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# Rural Banking 2.0

*The Globalization of the  
Countryside*

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## RURAL BANKING 2.0

### *The Globalization of the Countryside*

From the very earliest times, financial institutions have been closely integrated with rural and agricultural life. Indeed, some of the earliest bank deposits in the third millennium B.C. were in the form of grain and even cattle. In the third century B.C., Egypt's government granaries were transformed into a network of grain banks, centered in Alexandria.

Today, rural financial institutions range from the massive to the small—the kind based in a single community. Japan's Norinchukin Bank, for instance, acts as a form of central bank for nearly 5,000 cooperative organizations and supports lending and the taking of deposits through a multi-level system with 16,000 outlets. Agricultural Bank of China has nearly 25,000 branches spread across rural and urban areas. In Europe, there remain 4,500 cooperative banks of varying sizes with more than 60,000 branches in total and a strong presence in rural areas.

Many large banks with origins in rural communities continue to play an important role there, while substantially expanding their business lines and geographic coverage. For example, Raiffeisen Zentralbank Austria bears the name of Friedrich Wilhelm Raiffeisen (1818-1888), the pioneer of German cooperative banking. It has expanded its business aggressively into the new markets of central and eastern Europe and serves a total of

12 million clients. By the same token, France's *Crédit Agricole* has developed into a global, full-service universal bank, made larger by its merger with *Crédit Lyonnais* in 2003, yet still enjoys a particularly strong market position throughout rural areas of France. And *Rabobank* in the Netherlands is expanding rapidly overseas with strong agribusiness capabilities. The transformation of these large European institutions points the way for the future development of rural lenders in emerging markets such as Brazil, China, India, and Indonesia.

At the same time, several global trends are heightening the importance of providing effective financing to rural economies. Grain and rice prices are at near-record highs, and consumers

worldwide are demanding increases in food production (see Exhibit 1). At the same time, the increasing demand for biofuels places new pressure on the productive potential of the countryside. But these demands are coming at a time when investment in agricultural productivity has declined, as attention and money have shifted to technology over the past decade. There are calls for a new agricultural revolution—and someone needs to finance it.

### Rural Banking 1.0

Rural banking is different from urban banking. A quick look at the landscape of customers and their needs highlights why: The population is spread out across the countryside and so is more dispersed and harder to

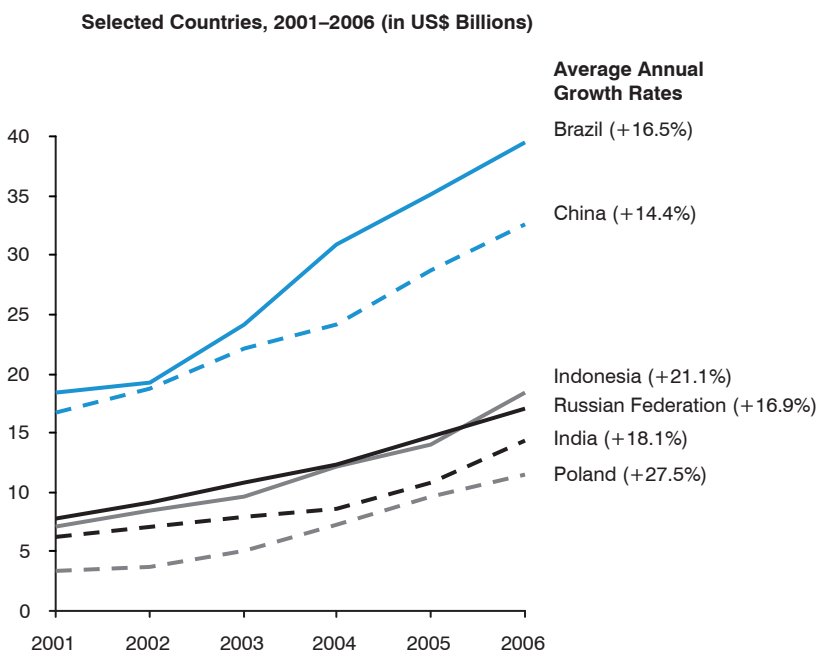
reach. In general, income levels are lower in rural areas than in urban areas. And agriculture, which is influenced by crop cycles, weather, and natural disasters, is typically the primary basis of customers' income and deposits, their collateral for loans, and their ability to repay. Finally, the nature of land ownership rights and land distribution is critical to determining what collateral can be offered and what recourse banks have if customers default. This all has a major impact on the riskiness and attractiveness of bank lending.

