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CASES

# AGROBANK

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Charting a New Path to  
Sustainable Growth



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Website: [www.cambridge-ifa.com](http://www.cambridge-ifa.com)

Tel: +44 (0) 207 078 7297

Email: [info@cambridge-ifa.com](mailto:info@cambridge-ifa.com)

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# A CASE STUDY ON AGROBANK: CHARTING A NEW PATH TO SUSTAINABLE GROWTH

Flipping through the latest data on the bank's performance, Wan Mohd Fadzmi Wan Othman, President and CEO of Agrobank, found himself recounting the excitement leading up to this moment. Agrobank had just completed its first phase of transformation and is now all geared up in rolling the second phase. Since joining Agrobank in 2011, Wan Mohd Fadzmi has been at the forefront of the bank's transformation journey, which hasn't been easy especially when dealing with legacy issues. It is a journey requiring commitment, a mindset shift and significant amount of effort as well as full participation in pursuit of a compelling transformation vision. In fact, the transformation journey was an extension of the strategic direction taken back in 2008 when Agrobank was corporatised and rebranded from Bank Pertanian Malaysia Berhad (BPMB) to its present name.

Agrobank's transformation was not an ordinary one. It also entailed conversion of the bank into a full-fledged Islamic bank, making the entire transformation exercise even more complex and dynamic. This is nothing short of a Herculean task, a task that would see Wan Mohd Fadzmi and his team grabbing the bull by its horns because inherent in all challenges are opportunities for success.

Wan Mohd Fadzmi was happy to see the numbers presented in front of him. Clearly, these numbers reflected the positive outcomes of the strategies implemented thus far. Armed with over 46 years of experience spearheading Malaysia's agricultural banking, Agrobank is now charting a new path to sustainable, profitable growth. Wan Mohd Fazmi is confident that Agrobank will realise its vision to be a leading bank with a focus on agriculture.

However, he still faced many of the problems common to organisations embarking on transformation. How do you sustain organisational energy during the transformation journey, maintain the sense of progress after changes are put in place, and match a shift in strategy with a shift in culture? These questions lingered on his mind as he picked up his pen and turned his attention back to the numbers placed before him.



## Early Days as BPMB

Agrobank was established in 1969 under the name Bank Pertanian Malaysia Berhad or BPMB (Agricultural Bank of Malaysia) by the Act of Parliament, Bank Pertanian Act No. 9/69 with an authorised capital of RM50 million and paid-up capital of RM42 million. Being a government-owned bank, BPMB is 100% owned by the Ministry of Finance (MOF) and is under the purview of the Ministry of Agriculture and Agro-Based Industry (MOA) as the ministry responsible for the development of agricultural policies. Hence, the bank's financing of the agricultural sector is driven by policies set forth by MOA. As a development finance institution involved in financing agricultural sector in Malaysia, the main function of the bank is to co-ordinate and supervise granting of credit facilities for agricultural purposes and mobilise savings, particularly from the agriculture sector and community. Formed in line with the Malaysian government's policies to promote sound agricultural development in the country, the bank is actively engaged in supporting a number of special government projects through lending operations.

Its maiden project financing was the massive irrigation scheme for the rice bowl areas in the Muda Valley in the states of Kedah and Perlis, located in the northern part of peninsular Malaysia. The irrigation project was to accommodate double cropping for paddy planting in line with the recommendations set forth by the World Bank in their appraisal report, which also proposed for the establishment of a special credit scheme to support the project implementation. The launching of its two maiden branches in Kedah and Kelantan marked the beginning and development of BPMB in its pursuit to provide credit assistance services to farmers.

By 1980, BPMB emerged as the largest credit services provider to the rural agriculture sector. The bank had established credit schemes for paddy production, tobacco production, crop loans, livestock as well as fisheries in support of the government's agricultural agenda. Starting with only two branches in 1970, BPMB had rapidly expanded to 49 branches throughout the country by 1985. Over ten years since its inception, BPMB had approved RM642 million loans, mainly for paddy producers and the tobacco industry.

## Agribusiness and its Increased Importance

Agriculture is one of the main economic activities of the Malaysian economy, although contribution of agriculture to the gross domestic product (GDP) has been declining since 1970 from 28.8% to 9.2% in 2014.<sup>1</sup> The decline of agriculture's contribution to national income is a normal phenomenon in the cycle of economic development. However, in terms of absolute value, it has increased from RM51.3 billion in 2010 to about RM58 billion in 2014, predominantly attributable to high value creation as a result of successful government policies and foreign direct investments in other sectors.

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1. Malaysia Economic Report (2013/2014)

Since 1984, several agricultural policies have been formulated and implemented in Malaysia alongside the National Agricultural Policy (NAP). The first NAP was introduced in 1984, but the collapse of commodity prices a year later prompted a shift in the government's thinking and ultimately the decision to take Malaysia from an agricultural economy to an industrial one. With the enactment of the Promotion of Investments Act 1986, the country saw rapid expansion of the manufacturing sector, altering the relative importance of the agricultural sector. By the 1990s, the agricultural sector had slid to third place in terms of importance in the GDP, after manufacturing and services. Strong competition also existed between plantations and food production. More than 83% of agriculture land in Malaysia is planted with oil palm and rubber. Food production such as the planting of rice, vegetables and fruit, and livestock-farming account for less than 17%.

The second NAP (1992–2010), an extension of the first NAP, placed greater emphasis on the efficiency and productivity of agricultural enterprises based on rapid innovations in products and processes and expanded use of latest technologies. The policy outlined strategies for expanding food production, a greater role for the private sector, marketing reforms and accelerating agriculture-based industrial development.

