Ex post evaluation – India

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Sector: Sustainable economic promotion
Project: NABARD XI, Reform of rural lending – BMZ No. 2005 66 620* reduced-interest loan (A), 2006 66 099 IDA loan (B)
Implementing agency: National Bank for Agriculture and Rural Development

Ex post evaluation report: 2018

All figures in EUR million	Project A (Planned)	Project A (Actual)	Project B (Planned)	Project B (Actual)
Investment costs (total)	100.00	100.00	40.00	30.00
Counterpart contribution	0.00	0.00	0.00	0.00
Financing	100.00	100.00	40.00	30.00
of which BMZ budget funds	100.00	100.00	40.00	30.00

*) Random sample 2015

Summary: In 2006, the Indian government devised a comprehensive revival package for India's large but still rather inefficient rural credit cooperative system. In addition to FC support, this comprehensive reform programme was co-financed by numerous international donors and implementing institutions (such as the World Bank, ADB, GIZ) on the basis of programme-based joint financing (PJF). As part of the overall project, FC granted a reduced-interest loan of EUR 100 million and an IDA loan of EUR 30 million (originally EUR 40 million). In 2012 the reform programme was suspended by the Indian government. In agreement with the Indian Ministry of Finance, a new loan purpose was agreed for the funds not yet drawn down, which was based on the original project focal area of NABARD XI (see below). In addition to the necessary legal and structural changes and adjustments which were made across the entire rural credit sector, the project also involved modernising the accounting system, formalising the operational planning, computerisation at the three levels of the credit cooperative sector, and strengthening the capital bases of the cooperatives.

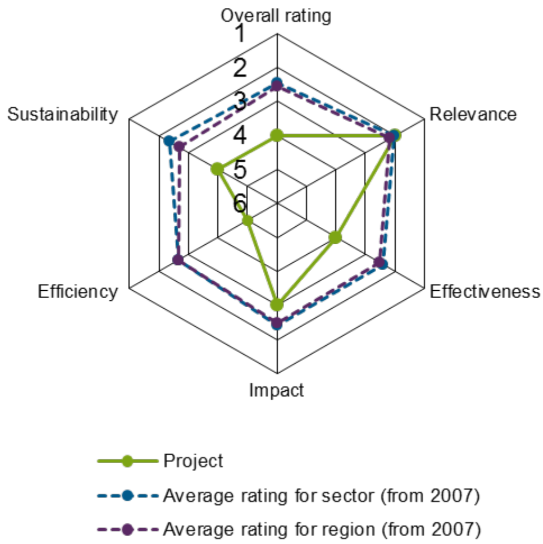
Objectives: The programme objective of both projects was to establish lasting access to financial services for the rural population in the participating union states via a sustainable and efficient cooperative system (outcome). The project was thus intended to improve employment and income opportunities for poor inhabitants of rural areas (impact).

Target group: By establishing and strengthening the cooperative banking system, a sustainable contribution was to be made to improving the lives of India's rural population.

Overall rating: 4 (both projects)

Rationale: The FC project stimulated the development of the rural financial sector. Financial support for the credit cooperative banks led to improved capital bases and enabled the institutions to increase lending to the rural population. However, it was not possible to establish the rural local credit cooperatives on a sustainable economic basis. Default rates are still high, stoking fears that the increased lending will be reflected in correspondingly high defaults in the medium term. Less than half of the rural local credit cooperatives are profitable, and the political will to close unprofitable institutions is still lacking. State influence, which still persists, stands in the way of establishing market-economy structures in the cooperative sector.

Highlights: In view of the poverty in rural areas and the climatic uncertainties, the actors visited are highly committed to continuing and actively shaping the reform process in the future.



Rating according to DAC criteria

Overall rating: 4 (both projects)

Ratings:

Relevance	2
Effectiveness	4
Efficiency	5
Impact	4
Sustainability	4

General conditions and classification of the project

The project was designed as programme-oriented joint funding (PJF) and served to finance part of the restructuring measures and assume recapitalisation costs for the rural cooperative banking sector in India. The Indian government put together a comprehensive revival package for this purpose in 2004.

