

**MANAGEMENT RESPONSE TO THE PROJECT PERFORMANCE EVALUATION
REPORT FOR THE RURAL MICROENTERPRISE FINANCE PROJECT
IN THE PHILIPPINES (Loan 1435-PHI[SF])**

On 4 August 2006, the Director General, Operations Evaluation Department, received the following response from the Managing Director General on behalf of Management:

1. Management agrees with the overall findings and assessment of the report, which rated the Project as successful. The combination of sound project design, conscientious and flexible implementation, and regular monitoring are largely responsible for this result. At the same time, we note certain limitations in the evaluation's methodology, and we consider that the evaluation may overstate the degree to which microfinance development in the Philippines can be attributed to the Project.

A. General Comments

2. The Project provided two credit lines (one for training and institution building and one for onlending) to be channeled through the People's Credit Finance Corporation (PCFC) to financial institutions using the Grameen Bank Approach for making microfinance loans. While the experience of ADB and other development agencies in establishing credit lines for onlending to targeted groups has met with mixed results, the credit lines in this Project appear to have had a positive impact on PCFC, intermediate financial institutions,¹ and clients. This success can be attributed to a mostly appropriate design, along with flexible implementation that allowed design flaws to be corrected early in implementation. Such flexibility and design changes can, in turn, be attributed to ongoing monitoring by the Government's executing agency and ADB.

3. The project design emphasized the catalytic effect that a wholesale credit line can have on financial institutions that make, or have the potential to make, microloans. In particular, it made the credit line available only to microlenders that met certain reporting and performance requirements, thus giving an incentive for NGO and cooperative microlenders to upgrade their operations and institutional capacity. Moreover, the credit line for onlending was combined with technical assistance and a credit line for institutional strengthening. At the same time, key changes in Project design occurred earlier, enhancing the effectiveness of the Project. These included (i) permitting financial intermediaries to use modifications of the Grameen Bank Approach rather than being limited to this one particular institutional form, and (ii) expanding the pool of financial intermediaries beyond the original target of NGOs and cooperatives to include rural banks and thrift banks. This second change appears to have catalyzed an increased interest in rural banks and thrift banks to provide microfinance services

¹ The PPER uses the term microfinance institutions (MFIs) when referring to the financial intermediaries that borrowed from PCFC and then made microloans to their clients. However, many of these so-called "MFIs" were rural banks and, therefore, are not MFIs as this term is generally understood.

as part of their portfolio of products and services, thus integrating microfinance with the formal financial sector. The Project also appears to have contributed to enhancing the policy environment for microfinance, particularly through the loan covenants to (i) prohibit interest rate ceilings, and (ii) prepare a time-bound plan to improve the regulatory environment.

4. While we concur that the project was a success in achieving its objectives and contributing to the development and outreach of microfinance in the Philippines, ADB should remain cautious in interpreting the reported results of this Project and replicating this design in other developing member countries. The Project Performance Evaluation Report (PPER), unfortunately, does not address the possibility that the credit lines crowded out other sources of commercial finance, including savings mobilization. Moreover, the PPER appears to be overly generous in attributing some aspects of sector development to this Project. For example, the PPER claims (as does the Project Completion Report²) that 618,906 poor clients gained access to financial services by December 2002, compared to a project target of 300,000 poor clients. However, these 618,906 clients appear to represent the entire microfinance clientele of financial institutions that borrowed under the credit lines, not necessarily the incremental clients due to the Project. Similarly, the PPER attributes the start-up and expansion of 505 branches using the Grameen Bank Approach to the Project, while such attribution cannot be clearly established. Furthermore, while we note the loan covenants referred to in para. 23, the evidence indicates that the Philippine Government was already committed to significant reforms and improvements in the policy environment, and the legislation (e.g., the General Banking Law of 2000) and central bank circulars went considerably beyond the soft conditionality of these loan covenants. While the PPER attributes most of the sector's development to the Project, and particularly the catalytic effect of the credit lines, it may be more likely that the sector's development benefited more from the improved policy and regulatory environment. This is the likely explanation, e.g., for the fact that the credit lines accounted for only 19% of project costs (compared to an original target of 54%) and financial intermediaries accounted for 76% (compared to an original target of 24%).

