

FINANCING FOR MICRO-ENTERPRISES, SMALL AND MEDIUM SIZED BUSINESS, AND POOR HOUSEHOLDS IN THE PHILIPPINES

*Mario B. Lamberte**

I. Introduction

Population in the Philippines currently stands at 76.5 million. With a population growth rate of 2.36 percent, which is well above the 1.3 percent world population growth rate, 1.8 million will be added each year to the country's population. Since the economy in the last 15 years has grown only modestly, the number of poor people inevitably keeps on rising. Thus, despite the fact that poverty incidence had declined from 49.3 percent in 1985 to 40 percent in 2000, the number of poor people had risen from 26.2 million to 31.3 million during the same period.¹ A great majority of the income earners of poor households are self-employed.

The 1998 Annual Poverty Indicators Survey (APIS) shows that 70 percent of poorest 40 percent of the respondents relied on entrepreneurial activities as main source of income. What is worth noting is that only 25 percent out of the 85 million families surveyed had obtained credit to finance their business.

There is no accurate information on the number of micro-enterprises, small and medium-sized enterprises in the Philippines because many of them do not register with concerned government agencies. Past and most recent statistics for manufacturing establishments alone suggest that some 90 percent are those with average total

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¹ In terms of families, poverty incidence declined from 44.2 percent in 1985 to 34.2 percent in 2000, or an increase from 4.4 million families to 5.2 million families.

employment of less than 10 workers. This does not include those in the agriculture and service sectors.

This economic landscape has not gone unnoticed by policymakers in the country. Since the country gained its independence in 1946 from the US, the government has put in place policies and programs to address the needs of small and medium enterprises and reduce poverty incidence. Financial policies and credit programs have been used as instruments for mobilizing and moving financial resources to micro-, small- and medium-sized enterprises (MicSMEs for short) and poor households. This will be the main focus of the discussion below.

The next section gives an overview of the entire Philippine financial system. Although this paper deals only with bank lending to MicSMEs and poor households, the overview helps in getting a clearer picture of the role of banking institutions in lending to the above-mentioned sectors. Section III discusses the existing policy framework and programs for bank lending to MicSMEs and poor households. A discussion on the current status of bank lending to MicSMEs and poor households is presented in Section IV. The last section analyzes the constraints facing banks, especially private banks, in lending to MicSMEs and also recommends some measures to address them.

II. Overview of the Philippine Financial System

The Philippine financial system consists of formal and informal financial sub-systems (**Figure 1**). The informal sector is composed of heterogeneous players, such as moneylenders, ROSCAS, etc. The formal financial sub-system can further be broken down into banking institutions, which are authorized to provide credit and accept deposits from the general public, and non-bank institutions, which are authorized to extend loans but are not permitted to accept deposits from the general public.

Non-bank institutions include government specialized financial institutions and non-financial institutions. The two largest pension fund systems, namely the Social

Security System (SSS) and Government Social Insurance System (GSIS), belong to the former. They provide housing and other small loans to their members. Another institutions that belong to the former are the specialized non-bank government institutions, which are created by law or administrative order for the purpose of providing credit to specific sectors. Examples are the Small Business Guarantee and Fund Corporation (SBGFC), which provides credit guarantee up to 100 percent of the loan and extends credit to small and medium enterprises, and the Quedan and Rural Credit Guarantee Corporation (QUEDANCOR), which provides credit-support mechanism for the benefit of farmers, fisherfolk, rural workers, cooperatives, retailers, wholesalers and agricultural processors and implements a guarantee system to promote inventory financing of agri-agra commodities, establishment of production and post production facilities and acquisition of farm and fishery equipment. Government non-financial agencies refer to regular government agencies, such as the Department of Agriculture, Department of Trade, Department of Labor and Employment, etc., and their attached agencies that implement various directed credit programs for the sectors they are mandated to serve.²

Both non-bank financial and non-financial government agencies obtain funds from the government and bilateral and multilateral donor agencies to finance their credit programs.