There are three levels to the Indian Cooperative Credit Structure (CCS). There are 31 State Cooperative Banks (SCBs) at the level of the union states. Depending on the union state, these can reach a considerable size and are highly flexible in the products they offer, allowing them to compete directly with modern commercial banks. The SCBs are also the central institutions for 368 District Cooperative Banks (DCCBs) with 12,500 branches. SCBs and DCCBs are classified as banks according to Indian legislation. At village level there are more than 100,000 Primary Agricultural Credit Societies (PACSs). They are funded by the DCCBs. PACSs are not financial institutions in the traditional sense, since in addition to being funded by the DCCBs they are only permitted to collect deposits from their cooperative members.

The cooperative sector is still the most important lender in rural India and thus plays a central role in creating employment and generating income for a large part of the rural population. The direct political influence on operational business activity, insufficiently motivated and under-qualified management as well as underdeveloped and inappropriate credit technology led to significant loan defaults and weakened the equity bases of the banks. The Indian government launched this reform programme to stop this negative trend and develop an economically viable cooperative banking sector that is stable in the long-term.

The FC measures (programme loans) formed part of a co-financing facility in cooperation with the Asian Development Bank (ADB) and the World Bank. German FC participated with a reduced-interest loan of EUR 100 million and an IDA loan of EUR 30 million, which were granted directly to the Indian government. The ADB and FC funds were reserved for five states supportive of the reform: Andhra Pradesh, Bihar, Madhya Pradesh, Maharashtra and Rajasthan. GIZ also participated and, working together with the implementing partner organisation NABARD, developed models for important components of the revival package, in particular by helping to create standardised formats for the Management Information System (MIS) and other audit systems.

Once the funds from the Indian government – which formed an integral part of the overall reform package for 2011 – were fully exhausted, the reform programme was officially discontinued in 2012. With a view to nevertheless implementing the funds which had not yet been paid out by FC at that time, the disbursement of which was linked to concrete reform measures, it was agreed with the Indian Ministry of Finance to build on the content of the original NABARD XI project and fund new capital support from the Indian state specifically for the DCCBs. These institutions, which had already received support as part of the original cooperative bank reform, were now placed under the supervision of the Indian Central Bank (RBI) and were required to meet new capital requirements. As part of this second phase the aim was to sustainably strengthen the DCCBs that had not yet met these increased requirements. The IDA loan and the reduced-interest loan cannot be meaningfully separated at the impact level, and as such the individual assessments apply to both projects.

Relevance

The importance of an efficiently organised financial sector for rural development, and for active poverty reduction in particular, has been a central focus of the Indian government for many years. At the time of the project appraisal in 2005, however, India's rural credit cooperative system was in a rather wretched state as a result of the government fixing interest margins, occupying positions in the governing bodies of financial institutions and subsidising over-indebted cooperative units. To remedy these inefficiencies, the Indian government devised a comprehensive reform package ("revival package"). The World Bank (WB) and the Asian Development Bank (ADB) became involved as the first financing partners. FC joined the reform programme – entitled "NABARD XI Reform of Rural Lending" – in 2007, following the design phase. The FC project took on the form of a "policy mix", based on PJF financing under the leadership of the ADB, and comprised three successive, contractually fixed implementation components. These included: an explicit political commitment to actively implement the reform programme by means of binding MoUs; the subsequent establishment of market-based governance rules which are relevant in terms of regulatory law and applicable to the institutions; and, in the third component, the resulting institutional reforms. The government institution NABARD, founded in 1982, was the implementing agency for this reform package on behalf of the Indian government and made itself available to the financial donors as an implementation partner.

The underlying concept of the reform package evaluated here is also seen as relevant and necessary in terms of development from today's perspective. The implemented reforms and their results represent an important milestone in the further development of India's rural credit sector, and were thus in line with the outcome objective of the results chain outlined in the programme proposal.

Given that the aim was to set up the cooperative system to cover costs and thus be self-sufficient, the implemented reforms had the potential to facilitate the integration of poorer segments of the rural population into the formal financial system and to improve the supply of financial services to farmers in the long term.

From today's perspective, this continues to represent a basic requirement for the sustainable improvement of income and employment in rural areas (impact objective). Without the implemented reform steps – which formed the basis for the economic recovery of the tripartite financial institutions in the Indian credit cooperative sector – it would have been much more difficult to ensure the sustainable provision of various services to the rural population. One of the basic requirements for a functioning results chain is a strong, sustained desire for political reform.

The training and education component for staff at the participating financial and local credit institutions – implemented by NABARD itself – also made a significant contribution to the successful implementation of the FC measure.