The agricultural sector registered a sharp decline of 3.3% in 1998 as a direct impact of the deepening Asian financial crisis. The impact of the crisis was more severe in the food sector, as Malaysia is a net importer of most food items. The depreciation of the ringgit had led to an increase in the cost of production and the prices of food. In 1999, total imports of food in Malaysia amounted to RM10.5 billion compared to total exports of food of RM6 billion. The crisis had awakened the vulnerability of the agricultural sector to the need to increase food production and self-sufficiency, stabilise food prices and reduce food import bills of Malaysia.

The third NAP (1998–2010) was in response to this financial crisis with the primary objectives of reducing trade deficit in food and adopting sustainable development. Banking institutions, in particular BPMB, were expected to play an important role in the development of the food sector. Under the Eighth Malaysia Plan (8MP), BPMB was mandated to manage various agricultural financing schemes with the objective to enhance performance of the agriculture sector in the economy.

In the fourth NAP (2011–2020), agriculture has been identified as a National Key Result Area. Consisting of two components - the National AgroFood Policy and the National Commodity Policy, the agriculture sector is targeted to increase the Gross National Income by RM28.9 billion to reach RM49.1 billion and to create more than 109,000 job opportunities by 2020. The main thrust of the National AgroFood Policy is to address challenges in domestic and global markets to ensure sustainable production for food security and safety. Among the key objectives of the policy are high value and sustainable agriculture development, private sector investment to modernise the sector as well as knowledgeable and informed human capital. Programmes and initiatives outlined include increased food production through optimisation and sustainable



land, development and upgrading agriculture infrastructure and increase the quality and safety of food by expanding the compliance of standards.

The various policy changes as highlighted in this section demands greater role to be played by BPMB in providing ease of access to financing, particularly in priority industries as set out by MOA. It was indeed a daunting task with many challenges as the bank had to demonstrate its support for the unbankable and less creditworthy segments of the population while at the same time maintain good credit practices and financial performance.

## Trouble Brewing

BPMB's primary role was to strengthen and co-ordinate public sector credit programmes for agriculture in support of the government's policy to eradicate poverty among farmers and fishermen. Each year, the bank received administrative grants (which are mostly borrowings or soft loans) from the government to cover cost of lending to these target groups as credit was provided at low interest rate. BPMB was also providing two categories of facilities for financing the agriculture sector, namely commercial funds and concessionary funds. The latter were funds established by the government and were channelled to BPMB as the administrator of these funds aimed at boosting the national food production with a view of reducing the country's dependence on food imports. The objective of providing these financing facilities was to provide working capital for new agriculture initiatives and for the expansion of existing agricultural projects. These funds were considered as incentives to promote the agricultural sector and are usually in the form of low cost of financing, longer duration of financing period and higher margin of financing. Amongst the schemes administered by the bank were Fund for Food (3F)<sup>2</sup>, Special Agriculture Credit Scheme, Food Production Credit Scheme, Paddy Credit Scheme, and Oil Palm Loan Scheme to name a few.

In carrying out its mandate, many a times BPMB would extend its support to a specific segment of the community with the intention to develop more entrepreneurs to participate in the agriculture business. Inherently, agriculture business is riskier compared to other businesses due to various external pressures such as variation in pricing, adverse weather conditions and floods that have a direct impact on business performance and eventually loan repayment.

In its first two decades of operations, BPMB posted indifferent performance as a passive farmers' bank with low resource base and dependent on government grants for its loan operations as well as administrative expenses. The bank's overall loan repayment rate from 1986 to 1989 ranged between 35.2% and 43.9%. Due to low margins and poor recovery, as at end of 1988, the bank recorded a loss of RM46 million and suffered an even bigger loss of RM258 million in 1989. By the end of 1990, BPMB had an accumulated loss of over RM410 million. The customer base of the

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2. The 3F Fund, which is an easy credit facility with an interest rate of 3.75% per year, was formed by the government to encourage investments in the agriculture sector, specifically in the food production industry. Agrobank is the sole distributor of 3F.

bank had shrunk to 295,000 from a high of 650,000 in 1981. BPMB had also been suffering from excessive liabilities since 1989. The bank had appropriated RM100 million for reserves in 1988 and RM259 million in 1989. For both years the bank reported a deficit.<sup>3</sup>

Several measures were introduced in an effort to improve financial conditions including establishing new departments to handle commercial business, enterprises and retail lending in order to improve the quality of loans and introduce a unified system to manage all loan approvals while setting policy guidelines for high-quality loan appraisal. The bank also established a new department, in addition to the loan management department, to handle loans in arrears and implement measures to address the issue of bad loans in a timely manner in cooperation with state branches.

As the bank expanded its lending to primary agricultural development, it began to broaden its base of financial products and provided financing to both upstream and downstream agriculture businesses (food processing, canning and distribution) as well as non-mandated businesses (commodities, oil palm, rubber, pepper, cocoa, forestry).<sup>4</sup> However, the bank's focus for financing remained on increasing national food production in accordance with the National Agriculture Policy and reinforcing the government's efforts in achieving national self-sufficiency in primary food production. Total loans and advances increased to RM2,039 million whilst deposits stood at RM3,303 million by 1996. Whilst commercial banks were the primary lenders of industrial crops such as oil palm, rubber and cocoa; BPMB was more focused on financing food production and SMEs.

In its pursuit of financial inclusion by extending its geographical reach and broadening its operational scope, the bank's earnings performance began to weaken. The Asian financial crisis in 1997 proved to be financially disastrous for the bank as its loan quality deteriorated further and its bottom line suffered. As a result, loan repayment performance deteriorated, this leading to lower collections, high arrears and increase in non-performing loans (NPLs). At the height of the crisis, NPLs recorded a high of 37% of total loans in 1997, the highest for any financial institution in the country, and 24.5% in 1998. As a result, the bank was in the red after recording a loss of RM45.6 million in 1997 and RM150.1 million in 1998, compared to a profit of RM23 million in 1996 (Appendix 1).