These factors can cause rural banking to generate higher costs, lower revenues, and higher risks than urban banking. Hence, both local and foreign banks in many countries have been focusing their expansion efforts on higher-income groups in the cities. This can lead to governmental and community concerns about lack of access to finance in the rural areas and about rural populations being left behind.

Some banks, however, have built their success in the countryside. Since the start of European cooperative banking, championed in rural areas by *Raiffeisen*, some banks have found ways to meet rural needs—and have done so profitably.

These banks have gained their advantage by making the local community their main focus. They often have branches in locations not served by other banks. Employees know local needs and circumstances far

**Exhibit 1**  
*Agricultural Exports*



Source: World Trade Organization

better than competitors do, so lending judgments can be based on personal knowledge and understanding of agricultural conditions. Reflecting this community focus and origin, many banks are organized as cooperatives, so their profits flow back to the local community. This has allowed profitability to be balanced with other community needs over time. It has also reinforced local identity and pride when smaller communities fear or resent outside institutions that make profits at the expense of the local community.

### The Globalization of the Countryside

Over the past 20 years, however, these success stories have been in the minority. Rural banking has largely been seen as a backwater, cut off from the more profitable urban and

international opportunities in the financial world. Banks of all kinds have faced the need to restructure rural branch networks to optimize profitability. Cooperative banks, with their historical culture of consensus, have sometimes struggled to make decisions rapidly enough to innovate at the same pace as their competitors with different structures. Competitive pressures have increased the need to focus on profitability as the key performance measure.

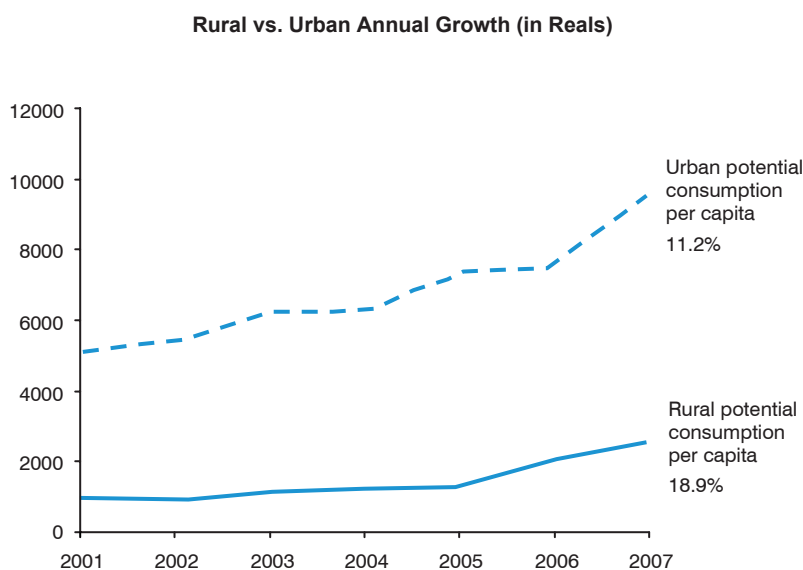
But now the spotlight is switching back to rural areas. The countryside is globalizing—and with it, rural banking. The same forces driving the globalization of international business are bringing new opportunities to rural financial services. Rural areas in some emerging markets are matching or surpassing urban

areas in consumption growth (see Exhibit 2). The mobility of people, capital, and ideas both changes customer needs and enables innovative ways of meeting them. Businesses and value chains are increasingly integrated both within countries and across borders. Technology and connectivity lower costs and improve real-time information access. The countryside is less and less isolated and increasingly integrated.

Lower-cost information and communications technology, such as mobile phones, the Internet, and e-mail, provides the basis for alternative distribution models that can raise the profitability and reach of rural banking. With the right design, technology can also provide a lower-cost means of monitoring and controlling operational risks across large distances. For example, bank lending officers in remote parts of China or Indonesia can now report their activities daily, whereas some lenders were previously able to visit the nearest branches no more than once a week. Combining increasingly inexpensive and mobile computing power with the Internet allows some micro-lenders in India to consolidate loan portfolio data from individual branches across the country every few hours.