In summary, the FC programme addressed the reasons underlying the previously inefficient operation of the rural financial system in the Indian cooperative sector. The needs and development wishes of the financial units were also clearly identified and addressed in the implementation. The programme was in line with both the 2004 sector concept for financial system development of the Federal Ministry for Economic Cooperation and Development (BMZ) and with the relevant five-year plans of the Indian government.

Coordination with other donors and implementing institutions (such as the WB, ADB, GIZ) was evident, at least in the design phase (e.g. harmonisation of objectives, regional funding priorities, alignment of content). However, the delayed implementation of the financing meant that coordinated implementations were much more difficult.

Relevance rating: 2 (both projects)

Effectiveness

The programme objective of both projects (outcome) was to establish sustainable access to financial services for the rural population in the participating union states via a sustainable and efficient cooperative system. In addition to the necessary legal and structural changes and adjustments which were made across the entire rural credit sector, the project also involved modernising the accounting system, formalising the operational planning, computerisation at the three levels of the credit cooperative sector, and strengthening the capital bases of the cooperatives. Based on a detailed list of requirements, the project aimed to change structural and organisational framework conditions and thus contribute to the development of market-based structures and economically stable institutions (e.g. preparation and implementation of draft laws and statutes, audits, MoUs, etc.).

In the first phase, the following indicators for the three levels of the cooperative credit sector were used to measure the practical and thus measurable achievement of the project objectives:

Indicator	PA target value	Status EPE	Comments
The credit volume for the funding of agricultural activities is increasing.	5% growth per year	15.3 % (average) annual rate of growth CAGR (04/2006 – 04/2016, compound annual growth rate / CAGR)	Achieved. Underlines the increased commitment of the FIs.
The number of rural borrowers (small and micro farmers) is increasing.	10.1 million (2006)	Roughly 20 million at end of project period 9.1% CAGR (04/2006 – 03/2015)	Achieved. In addition to the improvements in volume, this figure highlights that it was also possible to significantly increase the number of benefiting farmers, with the result that the growth is not only expressed as an increase in the average credit volume.
The NPA rate at the participating partner institutions decreases over the course of the project.	Decrease by 5 percent overall	In Rajasthan, the NPA rate of SCBs decreased from 36.41% (2010/11) to 19.63% (2016/17) of SCBs. In Maharashtra, the NPA rate of SCBs fell from 31.22% (2010/11) to 9.27% (2016/17).	Partially achieved. The portfolio quality of the SCBs and DCCBs has already improved. The results for the PACSs are mixed (increase in NPA in some places, but slight decline overall). There was a backlog in the following years, and this was also assessed as such by all parties involved.
The collateral proceeds of the loss-prone loan portfolio at the participating partner institutions increases over the course of the project.	Target value: > 90% (5% annual improvement)	SCBs: 95% (03/2015) DCCBs: 77% (03/2015) PACSs: 62% (03/2015)	Partially achieved. Particularly in rural areas where poverty can be widespread, it is difficult for the PACSs to noticeably improve their recovery rate. The aim must therefore be to increase the number of loans granted for productive purposes, for which repayment is largely guaranteed.
The profitability of the participating partner insti-	Target value: 95% of all	SCBs: 87% (04/2006)	Not achieved. The implementation of the reform pro-

tutions improves over the course of the project.	DCCBs and 70% of all PACSs are profitable (turn a profit): Annual improvement in this rate 2% (for DCCBs) 5% (for PACSs)	DCCBs: 76% (04/2006) PACSs: 46% (04/2006) SCBs: 87.5% (03/2015) DCCBs: 82.5% (03/2015) PACSs: 47.0% (03/2015)	gramme shows only marginal improvements in the profitability of the participating financial institutions, with the exception of the DCCBs, but these also failed to meet the targets.

The associated indicators for measuring the target achievement were primarily aimed at improving the functioning and efficiency of the rural credit cooperative structure in the supported union states (= tranche 1).

The implementation of the reform programme showed initial improvements in the profitability of the participating financial institutions. However, a lack of profitability was noted at the level of the PACSs in particular (see above). If the cooperative sector does not succeed in revitalising the impetus to reform and establishing a profitable structure across the board, further cross-subsidisation of the higher institutions will become necessary and international donors will have to be asked for renewed support.

As described above, since the purpose of the loan changed following the Indian government's official discontinuation and the reprogramming of the funds for the second FC loan tranche, the impact indicators had to be adjusted accordingly in 2015. The indicators of the second tranche are aimed instead at the financial sustainability of the DCCBs on the one hand, and the results of the structural and organisational reforms on the other (= tranche 2).