With these losses, the deficit in the bank's shareholder's funds increased from negative RM126.4 million in 1996 to negative RM172.4 million in 1997 and negative RM295.6 million in 1998. The bank was also inundated with high expenses as total expenses increased by more than 30% due to increase in interest expense and the poor performance of the loan assets. Losses incurred were also attributed to decline in investment income, increasing cost of deposit and reduction of administrative grant from the government. Administrative grant declined from RM34.2

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3. The authorised capital of Agrobank was RM100 million and the paid-up capital was RM42.5 million.

4. Agrobank's mandated financing includes food crops, fisheries and livestock.



million in 1996 to RM6 million in 1997 and RM4 million in 1998 (see Appendix 2). Apart from the lacklustre financial performance, BPMB was facing organisational problems. Over the years, the bank's workforce had become lethargic and was unconcerned about the bank's poor financial performance.

Throughout these tough times, BPMB persevered and continued to demonstrate a strong link with farmers, providing them with access to credits. Various measures were implemented to promote agricultural development and improve its management of loans and investments. Priority was given to the provision of loans from special funds designed to stimulate growth in the agricultural sector, namely Fund For Food, Fund for Small and Medium Industries, Fund for Rehabilitating Small and Medium Industries, Mechanisation and Automation Loan Scheme, Bumiputra Business and Industrial Community Loan Scheme.

Loans selection became more stringent to improve loan quality. Whenever possible, problem loans were rescheduled and, if necessary, additional loans were given to rehabilitate the projects. In 1999, due to the improved business environment and the various measures taken, the bank recovered and made a profit of RM5 million, but recorded a loss of RM124.3 million in 2000 with provision for bad and doubtful debts recorded at RM148.9 million and net NPLs stood at 15% of total loans.

In terms of access to credit for the agricultural sector, BPMB continued to be a major source of funding for agriculture projects. Of the RM244 million allocation provided to BPMB by the government in 2002, 45.1% was disbursed through several agriculture credit schemes benefiting some 30,000 smallholders, fishermen, livestock rearers and farmers. Apart from credit facilities, the government also extended special financial assistance amounting to RM1 billion, in early 2001, to assist more than 400,000 rubber and oil palm smallholders adversely affected by the sharp drop in commodity prices.

By 2003, BPMB had 119 branches, 20 sub branches and 194 outlets of which 12 were state offices. In addition, the bank had a total of 4,300 mobile counters nationwide in schools, farmers' markets and settlements, mostly in rural areas. In order to increase the efficiency of its delivery system and to curb its rising NPLs, a hub system was implemented nationwide. Under this system, all credit activities were managed by state offices, including management of NPLs and legal actions. Branches were restructured to focus on increasing new loans, supervising active loans and mobilising savings. The same year also saw the introduction of microcredit programmes by the government aimed at meeting the financial needs of SMEs through microcredit stimulus package, whereby RM500 million was disbursed to BPMB. However, the imposition of an interest rate ceiling of 4% caused BPMB to incur high operational cost.<sup>5</sup>

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5. S.K Yow, 2006

While BPMB continued to provide financing support to the more established agriculture sector, such as oil palm, there was increased focus in 2004 on new areas of financing such as support services and agro-based processing industries. This was the direct result of the transformation of the agriculture sector as a dynamic and commercially oriented sector, which subsequently led to increased demand for credit as well as the participation of the private sector.

By 2004, the main sources of funding for BPMB were deposits mobilised through its network of 181 branches and 5,135 mobile units nationwide. Deposits mobilised increased by 8.7% to RM4.1 billion (as opposed to RM3.8 billion in 2003) accounting for 63.3% of total resources. Borrowings from the government, which were mainly for the various government financing schemes increased by 4.5% to RM1.6 billion.

## **The Road to Corporatisation**

The journey to corporatise BPMB was initiated by Bank Negara Malaysia in 2005. A Steering Committee chaired by the Governor was established and members consisted of representatives of the Economic Planning Unit, MOA, MOF, Public Service Department and BPMB (the Chairman was the member). This steering committee was aided by the Policy Committee and Technical Committee of BPMB. The move to corporatise the bank was taken in a bid to strengthen the bank's financial position, enhance capacity and capability to achieve improved effectiveness and competitiveness and subsequently, chart a new strategic direction for the bank.

Restructuring of the bank's operations and structure was necessary to allow for bigger capital as well as to widen the scope of its banking products, which was then limited to offering loans to farmers and entrepreneurs in the food-production industry. Although under the Bank Pertanian Act 1969, Agrobank was not allowed to lend to non-agricultural sectors or projects, borrowers may consist of all levels of agricultural production, from upstream fertiliser manufacturing to the downstream distribution of produce. With its corporatisation, the bank's scope of financing was further broadened and greater focus was placed on offering a wide range of banking instruments to include checking accounts, dealing in gold and foreign exchange and foreign trade financing. Thus, positioning the bank to play a more effective role in the development of agriculture in the new millennium.

The first idea was to rebrand. An external consultant was deployed to carry out the PR and rebranding exercise for BPMB, penetrate the market and create awareness among the public. This was to align with the objective of the new rebranding, which was to position the bank as a forward looking, modern and progressive organisation, and at the same time contribute to the growth and sustenance of the agriculture sector in Malaysia.

On 1 April 2008, the bank was corporatised with a paid up capital of RM1 billion when the House of Senate approved the Bank Pertanian Malaysia Berhad Bill, thus allowing it to operate



as a commercial bank for the agriculture sector. Following the corporatisation exercise, the bank was rebranded under a new corporate identity under the name Agrobank. This initiative was to highlight the bank to be more upfront and competitive, while at the same time retaining its socio-economic responsibility of developing the agricultural sector and contributing to the sector's growth and sustenance.