Mobile phones, low-cost Internet access, and social-networking sites also provide economical new means of linking rural communities with one another—and with the millions of migrant laborers who move to the cities or

**Exhibit 2**  
*Brazil's Potential Consumption per Capita*



Source: IBGE; Target Marketing

overseas to work (see Exhibit 3). And the functionality available to even the poorest migrant laborers will continue to expand rapidly as technology costs continue to fall. The same technology connects rural areas to global financial markets and information. Farmers are now able to access market prices directly, rather than dealing with middlemen while themselves being ignorant of the final market price. Mushroom farmers in Yunnan, China, check the price of their wild pine-ear mushrooms in Japan several times a day by mobile phone to ensure that they are receiving the best price. In India, “phone-wallahs” make a business of investing in mobile phones and renting them out to other villagers.

Deregulation, new entrants into rural banking, and innovation are bringing new business models

for meeting rural needs—and enabling the faster rollout and adoption around the world of the models that prove successful. Organizations such as SKS Microfinance in India are adapting lessons learned from Starbucks and Wal-Mart, including how to use factory-style recruitment, systematized training, and standardized operational models to drive rapid rollout and growth. This has allowed SKS Microfinance to grow to nearly 700 branches covering 1.6 million customers in 20,000 Indian villages and slums since its launch in 1998 and to continue that growth by adding 30 branches and 130,000 customers every month. Rural banks everywhere can now take advantage of a breadth of diverse business models that have been proven in different countries—and then adapt them to their own local conditions.

At the same time, rising incomes and living standards continue to drive growth in the demand for food. The recent high commodity prices demonstrate the opportunities for continued investment in agricultural productivity and agribusiness development. As agribusiness organizations expand both domestically and internationally to meet these needs, financing will be a critical component of growth.

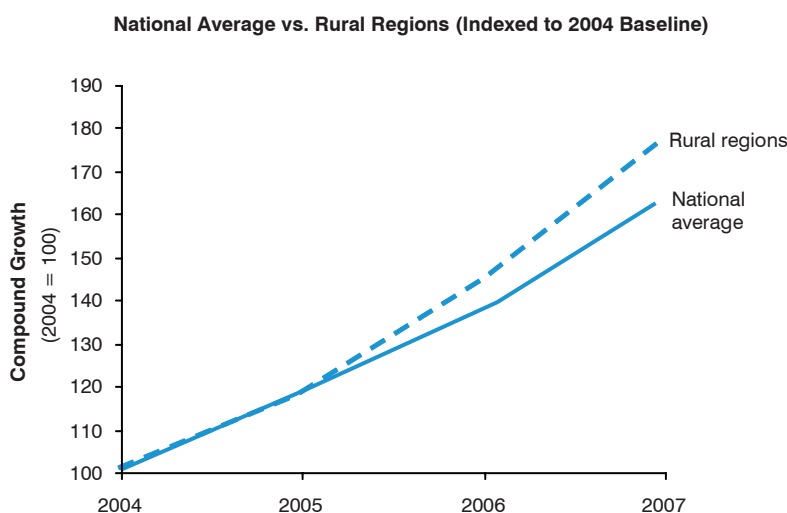
### Rural Banking 2.0

This evolution of the rural landscape is laying the groundwork for a reinvention of rural banking that we call “Rural Banking 2.0.” This new platform has three elements:

1. Renewing sustainable community-focused banking
2. Expanding and enhancing network value
3. Evolving from banking to financial solutions

Overall success in rural banking will, as previously, be contingent on success in chosen local communities. However, rural banks now have additional avenues through which to expand their business and then to reinforce and strengthen their core position in local communities. By linking together different communities and expanding the reach of the community to include those who move away to new places of work, larger banks can create additional value for customers. This sort of network offers value that is equal to more than the sum of its parts in different individual

**Exhibit 3**  
*Wireless Penetration in China*



Note: Rural regions include 10 of 31 regions with highest agricultural percentage of GDP.  
Source: Ministry of Industry and Information Technology; Booz & Company

communities. Similarly, banks can take advantage of their strong position in communities and with customers to broaden their product offering from banking alone to financial solutions, better meeting their customers' needs. The combination of enhancing network value and offering a broader range of solutions strengthens the original market position with individual customers and communities. The most successful banks in rural communities will use these three tactics concurrently, allowing each to reinforce the others.