The following new indicators were used to measure the achievement of the project objectives, especially with regard to the DCCBs.

Indicator	PA target value	Status EPE	Comments
Capital adequacy (CRAR) for the participating DCCBs improves over the project period (this is the determination of the capital adequacy ratio, or "Capital to Risky Asset Ratio", which the Indian Central Bank prescribes as a control variable for its institutions in the wake of the international financial crisis)	CRAR: 7.0% (03/2015) CRAR: 9.0% (03/2017) (at the beginning of the project, only very few DCBBs met this control parameter set by India's central bank)	18 of the 20 DCCBs had a CRAR > 7%	Not achieved. CRAR > 9% is an ambitious target for DCCBs, which has hardly ever been achieved in the past, but this now represents an achievable target.
NPA rate at the participating DCCBs decreases over the course of the project	Halving the NPA rate	No DCCBs succeeded in halving NPA; the actual reduction was between 0.22% and 38.6% (March 2017)	Not achieved. Halving the NPA rate was an ambitious goal that could not be achieved overall; however, this also failed due to political resistance to the clo-

			sure of unprofitable PACSs.
Deposit ratio at the participating DCCBs	+15% p.a. compared to the previous year	Growth rates were between -6.8% and +11.8% (March 2017)	None of the DCCBs were able to achieve the target growth rate of 15% in the 2015/16 or 2016/17 financial years.
Governance structures improve at the participating DCCBs over the course of the project	Appointment of a CEO according to the "fit and proper" criteria set by India's central bank the RBI Appointment of members of the co-operative to the DCCB committees	17 out of 20 DCCBs met this criterion (March 2017)	Largely achieved. Useful and important instrument in the context of structural reform, which has been implemented as far as possible
Operational procedures and practices among the participating DCCBs improve over the course of the project	All funded DCCBs are part of the CBS platform	4 of the 20 DCCBs use CBS (March 2017)	Not achieved. The computer-based IT system (CBS) has as yet only been implemented in rudimentary form, but the DCCBs are still working on its implementation
Profitability of the PACSs at the DCCBs improves over the course of the project	Development plans for PACSs including diversification strategy	19 of the 20 DCCBs were assessed (March 2017)	Partially achieved. Economic situation of some PACSs significantly improved, but there is little political interest in closing down unprofitable PACSs in the short term

Overall, the project objectives of the reform package, as measured by the above-mentioned indicators, were largely not achieved. From the evaluation point of view, the indicators were appropriate and suitable, particularly for analysing and ultimately assessing the economic improvements to the participating financial institutions. It was more difficult, however, to assess changes in the area of legal adjustments to structural and organisational framework conditions. Generally speaking we can say that the desired changes were implemented and have thus generated a positive impulse for the entire cooperative banking system in the Indian union states visited.

Despite the positive results described above, however, some of the targets are still a long way off (economic stability of all PACSs, provision of computers, technical progress, etc.).

The decision to suspend the reform programme, which was taken by the Indian government in 2012, ultimately exerted a very negative influence on the achievement of the objectives. On the one hand, the implementation of individual project objectives (such as providing the PACSs with computers, further training and education measures, etc.) tended to be delayed, and the overall economic strengthening of the cooperative banking system was also significantly curtailed.

At the same time, other state interventions also served to hinder the establishment of stable market-economy structures in the Indian cooperative sector and thus reduced the effectiveness of the project. These included, for example, the 0% interest rate policy for agricultural loans, which is partly subsidised by the government. The local credit cooperatives therefore have no opportunity to set risk-adjusted interest margins and to use these to actively control their lending and risk provisioning. The same applies to the issue of state "loan waivers", which tend to be used by the government as election campaign gifts. These involve the central or local government taking over the outstanding lending volume of the often very poor rural borrowers and reimbursing them for any previous debt servicing. Measures such as these, while they form part of a supposedly well-intentioned subsidy policy, damage the rural financial sector as a whole and ultimately generate windfall profits and false expectations for future loan commitments. Finally, the de facto cash devaluation that took place in November 2016 through the demonetisation of certain banknotes also damaged the economic strength of credit institutions by creating additional administrative work, resulting in a loss of confidence among the population and disruptions to general business operations.

The overall effectiveness of the programme is therefore rated as insufficient, despite some positive partial results.