This was indeed a milestone in the history of the bank as the corporatisation enabled the bank to be more competitive with other commercial financial institutions by enhancing its capacity to lend and to offer a broader range and more innovative financial and non-financial products and services. It also provides the bank with a stronger footing to carry out its mandate as the implementing agency to support the agriculture and agro-based sector as well as to strengthen its role to be more effective in meeting the need of the entire value chain of agricultural activities.

Following 3 years after its corporatisation, Agrobank achieved commendable results despite the turmoil faced in the global economy at the outset of the global financial crisis in 2008. Net profit in 2011 increased to RM409.5 million; since the bank's corporatisation in 2008. The Return on Equity of 24.1% was well above the industry average and contributed to the overall improvement of the shareholder's fund from RM387.9 million in 2008 to RM2,251 million in 2011. In terms of lending operations, the loan approval and the gross loan assets had grown by 97.9% and 8.7%, respectively (Appendix 3). At the same time, the bank registered an overall improvement of asset quality.

## **Transformation Journey (2012–2016)**

In 2012, under the helm of the new President and CEO, Wan Mohd Fadzmi, Agrobank embarked on a much greater transformation journey that would see the bank progressively modernising its banking operations. "The bank needed to reposition itself given the dynamics of the food industry today. To carry out their roles effectively in the new millennium, banking institutions have to be strong, resilient and innovative in financing," said Wan Mohd Fadzmi. Hence, a 5-year strategic business plan was drawn up outlining strategic goals for the bank that would ensure Agrobank fully perform its mandated role of focusing on the agricultural sector and achieve business sustainability with a rational target of becoming a full-fledged Islamic bank by 2015.

These strategic goals are supported by key strategic drivers that include exploring new business or growth areas, improving and enhancing processes, capitalising on technological enhancement, improving strategic alliances and rejuvenating human capital. As part of its transformation, Agrobank has steadily expanded its financing solutions to the entire agriculture value chain, i.e. from farm to table. This comprises both upstream and downstream activities ranging from production, processing, storage, marketing and services. "As a bank that understands agriculture better than other players in the financial system, Agrobank is better positioned to provide a comprehensive financing solution for agriculture across the whole value chain that includes financing for upstream activities such as the supply of agricultural production inputs to

downstream activities such as processing and selling of agricultural products to consumers,” said Wan Mohd Fadzmi.<sup>6</sup>

Conscious efforts were made to provide a full range of products and services in fulfilling client needs as well as meeting the products demand along the agriculture value chain. By end of 2015, a total of 44 new or enhanced products and services were launched, which included term financing, working capital financing, micro financing, new fee-based services such as motor takaful and will writing, diverse deposit products to cater for different customer age profiles and electronic banking services. Renewed efforts to forge strategic alliances with various agencies under the MOA were intensified through the establishment of the Strategic Alliance Task Force, which is tasked to spearhead inter-agency initiatives. Strengthening strategic alliances was deemed critical in providing greater opportunities for business expansion, something that has been lacking in the past.

The strategic business plan outlined 3 growth areas for the bank as set forth by MOA: (1) agro-based processing as the main source of growth, (2) industrial crop as the growth pillar for crop financing and (3) poultry as the main source of growth for livestock. In line with the DAN, the bank also places greater emphasis on food crops financing. As of September 2015, Agrobank contributed about 23.8% or RM2.69 billion of financing to the primary agriculture (food) production segment from a total funding of RM11.28 billion, which represented almost one fourth of the market share of primary agriculture (food) financing in the banking system.

In striving towards meeting its mandated role of financing the agriculture sector in line with government policies, namely the National Agrofood Policy 2011-2020 (DAN) and National Commodities Policy (DKN) 2011-2020; the bank's mandated financing increased to 82% in 2015 from 69% in 2012. After its corporatisation in 2008, Agrobank intensely pursued non-mandated business up to a point where non-mandated had outgrown its mandated business portfolio. The agreed threshold was 70:30 where 30% was the maximum allowable non-mandated portfolio composition. In 2010, personal banking contributed 45% to Agrobank's loans/financing balance whilst 40% was from Agro banking and 15% from business banking. A cognisant decision was taken by the management to sustain growth in mandated financing.

In support of Bank Negara Malaysia's financial inclusion agenda, Agrobank proactively broadened its rural network, expanded utilisation of its electronic banking platform and provide a full range of services such as affordable credit, savings and remittance services. In 2014, Agrobank launched a new banking platform called "AgroAgent™" to widen its reach in providing basic banking facilities especially to the underserved segments of the population in rural areas. Agent banking, known as "AgroAgent™", is a cost-effective way for the bank to expand its reach to provide services in rural areas with appointed agents under the agencies of the MOA. "AgroAgent™" will allow the bank

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6. Positive Outlook for Agriculture, Bernama, 30 December, 2015.



to leverage on its technology platform to provide innovative banking products and services to all," explained Wan Mohd Fadzmi. Under such service, Agrobank will appoint authorised banking agents to provide basic banking services of accepting deposits and facilitating withdrawals. Other basic banking services that can be provided by the agents are fund transfers, bill payments and mobile top-ups. Although this concept was not entirely new in Malaysia, Agrobank's approach was different in that it focuses its expansion only with structured establishments and entities under relevant agricultural agencies such as agricultural cooperatives.

Increased competition and sophistication of customers require that Agrobank rethinks and designs processes, procedures, products and services that are cost efficient and effective with the aid of technology to remain competitive and profitable. In light of these market realities, Agrobank also implemented a branch model re-engineering (BMR) in 2014 that would contribute to a more simplified and systematic processes to allow the bank to effectively optimise internal processes. The bank also conducted an internal operational review of its branches and departments with a view of assessing the effectiveness of the bank's internal operating processes on a regularly scheduled basis.

