysis of investor demand indicated cautious interest amongst investors. Of particular concern were the current Chinese practice of imposing interest rate caps, the potential for Central bank interference with MFI operations and lending procedures, the lack of a clear legal and regulatory environment for microfinance and proposed geographical restrictions upon operational areas which were considered too small to allow sufficient scale operations for profitable operation of MFI's.

3.8 Study Tour to Qinghai, Inner Mongolia and Tianjin

25. In addition to the classroom-based training program, the technical assistance provided a study tour for provincial level staff of the People's Bank of China, China Bank Regulatory Commission, the Rural Credit Cooperative Union (RCCU), Prefecture and County Level

¹ Following consultations by the ADB project officer (Ying Qian) with the Financial Office of Inner Mongolia Province, it was recommended that Inner Mongolia be included amongst the provinces piloting privately-owned microfinance institutions.

Government Officials. This study tour visited three microfinance programmes in Qinghai, Inner Mongolia and Tianjin city. The study tour provided an opportunity to observe a variety of microfinance operations operating under public and private (NGO) management, using different microfinance models amongst different clients in differing environments.

26. During the study tour groups of participants were required to analyse the MFIs with respect to the strengths and weaknesses of their institutional capacity, products and services, and financial performance. These sub-groups provided presentations to the remaining group members at the conclusion of each MFI visit.
27. The study tour generated much interest and discussion amongst the participants and was referred to frequently, in later times, as a pivotal point in their understanding and appreciation of microfinance.

3.9 Negotiation Terms and Conditions of Licences in Guizhou and Inner Mongolia, and Tender Preparation

28. The negotiation of the terms and conditions for microfinance licences to be issued in Guizhou and Inner Mongolia was a lengthy process and took more time than expected. Extensive discussions were held with provincial, prefectural and county authorities in Guizhou and with the Financial Office and PBC in Inner Mongolia. In addition extensive consultations were made with the National PBC and CBRC. The Microfinance Institutional Development Specialist (MIDS) also made a number of presentations in this respect including the National Workshop on Microfinance hosted by the People's Bank of China in Beijing.
29. Following this extensive consultation agreement was finally struck on the terms and conditions of the two licences. The term license was dropped in favour of "Authority to Operate" and responsibility for the supervision of the MFI's was delegated to county level government. Substantial and valuable assistance was provided by Ying Qian, the ADB project officer, during these consultations.

3.10 Finalisation of License Draft License Terms and Conditions

30. Robert Hickson (the Microfinance Institution Development Specialist) prepared international tender documents (Requests for Proposals) for the competitive bidding for the authority to establish private MFIs Guizhou and Inner Mongolia. These were reviewed by a Shanghai-based legal firm which specialises in the international investment in China and company law. Evaluation procedures complying with the ADB's rules for procurement were developed for the assessment of tender submissions.
31. The tender documents were translated into Chinese under the supervision of the Microfinance Applied Research Specialist (MARS).
32. The tender documents and supporting materials (eg. the demand studies and the Tongren macro economic study) were sent directly to all known interested parties. In addition, these were placed on the ADB's web site. The tender was advertised on the CGAP web site as well as the China Development Brief.

3.11 Evaluation of MFI Tenders

33. Following the deadline for submission of tenders Ying Qian, Du Xiaoshan and Robert Hickson participated on the provincial tender evaluation committees together with provincial authorities in Guizhou and Inner Mongolia. Twelve proposals were received (including two from foreign institutions) for the license to operate in dongsheng district of Erdos municipality in Inner

Mongolia; and two were received for Jiankou county of Tongren prefecture in Guizhou. In May 2006 the two successful bidders were announced in Guizhou and Inner Mongolia.