Effectiveness rating: 4 (both projects)

Efficiency

The implementation of the reform package to improve the rural credit cooperative system in India represents a major structural adjustment project in terms of its overall scope, its regional expansion and the time needed. It was possible to implement a large number of individual measures in the union states as part of the reform programme. Despite the long implementation period though, only partial successes are visible in many areas.

Between the project design and the practical start of implementation (signing of the MoU with the credit institutions) there was a rather long coordination process, which all the surveyed actors rated as unproductive and inefficient overall. Clear inefficiencies are discernible in this respect. However, it is difficult to conduct a quantitative analysis or evaluation to determine what might have otherwise been achieved.

Another fundamental inefficiency was caused by the official discontinuation of the reform package by the Indian central government and the resumption of the FC programme only about three years later following the lengthy reprogramming of the remaining FC funds. Here, too, it is difficult to quantify the potential implementation losses.

Given that the implemented funds failed to achieve the hoped-for developmental effects, and considering the time delays and the temporary project standstill, the overall efficiency is assessed as insufficient.

Efficiency rating: 5 (both projects)

Impact

The overarching development objective of the project was to contribute to the creation of income and employment in rural areas (impact) by sustainably improving access to financial services for India's poorer rural population groups (outcome). The basis for creating sustainable access to financial services is the direct project objective of developing a sustainable and efficient cooperative banking system in the participating Indian states.

As a result of the discussions and investigations which took place during the evaluation trip, the project as a whole has made a direct contribution to broadening and expanding the financial sector. For example, the conversion of state participations into equity capital naturally improved the balance sheets of the participating cooperative institutions. The resulting improvement in the capital structure enabled lending to the rural population to be boosted. The financial resources of the PACSs, most of which were granted in the form of harvest loans, secured employment and income. After the harvest season, the profits were deposited with the PACS as new deposits, so they would be available again in the next harvest cycle to finance the purchase of new seeds, fertilisers or pesticides.

The reform of the rural credit cooperative system has thus strengthened the operating units economically, at least in the short term. Discussions with the rural population have also confirmed that the reform has had a lasting positive impact on the relationship of trust in the cooperative sector. The implemented reforms strengthened the self-determination of the institutions at both PACS and DCCB level. In this context, entrepreneurial activity increased and the active search for new market segments and practical business opportunities intensified. A large number of PACSs now offer additional activities alongside their traditional business (e.g. pesticide and fertiliser trade, expanded storage capacities, various rental and repair options for agricultural equipment, simple supermarket sales units, etc.). Unlike in the past, business and cooperation partners can now be selected individually and independently by the PACSs, which reduces potential losses and boosts business growth. This positive development trend goes hand in hand with greater expertise and specialist know-how. These effects were also made possible by the various training courses and seminars, some of which were financed and implemented using programme funds[1]. The mandatory admission of certain professional experts to the management bodies of the DCCBs and PACSs has also significantly strengthened the professionalism of management in the institutions and secured this over the long term.

Nevertheless, it was found that the state still has a certain amount of political influence, even after the reform programme. This is still evident when preferential treatment is given to certain individuals in the context of accepting new members into the credit cooperatives, from which certain positions in the supervisory bodies are subsequently filled. On the other hand, the interest subsidies and state-ordered loan waivers discussed above impact on the innovative strength and long-term legal basis of the DCCBs and PACSs.

All things considered, the reform programme has succeeded in fundamentally reforming and broadly promoting the rural credit cooperative sector to a limited extent only, and, as a result, the overall development impact is no longer satisfactory.

Impact rating: 4 (both projects)

Sustainability

One major priority area of the project evaluated here was financial support for the reform of the rural credit cooperative sector. If political support had been sustained, the implemented changes in legislation and supervision would have had fairly high sustainability potential due to their binding nature and territorial scope. Overall, we can assume that the institutional steps taken have made an important contribution to permanently establishing new structures in an underdeveloped sector.

Despite the improvements achieved, in terms of quality the project has not yet been able to close ranks with the competing commercial banks, which generally have a richer clientele and a broader range of services. The rural credit cooperative sector tends to serve the poorer rural segments of the population, who have only limited access to financial services. It is estimated that 80% of the working population is still not in formal employment. Due to the country's extreme climatic conditions, the agricultural sector remains highly vulnerable and insufficiently protected against natural and weather disasters (such as droughts, heat waves and floods).