More emphasis was placed on implementing rigorous credit evaluation standards, imposition of prudent and tighter guidelines and strengthening credit processes and procedures in an effort to improve financing quality and sustainability, particularly the pre disbursement condition precedent. As a result, the bank recorded improvement in quality of loan assets as reflected in the lower gross impaired financing ratio from 22.1% in 2010 to 9.3% in 2014.<sup>7</sup> The 5 year strategic plan also aimed at reducing the bank's dependency on government fund assistance through greater deposit mobilisation. The target ratio of government funds to depositors' funds of 24:76 was set forth by 2016.<sup>8</sup>

Since its corporatisation, Agrobank has accelerated its offering of Islamic banking products and services under its Islamic banking window. Agrobank's transition to a full-fledged Islamic bank is seen as a positive development based on the rapid growth of the Islamic banking sector in Malaysia. This transition is in line with the government's target to increase Islamic financing up to 40% of total financing by 2020. With this transition, the bank is now able to provide Islamic banking products and funding to cater for the halal food industry. Operating as a full-fledged Islamic bank, Agrobank aims to provide Shari'a-compliant products and services to the agriculture community as well as supporting the government's initiative to establish Malaysia as a global hub for Islamic finance and the halal industry. "The bank's transformation into a full-fledged Islamic bank was implemented in stages from 2012 onwards," explained Wan Mohd Fadzmi. "It is our aspiration that with such transformation, customers will be more confident to take up financing and deposit products based on Islamic principles with us." By 2014, Agrobank had successfully converted 100% of its deposits to Islamic, while 80% of the financing portfolio was successfully

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7. The targeted gross impaired financing ratio for 2015 and 2016 is 5.54% and 4.16%, respectively.

8. The ratio of government funds to depositors' funds for 2014 was 26:74.

converted to Islamic.

With the increasing concern surrounding the shortage of food and climate changes, the Malaysian government, in its bid to cut down export of produce from the international market, had included the agriculture sector as one of the National Key Economic Areas (NKEA) to revive and develop the industry. "We believe that by offering Shari'a-compliant financing, Agrobank will give more confidence to entrepreneurs, food operators and customers to conduct their business in accordance to Shari'a principles," said Wan Mohd Fadzmi.

The transformation was not without its challenges and pains. The transformation was implemented across all areas of the organisation and this required the support of every individual in the company from the Chairman, board members, management and staff. "Even though the journey to be a full-fledged Islamic bank was very challenging - we take pride that our efforts and hard work contribute towards strengthening the Islamic economy," Wan Mohd Fadzmi explained. "Indeed it was a difficult process but one we needed to go through. No shortcuts were taken. Strategic delivery plans and outcomes were monitored. Project management with a crystal clear focus on outcomes is without a doubt integral for a successful project. We were fortunate to have had the full support of our board and commitment of the staff, which made the journey less daunting than otherwise it might have been. But most importantly, I was convinced that this was the right thing to do!" And indeed it was! In 2015, Agrobank took home the 'Upcoming Islamic Bank 2015' accolade by the Global Islamic Finance Awards (GIFA) for upholding Shari'a-compliant banking and elevating Malaysia in its efforts to be an established global Islamic financial hub.

## The Conversion Story

Islamic banking is not new to Agrobank as it had started introducing Islamic financial products back in 1997. Through the establishment of an Islamic Banking Unit with only 2 officers, the bank was offering customers 3 types of Shari'a-compliant products, namely savings (wadiah), project finance (bai bithaman ajil) and fixed deposit (mudaraba). The success of these products encouraged the introduction of a host of new Shari'a-compliant products. The Islamic Banking Unit was also expanded to become a department. In 1999, the Islamic division contributed almost a quarter to the bank's bottom line. By the end of 2001, Agrobank's Islamic banking operations registered a 700% increase in profit from RM400,000 in 1999 to RM6.4 million. Islamic banking's assets had also increased by 27.6% to RM384 million whilst deposits increased by 15.4% to RM344.7 million.

In 2002, Ar Rahnu (Islamic pawn broking) was offered after the bank entered into a memorandum of understanding (MOU) with Bank Kerjasama Rakyat Malaysia (Bank Rakyat) that paved the way for a two-way cooperation between them in extending the Islamic banking products, especially the Ar Rahnu scheme. This exchange of knowledge with Bank Rakyat would see Agrobank imparting its knowledge on project financing to Bank Rakyat in exchange for technical know-how on Ar Rahnu covering issues such as product briefing, training and implementation courses.



During this period, the bank had already stopped offering new conventional products and were focused more on developing and offering Shari'a-compliant financial products.

"The intention to develop and offer Islamic financial products and services had always been on the horizon. Many a times top management would discuss this in the board room but it never materialised until Datuk Sulaiman Daud took the chairmanship of the board," explained Lodz, who headed the Islamic Banking Unit during its formation years. "The full support from Datuk Sulaiman Daud was the vital step forward for Islamic banking in Agrobank," he said. Now with the full support from the board and top management, the journey towards the conversion of Agrobank into a full-fledged Islamic bank had begun with a target set for January 1, 2014.

However, this was short-lived when the bank's state of financial affairs deteriorated badly, which subsequently led to its corporatisation in 2008. Since the focus was on reviving the bank, any further progress on Islamic banking was dampened. "After the bank was corporatised, there was a sort of cooling off period for all activities related to the conversion. In fact, Islamic financing slowed down," said Lodz.

It wasn't until a year later in 2009 that the newly appointed President and CEO reinitiated the conversion plan. The first order of the day was to recruit Shari'a personnel and build up internal capability. A new proposal for the bank's conversion was also drawn up and presented to the management. Next was pairing conventional with Shari'a-compliant products with a focus on moving towards a new balance sheet growth. This was part of the gradual approach taken by Agrobank as the bank prepared for its conversion into a full-fledged Islamic bank. Product mapping was an integral part of product conversion where conventional products that could be replaced with Islamic financing were identified, and consequently offered to customers. For conventional financial products that couldn't be paired, these were declared as non-Shari'a assets.