4. Lessons Learned

34. This technical assistance was particularly innovative in that it involved support to the development of a new financial sector in China, involving private microfinance institutions. This was challenging in two respects. Firstly, in China there existed almost no privately owned financial institutions. Secondly, the existing non-profit microfinance sector in China is quite immature compared to most other developing economies around the world. Consequently the technical assistance operated in an environment in which there were no precedences to follow and no regulatory framework in which to work. This required the consultants to work closely with the Executing Agency, the Central Bank and other stakeholders building a better understanding of 'best-practice' and common approaches used in other countries and assisting these agencies to derive an approach suitable for the needs of China.
35. The technical assistance could not have achieved this task without the high level of support provided by Ying Qian from the ADB and the benefit of his keen understanding of the Chinese financial sector. Moreover, the Bank's flexibility and readiness to respond to the changing needs of the TA proved critical to successful implementation. This allowed the consultants to maintain a highly interactive approach; and to remain responsive to the changing needs of the task as the counterpart agencies developed and matured their understanding of the needs of a private microfinance sector.
36. A number of international donor and investment agencies operating in China have an interest in the development of a sound microfinance sector. These include DFID, GTZ, the World Bank, the IFC, UNDP and Citigroup. The TA played an import role in the promotion of inter-donor communication to ensure a coordinated approach to the development of a robust microfinance sector. Of particular importance was the coordination with GTZ who are providing capacity building in the field of microfinance regulation and legislation.
37. During the TA representatives from the PBOC, CBRC, county governments and the RCCUs were taken on a study tour of other successful Chinese non-profit MFIs. The value of this study tour was particularly noticeable as the participants had very little experience of microfinance and this helped greatly in grounding their understanding of microfinance and appreciation of its potential to support low-income households.
38. A variety of capacity building activities were carried out with RCCs with the support of the RCCU. These activities were well attended; however, such training is unlikely to have a major impact upon RCCs while they retain their current structure of ownership and governance. Even among the RCCs undergoing transformation there was very little sense among staff that they were now responsible for their own management and performance. For example, many of the RCC participants attending the training in market research for new product development; were unable to conceive the notion that they might take responsibility for developing or tailoring individual products that might better met their client's needs. It was difficult for them to conceive a change from the current process in which all RCC products are developed at the national level without any systematic process of market research, nor the ability for individual RCCs to adapt these to local needs. Until these RCCs are accountable to governors who have a clear ambition to make them competitive and profitable in their local markets it is unlikely that the transformation process will succeed.

5. Conclusions

39. The original project design limited its objectives to the support for the establishment of a single MFI in Guizhou. This is the first time that the ADB has specifically funded technical assistance designed to directly support the establishment of a private MFI. Even more remarkable, is that this was done in China, where, at the time, no private MFIs existed. In fact, at that time, only one fully private retail financial institution existed in all of China (the Minsheng Bank).
40. The technical assistance has achieved much more than its ambitious design had intended; which was to establish a single private MFI in Guizhou. In both Guizhou and Inner Mongolia, feasibility studies for the proposed institutions were completed; the regulatory framework to govern these institutions was designed and finalised as a result of extensive consultation with the central bank and other relevant authorities; and the competitive bidding process for the two licenses was prepared and implemented. As a result two privately owned microfinance institution licenses have been granted in Guizhou and Inner Mongolia and these MFIs are now operating under the supervision of the respective county governments.
41. The second objective of the technical assistance was to provide support to the RCCs in their process of transformation into competitive, financially viable, institutions. In response to the RCCs training requests, the project provided training on a variety of subjects including market responsive product development. This training will be extremely important to the RCCs if they are to become competitive in a privatising financial sector.
42. These MFIs may require additional technical support to enable them to effectively service poor households and rural clientele. Such support might be considered in future ADB technical assistance to the financial sector.
43. More important, however, is the provision of support to the establishment of a sound microfinance regulatory framework within China which would allow private sector MFI's to operate freely throughout China under the supervision of the central bank. Currently the German Agency for Technical Assistance (GTZ) is providing technical support in this area, however, given the importance and scale of this task, the ADB's support and influence in the promotion of a healthy regulated micro finance sector would be extremely valuable.