5. We would, however, emphasize that our methodological and interpretational reservations are only a matter of degree. It does appear that the Project played a catalytic role in upgrading the operational efficiency and capacity of NGO and cooperative lenders, in bringing formal banks into the microfinance sector, and in enhancing the enabling environment for microfinance in the Philippines. In this respect, although the Project was designed before the adoption in 2000 of ADB's Microfinance Development Strategy,³ it is consistent with the Strategy's emphases on (i) using ADB loans to catalyze sector development, (ii) enhancing the enabling environment for microfinance, and (iii) focusing on the development of sustainable, market-oriented microfinance institutions. As such the Project and its success provide valuable lessons to inform future microfinance initiatives.

² ADB. 2005. *Project Completion Report: Rural Microenterprise Finance Project (Philippines)* (Loan 1435-PHI[SFI]). 14 February. Manila.

³ ADB. 2000. *Finance for the Poor: Microfinance Development Strategy*. Manila.

B. Specific Responses to OED Recommendations

6. OED made five recommendations for ADB consideration. Management generally concurs with the recommendations. ADB will continue its dialogue with the government agencies and the institutions responsible for the follow-up of the recommended actions and monitor their progress. Management's responses to OED's recommendations are given in the following table.

Recommendations	Management Response
1 & 2. Strengthen the Capital Base and Governance Structure of PCFC.	Management concurs. The likely mode of achieving this will be for a government financial institution (GFI), e.g., the Land Bank of the Philippines, to buy out and take over PCFC. As a GFI subsidiary, PCFC will be subject to less political interference and greater supervision as it will fall under the supervisory authority of the central bank.
3. Develop an effective monitoring system to oversee savings mobilization of NGOs.	Management concurs. Under ADB's Loan 2199-PHI: Microfinance Development, approved on 22 November 2005, the Philippine authorities will develop and adopt a regulatory framework for MFIs to promote financial soundness of the microfinance sector, protect small clients, and promote the establishment of an accurate, reliable, and transparent set of financial information for all types of MFIs. This framework will include NGOs and cooperatives.
4. Enforce performance standards for cooperatives and NGOs.	Management concurs. As noted in our response to the previous recommendation, a regulatory framework applicable to cooperatives and NGOs is being developed and adopted. Enforcement will be supported by a project financed by the Japan Fund for Poverty Reduction. This project is designed to develop monitoring and regulatory capacities of the Cooperative Development Authority, and provide capacity building of the savings and credit cooperatives sector for efficient and sound operations and financial services to the poor. Monitoring of loan conditions by the Government and ADB is expected to enhance enforcement of the NGO regulatory framework and reporting and performance standards.
5. Develop a cost-effective monitoring and evaluation system.	Management concurs, with qualifications. The PPER implies that MFIs should maintain data and monitoring systems that allow them to measure impact on their clients. However, impact measurement is complicated by potential biases due to self-selection of clients and endogenous program placement by lenders. As such, it requires expertise not typically found in MFIs or necessary for MFI operations. Moreover, a rigorous impact assessment requires considerable data, most of

Recommendations	Management Response
	<p>which is useless for an MFI's regular operations. Importantly, as demonstrated by recent research,⁴ impact studies do not require "baseline" data, but can be based on cross-sectional data collected at a given point in time. We believe, therefore, that impact studies should not be the responsibility of the MFIs themselves, but should be conducted by outside specialists engaged by those who require them (e.g., government and donors).</p>

⁴ See, e.g., (i) Pitt, M., & Khandker, S. (1998). The Impact of Group-Based Credit Programs on Poor Households in Bangladesh: Does the Gender of Participants Matter? *Journal of Political Economy*, 106, 958-996; (ii) Coleman, B. (1999). The Impact of Group Lending in Northeast Thailand. *Journal of Development Economics*, 60, 105-142; (iii) Khandker, S. (2005). Microfinance and Poverty: Evidence Using Panel Data from Bangladesh. *World Bank Econ Review*, 19, 263-286; and (iv) Coleman, B. (2006). Microfinance in Northeast Thailand: Who Benefits and How Much? *World Development*, forthcoming.