Full conversion of the bank was accelerated in 2012 onwards when Wan Mohd Fadzmi took over the helm at Agrobank. The bank's focus was on offering Islamic financing products, system conversion process operations, conversion of existing loans and deposits as well as providing training and guidance to Agrobank's staff. In pursuing a more pragmatic approach to conversion, the first products that went through the conversion process were deposits and savings. This involved sending notices to existing customers informing them of the bank's intention to convert these financial products. For these products, no disputes were construed as acceptance of agreement for conversion. In the case of fixed deposits, conversion to investment account was done only after maturity. "In the letter, we informed our clients that even after the conversion the economic features of these products remain unchanged," explained Muhammad Yusri, Project Manager of the Full Fledged Islamic Banking (FFIB) team.

But not all existing products could be converted due to their inherent features. For example, the Agro2020 could not be converted due to its insurance element. "As no takaful company was willing

to co-finance Agro2020, the bank had to refund deposits for active customers as incentives," added Muhammad Yusri. "Then there was the issue of financing extended to companies involved in non Shari'a-compliant products such as tobacco and pork," said Hishamuddin Ab Hamid, Secretary of Shariah Committee. "As an Islamic bank, we couldn't finance such activities but we were also mindful of our mandate and virtue of being a development finance institution for agriculture, which obviously included livestock such as pork and agriculture product such as tobacco. So we collaborated with Hap Seng Credit and transferred all these loans to them without putting any financial burden onto our customers."

"The main challenge was the conversion of loans to Shari'a-compliant financing. This involved tracking down both clients and their guarantors and requesting them to enter into new financing contracts," explained Muhammad Yusri. In many instances, either the clients or guarantors had moved, which required the bank to track down every single one of them. It was a painful but necessary process as part of the conversion exercise. Sharing his personal experience, Hishamuddin Ab Hamid said, "Where customers and guarantors could not travel due to either health or other reasons, our staff together with our appointed lawyers would personally pay them a visit. All these were done to ensure that our customers are not burdened in anyway."

In order to make the process as efficient as possible to everyone involved, staff were equipped with the necessary knowledge on the benefits of Islamic banking and were ensured that they were able to explain such benefits to customers. However, for cases where customers or guarantors refused to sign on the new Islamic contract, such cases were transferred to headquarter (HQ) for further action. "We worked closely with the branches and our Shari'a champions. An open line of communication was always maintained in order to proactively identify and address issues," he added. "Our role at HQ was to facilitate our branches in addressing any issues that arose. Keeping their morale and spirits high fell on us at HQ. Many a times when our staff at the branch level encountered difficult customers who flatly refused to convert their existing loans, we would step in to deal with these customers."

Taking a soft approach, Agrobank would not push hard if customers in the end insisted not to convert their loans. "In such cases, we would respect their decisions and allow the loans to mature," explained Muhammed Yusri. By January 2015, the bank had successfully converted 96% of its existing non-Shari'a loans. "The 4% of loans that we were not able to convert for various reasons were taken off the balance sheet. However, the recovery process is still ongoing. We haven't written them off. Instead, any loans recovered are used for charity purposes for the benefit of the community at large," said Wan Mohd Fadzmi.

FFIB unit became the bridge between the branches and the HQ with Shari'a champions becoming the eyes and ears of the bank. "All assistant branch managers were appointed as Shari'a champions in their respective branches. Their primary roles were to be our eyes and ears on all Shari'a matters. They were given direct access to our Shari'a department so that they could seek



advice from HQ when in doubt. Most importantly, we ensured that they were not penalised for reporting non-compliance,” said Hishamuddin Ab Hamid.

In order to ease the conversion process on the part of the customers and ensure that in the process they were not financially burdened, all costs pertaining to the conversion were fully absorbed by the bank. The bank would bear all related costs incurred by customers and guarantors in traveling to the bank to sign the new Islamic contract. No expenses were spared. The bank also ensured that balance and instalment amount remained unaffected even after the conversion process. Customers were also given enough economic reasons to ensure that they agreed to convert their existing loans. “For corporate customers, for example, they were given 10% rebate or RM3,000 whichever is the maximum as an incentive to convert their loans to Islamic financing. No additional costs of conversion were imposed on our customers,” explained Muhammed Yusri.

To ensure the whole conversion process was done smoothly, Agrobank had in place a control factor whereby all documentations pertaining to conversion of products and loans including disbursement of conventional to Islamic financing were done only at the HQ. This meant that branches and HQ had to work closely with each other with strong coordination. Any delays in processing due to lapse in communication and lack of coordination would result in costly reworks and delays in disbursements. “Processes had to be robust. Goals had to be clear. And the correct tone needs to be set by management. Walk the talk, as you say...,” stressed Wan Mohd Fadzmi.

## **A New Model of Islamic Banking**

Agrobank is a bank with direct involvement in the real economy – something that has been emphasised by the proponents of Islamic banking right from the beginning and what remains a challenge in Islamic banking and finance. Other high street banks in Malaysia – both Islamic and conventional – primarily focus on the consumer banking and corporate segments. Agrobank, on the other hand, targets farmers and other businesses related with agriculture to ensure that the government’s development agenda and its policy of financial inclusion are implemented. “Innovation and product diversity are integral to the further development of Islamic banking and finance. Since Islamic banking mainly focuses on asset financing, there is a dearth of products to cater for different financial needs of business, particularly the SMEs,” stated Wan Mohd Fadzmi.

In order to cater for this growing demand, Agrobank provides a wide range of financial products and services including trade finance for SMEs in the agricultural sector. Other products and services are in the areas of consumer banking, business banking, electronic banking and deposit services including Hartani-i, AgroCash-i, MAEF-i and Ar Rahnū. In 2014, Agrobank accounts for 32% of financing provided to Malaysia’s food production sector, a vital sector in the gross domestic product (GDP) of the country. Emphasizing on the importance of food, Wan Mohd Fadzmi commented, “Food is synonymous with agriculture sector and halal factor is essential to the Muslim community. After the conversion to a full-fledged Islamic bank, we are able to provide Islamic banking products and funding to complete the cycle of halal food production.”