#### *1. Renewing sustainable community-focused banking*

Historically, many banks in emerging markets have encountered higher credit and operational risks in the countryside and have found it hard to make attractive returns. This does not allow for a sustainable business. In the face

of higher credit and operational risks, they have centralized risk management and imposed processes that often do not recognize the distinct nature of rural lending. Now, however, there is an opportunity to implement a mix of processes and people together with technology in a way that meets the needs of the local community and provides the base for profit and thus for sustained business operations.

A good starting point is the recognition that the key sources of information about credit and operational risk in the countryside are different from those in the city. For example, spending time talking informally with influential figures in a village community can yield much better information about people's true character and business relationships (and hence their credit risk) than any number of questions on a credit application form. At the same

time, advances in technology allow for simpler, lower-cost tracking of repayment behavior once an initial loan has been made, so that reliable behavioral scores can be generated quickly. They can then provide the basis for higher lending limits while controlling risks.

Mobile phones and Internet access (which will increasingly come through mobile phones, rather than just through PCs) also provide the basis for more rapid, lower-cost communication and operations, especially in geographically remote areas with limited infrastructure. This lower-cost platform enables banks and others in emerging markets to serve lower-income customers where they live and work and to do so at a profit. Customers no longer need to make long journeys, often on foot, to distant branches for simple transactions. Banks and telecom

### **Case Study: ICICI Bank, India**

ICICI Bank is India's second-largest company and the largest bank in the private sector, with assets of approximately US\$88 billion. The bank and its subsidiaries offer comprehensive banking services in India, as well as life insurance, general insurance, asset management, investment banking, and private equity and venture capital.

The bank takes a holistic view of the rural sector, choosing to focus on both agricultural and selected non-agricultural rural sectors, such as infrastructure, health, education, tourism, and logistics. Within agriculture, it has developed sector-specific programs such as financing for the production of hybrid seeds in the seed sector, with similar concepts in the poultry, horticulture, and rural infrastructure segments.

ICICI's strategy is characterized by the use of a wide range of channels, from traditional branches to micro-finance branches, local franchises, and kiosks. Looking forward, ICICI aims to have some form of touch point within 10 kilometers of every customer. A core enabler for building a cost-effective widespread local presence is the creative use of new technologies supporting both customers and partners.

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### Case Study: Weifang Rural Credit Cooperative, China

Weifang Rural Credit Cooperative is a Chinese cooperative bank operating in an area of 15,800 square kilometers with a population of 8.5 million around the prefecture-level city of Weifang in the central Shandong province. The bank has achieved great success since its establishment in 2000, based on three key factors: an extensive distribution footprint, a wide product range, and an innovative credit evaluation process.

Weifang has set up a dense distribution network consisting of more than 500 branches, sub-branches, and outlets. On average, Weifang has one sub-branch or outlet per 34 square kilometers, each serving a population of 18,000 people.

Weifang has specifically developed a series of products targeting each market segment. It offers five loan products aimed at micro-businesses, seven products for small and medium enterprises, and a series of group and individual lending products for poor rural households. The bank has also established business partnerships—for example, one with China Everbright Bank to sell its wealth management products.

The credit evaluation process at Weifang is truly innovative. In each village it has established a credit evaluation group of 7 to 11 people: local government administrators, village coordinators, representatives of the village residents, and members of rural cooperatives. The group conducts the credit evaluation through secret ballot.

companies around the world are experimenting with new business models that integrate the mobile phone into banking services. In Kenya, Vodafone has attracted 2.3 million customers to its M-Pesa service, which gives customers the ability to transfer money to people through a combination of their mobile phone and the mobile phone agent network. Many of these models still face customer resistance, regulatory hurdles, and operational risk challenges, but the obstacles are gradually being addressed. Even ahead of acceptance by customers, banks can often use the same technology internally to facilitate improvement of both communication and control.