Overall, the project took an important step towards the economic stabilisation of the rural credit cooperative sector. In the credit cooperatives, both the deposit and lending business – which serve as the basis for stable, sustainable development – found their footing once again to some extent. For example, the loan business of the PACSs grew by 73% in Uttar Pradesh, 53% in Madhya Pradesh and 23% in Odisha in 2009/10 as compared to the same period in 2006/2007. However, these increases are primarily attributable to the availability of fresh capital for lending.

In this context, the implemented training and education programmes could have played an important role in creating sustainable market structures in rural areas, too.

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[1] NABARD's main field of action involved the provision of a wide range of training and education services throughout the country, including other government subsidies in addition to the funds provided under this programme. In this respect, the institutions visited were unable to clearly reveal a clean separation of the source of the funds, but they did make clear their assessment of the high demand and high degree of efficiency of previous measures.

Nevertheless, a number of government measures (in the form of sanctions, such as the demonetisation of banknotes in November 2016, numerous subsidy decisions in the form of loan waivers or government-imposed maximum interest rates for certain exposures) continue to hamper the economic independence and market economy operations of many rural PACSs. State interference hampers the sustainable development of these units in terms of their independent design and ability to increase their sources of income. In this context, the envisaged secondary objective of closing unprofitable PACS units has remained largely unfulfilled and politically untouched.

Building on the improvements of the education and training measures that have already taken place, digitalisation and the broad-scale computerisation of the rural credit sector will play a special role in the future. While the financial security of these measures remains to be clarified, the Indian government, NABARD and the credit cooperatives intend to focus more closely on these developments in the future.

The results achieved in the NABARD XI reform project are rated as insufficient overall. Some satisfactory results were achieved, however. Overall, though, a number of individual measures fell short of the original expectations, especially in term of their final implementation in rural areas. The premature discontinuation of the reforms in 2011 in particular meant that the objectives set at the DCCB and PACS levels could not ultimately be achieved. Ultimately, new state funds must now be used to implement the full reform project as it was originally designed and, above all, to ensure its lasting success. Despite the positive partial results in the first phase (structural changes and institutional adjustments), due to the lack of interest in reforms on the part of the Indian government and shortcomings in the practical implementation phase, the overall sustainability of the project is given a rating of 4.

Sustainability rating: 4 (both projects)

Notes on the methods used to evaluate project success (project rating)

Projects (and programmes) are evaluated on a six-point scale, the criteria being **relevance, effectiveness, efficiency** and **overarching developmental impact**. The ratings are also used to arrive at a **final assessment** of a project's overall developmental efficacy. The scale is as follows:

Level 1	Very good result that clearly exceeds expectations
Level 2	Good result, fully in line with expectations and without any significant shortcomings
Level 3	Satisfactory result – project falls short of expectations but the positive results dominate
Level 4	Unsatisfactory result – significantly below expectations, with negative results dominating despite discernible positive results
Level 5	Clearly inadequate result – despite some positive partial results, the negative results clearly dominate
Level 6	The project has no impact or the situation has actually deteriorated

Rating levels 1-3 denote a positive assessment or successful project while rating levels 4-6 denote a negative assessment.

Sustainability is evaluated according to the following four-point scale:

Sustainability level 1 (very good sustainability): The developmental efficacy of the project (positive to date) is very likely to continue undiminished or even increase.

Sustainability level 2 (good sustainability): The developmental efficacy of the project (positive to date) is very likely to decline only minimally but remain positive overall. (This is what can normally be expected).

Sustainability level 3 (satisfactory sustainability): The developmental efficacy of the project (positive to date) is very likely to decline significantly but remain positive overall. This rating is also assigned if the sustainability of a project is considered inadequate up to the time of the ex post evaluation but is very likely to evolve positively so that the project will ultimately achieve positive developmental efficacy.

Sustainability level 4 (inadequate sustainability): The developmental efficacy of the project is inadequate up to the time of the ex post evaluation and is very unlikely to improve. This rating is also assigned if the sustainability that has been positively evaluated to date is very likely to deteriorate severely and no longer meet the level 3 criteria.

The **overall rating** on the six-point scale is compiled from a weighting of all five individual criteria as appropriate to the project in question. Rating levels 1-3 of the overall rating denote a "successful" project while rating levels 4-6 denote an "unsuccessful" project. It should be noted that a project can generally be considered developmentally "successful" only if the achievement of the project objective ("effectiveness"), the impact on the overall objective ("overarching developmental impact") and the sustainability are rated at least "satisfactory" (level 3).