There are numerous companies engaged in halal businesses – from large to small and medium size enterprises, which receive banking facilities of different types from Agrobank. As a development finance institution, Agrobank provides an example of cooperation between banking and finance and the real economy – all in a Shari’a-compliant way. With the Muslim population reaching 1.8 billion and growing, this will further propel the halal economy, which stands at a current worth of US\$2.3 trillion. This includes Islamic banking and other halal components, of which US\$700 billion is from halal food. “Our vision is to position Agrobank as an enabler in the halal industry by providing Shari’a-compliant food-based financing. This completes and complements the halal food value chain,” stressed Wan Mohd Fadzmi.

### **Cultivating the Culture of Teamwork and Excellence**

For the transformation agenda to be successful, common organisational vision must reach out to all employees, loud and clear. “Employees are the backbone of any organisation. The direction the bank is taking would be meaningless if they are not aligned to the organisation’s vision,” said Mohamad Taufik Mahamad Zakaria, Head, Corporate and Strategic Planning Department. Several human capital development initiatives were introduced aimed at developing the capacity and capabilities of staff. These included providing comprehensive training to all staff to enhance their understanding of Islamic banking as well as ensure they are ready to embrace the new culture that comes with the transformation exercise. “Our focus will still remain in the agriculture sector. We’re in the midst of a ‘find and shine’ process to tap our employees’ talents and capabilities,” explained Wan Mohd Fadzmi.<sup>9</sup>

A road map was also developed following the conversion of the bank, which outlined progressive steps over a 2 year period that will build deeper understanding of Islamic banking amongst the staff. “All staff will need to undergo training which covers conceptual Shari’a up to technical knowledge of the bank’s products. They will also be tested to ensure they attain sufficient knowledge in Islamic banking,” said Mohamad Taufik. “When staff embrace Islamic banking, this will have a trickle effect in promoting Islamic banking to customers.”

“Successful transformation of Agrobank into a more competitive organisation also requires a shift in mindset. We could no longer accept how things were done in the past but rather strive to ride the wave of innovation and improve business operations,” explained Mohamad Taufik. A particular shift in mindset was needed amongst employees who were used to receiving grants and soft loans on a silver platter from the government giving the perception that there was no pressure or compulsory to collect. “Time had changed and employees needed to understand that the bank has to be competitive to remain relevant,” said Mohamad Taufik. This meant that every single bank personnel must be on board with the transformation and understand that the bank has to be competitive to thrive in a new economic and financial landscape. This involved constant communication with employees.

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9. Business Times, September 23, 2011.



Senior management would travel to different states to host numerous engagement sessions and roadshows with the bank staff. "Transparency is key to getting everyone on board the journey. Our President wanted to ensure that all staff were aware of what was happening. Interactions with them allowed us to better understand the concerns and problems they faced as we continue to design and improve our organisational strategy to make it more holistic," said Mohamad Taufik.

When the transformation programme was first introduced, it was indeed a bold measure on part of the management team as it threatened the status quo of long ingrained culture of inefficiency, bureaucracy and complacency. "Our leaders were steadfast and willing to make difficult and unpopular decisions to create a deep and lasting changes for the long term benefit of the bank," said Muhammed Yusri. "There were instances where our Shari'a Committee's decisions affected the bank's bottom line. But management abided to the rulings as they took a long term view on the bank's performance," shared Hishamuddin Ab Hamid.

"Part of the transformation agenda was changing the work culture, overcoming bureaucracy, introducing performance-based compensation system and investing in technology. The seniority-based promotion that was entrenched in the bank for so long was replaced by a performance-based and merit-based incentive system," Wan Mohd Fadzmi explained. But this was done progressively. "Culture change can't be forced, rushed or sped up. It is an ongoing journey – a journey that requires leaders to understand the current state of the organisation, establish a clear vision, align behaviours and instil accountability."

## 2016 and Beyond

With the success of the first phase of transformation, Agrobank began embarking on the next phase with a focus on six strategic areas – effective stakeholder engagement, effective intermediary function, sound and sustainable operating model, high performing and sustainable organisation, sound and prudent financial management and capacity, and centre of excellence in agriculture sector. The business focus for 2016-2020 is two-pronged: (1) to provide comprehensive financial access to agriculture community in line with the aspiration to be the leading financial institution with a focus on agriculture sector, and (2) to pursue greater diversification by retaining the bank's market share in the agrofood whilst expanding its presence in the agro-based industries.

At present, the bank's mandated financing portfolio consists of 92% primary agricultural and 8% agro-based, where 51% of total financing was channelled to primary agriculture. By 2020, the bank aspires to achieve 82:18 in terms of composition of primary to agro-based. The mandated financing portfolio is targeted to grow at an annual growth rate of 12.6%, which would realise Agrobank's aspiration of increasing its mandated share from the present 7.9% to 11.1%.

As Wan Mohd Fadzmi reviewed the report in preparation for the upcoming executive meeting, he is both excited and intrigued to see Agrobank successfully completing the first phase of its

transformation journey. Much has been achieved but there is a deep awareness that much still remains to be done. Agrobank today is the largest financier for primary agrofood segment with 23.8% market share. Its mandated financing continues to record strong growth, rising from 69% in 2012 to 82% in 2015. The bank registered profit before tax of RM197.8 million in 2015, surpassing the budget of RM155.7 million. It also achieved the highest growth rate of 9.2% in 5 years with an average of 6% per annum. Asset quality has improved significantly from a double digit high of 22.1% in 2010 to 6.4% in 2015. In terms of its role in providing inclusive finance, Agrobank is playing a prominent role in increasing the financial inclusion in the country through its 175 AgroAgent and 189 branches and kiosks nationwide with 71% located in rural areas.