Careful design of processes and roles—and ultimately even ownership structures—can

reinforce the community focus and allow the bank to meet the needs of local customers. Banks in emerging markets can also look to the developed markets for approaches to adopt. In the U.S., banks such as Fifth Third and Commerce Bank have gained share by giving extra authority to branch managers. These managers can tailor branch opening hours and service levels to local needs and develop strong personal relationships with customers.

Finally, banks can develop alternative ownership and management models to both increase their community focus and manage financial, operational, and credit risks. In Australia, Bendigo Bank has developed a community banking model to reinforce its relationships and position within a wide range

of local communities. Bendigo provides the infrastructure and expertise to help a community set up its own bank in a kind of franchise arrangement, in which a locally formed public company is the legal owner, not Bendigo. The revenues are then shared between Bendigo and the local company. For some institutions, this strong position in the local community can be exploited further to provide the basis for distributing nonbanking services, such as mobile phones and even food.

Many banks are pointing the way on how to renew sustainable community-based banking, but the path is not easy. In particular, controlling complexity and cost remains important. The low incomes of many rural customers can clash with the desire of branch managers to customize

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services to their needs: Customized services could easily generate additional costs and complexity not justified by rural customers' relatively low revenue-generating capability, thus jeopardizing profitability. Risk control remains vital in a business where much information will continue to be in people's heads rather than in centralized databases.

## *2. Expanding and enhancing network value*

Two trends increase the value of the branch network for rural banks, both at home and in key overseas markets. The key challenges are to build—or get access to—the right network and then to get full value from that investment.

First, globalization has put much of the rural population on the move, both within and between countries. Migrant workers leave the countryside and move to the cities, creating the need for sending money home and for banking services in their new place of work. Within China, about 150 million migrant laborers are estimated to be working away from home at any given time. Migration is also occurring on a large scale across borders. About 5 million Indian migrant workers, many of them from the countryside, are estimated to be working in the Persian Gulf.

Second, agribusiness companies are expanding in rural areas to add value to local agricultural production by moving up the value chain into distribution and processing. As they do so,

they also seek to expand their marketing and sales presence in major cities. And agricultural trade is booming internationally. Farmers in Africa send fresh produce daily to be sold in supermarkets in the U.K. A recent OECD/FAO report estimates that agricultural export volumes from developing countries will grow rapidly in the next 10 years: Beef exports, for example, are predicted to grow 50 percent. Agribusinesses will also be increasingly involved in imports. China is projected to be the world's second-largest importer of oilseed and vegetable oils by 2017.

Given these two trends, a good place to start in building the right network is with an analysis of current customer movements, linkages, and market trends: Which cities do people move to, and from which areas? What is the geographic location of the different players in specific agricultural value chains, and how is this likely to evolve? Which countries will represent the most important export and import markets for agricultural products? This analysis also highlights which linkages will be most important and where to focus the effort to capture network value.

In building the network, banks face a further choice between adding their own branches (either by building new or through acquisition) and working through partnerships. One growth route for smaller, regional banks is through partnerships and network-sharing approaches—a

form of enhanced “correspondent banking,” in which banks in different locations agree to support the needs of one another's customers. This may also apply internationally. For larger banks, acquisition and the establishment of international representation in key locations may be more attractive.

With the right network in place for the future direction of agricultural and rural development, banks need to focus on capturing the value in a profitable way. Migrant workers, new to the city in which they are working, look for ways to stay in touch with their community back home and also need help in orienting themselves in an unfamiliar environment. Mobile phone and Internet technology provides a means to expand the community to those far from home at a small cost for even the lowest-income workers. In the enterprise sector, organizing relationship managers into teams, split across multiple locations, to serve a specific value chain (such as rice, fruit, or beef) ensures that the right network connections are made. This improves customer service, helps identify new business opportunities along the value chain, and assists risk management by increasing expertise and knowledge of industry trends and risks. It also identifies the needs for new products such as receivables financing, trade financing, and even M&A advice as individual businesses seek to expand.

While the opportunities in capturing the full network value

are clear, they are often hard to realize. Coordination is required across organizational units and departments that are often geographically far apart and may not be accustomed to working with one another. Success comes from a coordinated set of changes to processes, measures, incentives, training, and communication. Equally, success will be greater when top management picks some priorities—areas where the value of the network is greatest—and focuses on implementing them first. If this is not done, complexity and costs rise together. The organization risks gridlock by trying to do too many things at once, and could end up doing nothing.

### 3. *Evolving from banking to financial solutions*

Rural finance is no longer simply a matter of farmers' loans and deposits. Financial markets are playing an increasingly important role in all aspects of the rural economy. In particular, agricultural

commodities are increasingly traded on exchanges around the world and attract the interest of institutional investors who seek to profit from pricing changes. India, for example, established its Multi Commodity Exchange in 2003; in China, the Dalian Commodity Exchange is a major center for corn futures trading.

At the same time, many agricultural businesses are themselves growing and globalizing, following in the footsteps of major enterprises such as ADM, Bunge, and Cargill. These changes increase customers' requirements for financial advice, access to capital markets, and innovative financing techniques. This shift necessitates that banks in rural markets offer investment banking capabilities alongside the more traditional commercial banking skills. Customers are increasingly looking for new financial and risk management solutions to manage cash flow and pricing risk. At the same time, the increasing interest

of institutional investors offers the opportunity to develop new asset management products linked to the sector. These changes can also reinforce the need for larger banks to develop an overseas network and for smaller banks to seek a foreign partner. An overseas presence not only supports continued service to major customers as they expand internationally but also provides a platform for access to specialized capital markets, capabilities, and talent.

Winning in these new markets and business lines requires a mix of financial skills, a specific knowledge of the industry dynamics for those commodities, and the management culture to operate successfully in different markets. For example, in commodities risk management and hedging, Cargill—with its commodities expertise—competes with financial giant Goldman Sachs. Rural banks have a unique heritage that positions them well to play in these new markets,

### **Case Study: Rabobank, the Netherlands and International**

Rabobank, a collection of 183 local cooperative banks, has a long history of leadership in the Dutch agricultural sector, and as such can act as a model for similar cooperatives in emerging markets. It has more than 80 percent market share and competes as one of the top three players across broader retail and commercial sectors. Its network of 1,200 branches in the Netherlands ensures a ubiquitous local presence.

Through focused acquisitions of rural banks abroad, Rabo has also consciously adopted an international strategy based on food and agribusiness. In doing so, it has built a wholesale branch network covering the main trading locations of selected food industries—for example, it is active in all of the world's major dairy-exporting countries.

Finally, Rabo's approach to international food and agribusiness makes a point of encompassing the entire value chain. This strategy ensures that Rabo is active in each step: farm inputs, agriculture itself, processing, trade, and retail and food service activities.

drawing on their experience with agriculture. Of course, they also face substantial challenges in moving into new business lines. In particular, the fast-moving and risk-taking culture required for success is often very different from the more consensus-based, cooperative style of decision making used by many rural banks. To balance the risk taking, more sophisticated risk management capabilities are needed too. Finally, capital is important in taking proprietary positions—making this an opportunity best suited to the larger rural banks.

The past decade has seen rapid growth in the infrastructure investment sector around the world, stimulated by underlying growth in demand and the deregulation and privatization of the sector. Macquarie, the

Australian bank, has built a distinctive, rapidly growing, and highly profitable business on the basis of this growth in infrastructure. It acts as advisor to clients, raises funds from third-party investors, and then manages the funds, invests its own capital, lists securities and funds, and develops many innovative financial products. In short, Macquarie has developed multiple revenue streams by identifying different financial needs along the infrastructure value chain, while maintaining a tight control on risk. As developing economies acquire ever larger and more diverse appetites for food, and governments and farmers alike seek to raise the productivity of their rural sectors, who will bring risk-controlled innovation to the agricultural sector?

## Conclusion

Over the past 20 years, rural banking often remained in the shadows as banks focused on opportunities in urban markets and the corporate sector. This is now changing. The globalization of the countryside is just beginning. And it is bringing the tools and techniques that banks need to develop sustainable and profitable businesses. Rural Banking 2.0 provides a new platform for business development. Renewing sustainable community-focused banking, expanding and enhancing network value, evolving from banking to financial solutions—every bank must develop its own distinctive business on this newly attractive platform.

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