Agrobank's work in the financial inclusion space is also being recognised internationally. In early 2016, the bank received an award by the Association of Development Financial Institutions in Asia Pacific (ADFIAP) for its outstanding work in financial inclusion particularly to the agriculture community and underserved segment. In May 2016, Agrobank bagged the 3G Financial Services Award at the Global Good Governance Awards held in Istanbul in recognition of the bank's commitment and outstanding contribution in financial inclusion and initiatives undertaken to broaden access to finance.

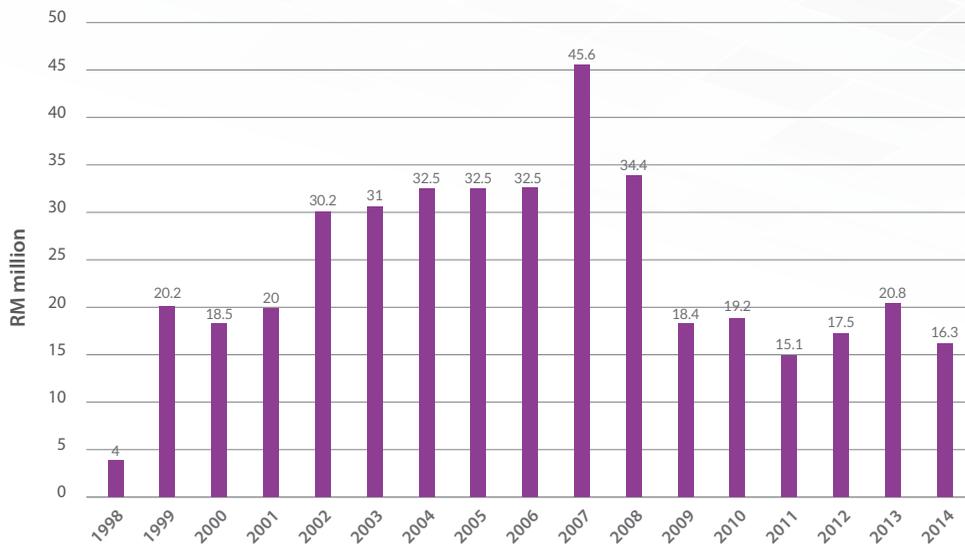
Looking back and trying to draw up some kind of overview of what has been done and what results have been achieved, he is mindful of the need to look at the present challenges and try to look at possible future strategies. "The GDP for the agricultural sector is projected to reach RM93.2 billion and the figure is estimated to reach RM110.7 billion by 2020," read Wan Mohd Fadzmi quietly to himself, before turning over the page of the report and then nodding his head with the greatest determination.



## Appendix 1: Five Year Financial Highlights 1994–1998 (Year Ended 31 December)

	1994	1995	1996	1997	1998
<b>Statement of Income &amp; Expenditure (RM million)</b>					
Income	279.4	296.1	379.2	362.2	388.5
Expenditure	246.6	271.4	358.8	407.8	510.9
Profit/(Loss)	32.8	24.7	20.4	(45.6)	(122.4)
<b>Balance Sheet (RM million)</b>					
Total Assets	2,918.1	3,975.6	4,098.2	4,425.4	4,357.3
Loans and Advances	869.1	1,126.2	1,465.8	1,563.5	1,471.3
Investment Assets	899.9	1,902.9	1,661.7	2,206.2	2,403.8
Total Deposits from Customers	2,275.5	3,244.4	3,303.5	3,660.2	3,752.6
Long Term Loans	613.5	614.1	600.8	600.7	612.3
Shareholders' Funds	(164.7)	(146.4)	(126.4)	(172.4)	(295.0)
<b>Financial Ratio/Productivity Indicator</b>					
Profit/Average Assets (%)	1.12	0.71	0.51	(1.06)	(2.78)
Profit Per Staff (RM'000)	14.8	10.0	8.0	(18.1)	(50.2)
Emolument Cost Per Staff (RM'000)	17.3	18.2	23.4	20.9	21.6
Overhead Ratio to Staff Cost (%)	97.2	95.6	82.6	103.2	103.8

## Appendix 2: Government Grants Received by Agrobank (RM million)





### Appendix 3: Financial Highlights 2010–2015 (Year Ended 31 December)

	2015	2014	2013	2012	2011	2010
<b>Profitability (RM Million)</b>						
Operating revenue	791.3	760.7	889.1	1,057.5	768.2	858.4
Operating profit	200.6	204.5	338.3	410.0	305.3	449.4
Profit before tax and zakat	165.0	192.6	319.3	355.4	376.6	376.8
<b>Key Statement of Financial Position Data (RM Million)</b>						
Total assets	12,292.7	11,996.0	11,138.7	11,461.4	12,111.1	10,570.4
Loan, financing & advances (net)	6,986.7	6,293.3	5,850.2	5,867.6	5,456.4	4,804.6
Total liabilities	9,803.4	9,545.8	8,789.3	9,136.1	9,943.0	8,683.2
Deposits from customers	7,040.7	6,854.3	6,594.6	6,863.2	7,546.5	6,452.8
Shareholders' equity	2,484.4	2,450.2	2,349.4	2,325.3	2,168.1	1,887.3
<b>Financial Ratio (%)</b>						
Return on equity (before tax)	6.6	7.9	13.6	15.3	17.4	20.0
Return on average ratio (before tax)	1.3	1.6	2.9	3.1	3.1	3.6
Cost to income ratio	66.7	62.7	50.0	45.4	44.1	38.2
Financing to deposit ratio	78.9	74.9	76.0	74.4	64.5	66.8
Gross impaired financing ratio	6.6	9.3	10.0	12.4	14.7	22.1
Risk-weighted capital ratio	32.5	34.3	35.7	33.7	28.2	20.0





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