Private non-bank financial institutions, on the other hand, include insurance companies, investment institutions, finance companies, lending investors, trust companies securities dealers, pawnshops, etc.

The banking system is composed of the commercial banking system (universal and ordinary commercial banks), the thrift banking system (savings and mortgage banks, private development banks and stock saving and loans associations), the rural banking

² Lamberte et al. (1998) found out that 13 non-financial government agencies have implemented or managed at least 37 special or directed credit programs that were mostly inefficient and effective.

system, and government banks.³ These different bank categories are authorized to perform different functions (**Table 1**). Understandably, they have different minimum capital requirements commensurate to their authorized functions, i.e., those that are authorized to have more functions have higher minimum capital requirements than those that have limited functions (**Table 2**). Among the different bank categories, the universal banks are allowed to perform the most number of functions (both commercial and investment functions). At the other end of the spectrum are the rural banks, which are authorized to perform a limited number of functions.

As of December 2000, there were 16,676 offices (head offices, branches and extension offices) of the financial institutions in the country (**Table 3**). Of these, some 45 percent were offices of banking institutions. Over 50 percent of banking offices of commercial banks are concentrated in Metro Manila, while most banking offices of thrift and rural banks are located in areas outside Metro Manila. The offices of rural banks are widely dispersed in rural areas.

In terms of assets, the banking system overwhelmingly dominates the financial system. Its total assets as of December 2000 amounted to P3.3 trillion or 82 percent of the total assets of the financial system. The total assets of the commercial banking system stood at P3 trillion or 74 percent of the total assets of the financial system.

Going back to **Figure 1**, this paper will focus only on the banking system, which is only a part of the Philippine financial system that deals with MicSMEs and poor households.

³ Credit unions or credit cooperatives are not part of the system described above. Although they mobilize deposits from their members, they are not considered as part of the banking system. However, cooperative rural banks are a segment of the rural banking system.

III. Existing Policy Framework and Programs for Bank Lending to MicSMEs and Poor Households

This section discusses the government’s operational definition of MicSMEs and poor households and the elements of the policy framework and programs for bank lending to MicSMEs and poor households.

A. Operational definition

It is important for policy direction and for evaluating the effectiveness of policies and programs to have a common definition of MicSMEs and poor households. When dealing with farm enterprises, the Comprehensive Agricultural Reform Law provides an operational definition of what constitutes small farm enterprises. Since the retention limit for agricultural lands is 7 hectares, then small farm enterprises refer to those who own and farm 7 hectares or less. As regards MicSMEs, Section 3 of the Magna Carta for Small Enterprises (Republic Act No. 6977 as amended by Republic Act No. 8289) provides an operational definition. It states that “small and medium enterprise” shall be defined as any business activity or enterprise engaged in industry, agribusiness and/or services, whether single proprietorship, cooperative, partnership or corporation whose total assets, inclusive of those arising from loans, but exclusive of the land on which the particular business entity’s office, plant and equipment are situated, must have value falling under the following categories:

| | | |
|--------|-------------------|------------------------------|
| Micro | : less than | Php1,500,001 |
| Small | : PhP1,500,001 – | PhP15,000,000 |
| Medium | : PhP15,000,001 – | PhP100,000,000. ⁴ |

The same law authorizes the Small and Medium Enterprise Development Council (SMEDC) to periodically review the above definitions and, if necessary, adjust them

⁴ The exchange rate as of 16 November 2001 was PhP52/US\$1.

upon recommendation of sectoral organizations taking into account inflation and other economic indicators.⁵

In the context of the Social Reform and Poverty Alleviation Act (SRPAA) of 1997 (Republic Act 8425), the poor households refer to the “basic sectors”, which include the disadvantaged sectors of the Philippine society, namely: farmer-peasant, artisanal fisherfolk (i.e., municipal, small scale or subsistence fishermen who use fishing gears which do not require boats or which only require boat below 3 tons), workers in the formal sector and migrant workers, workers in the informal sector, indigenous peoples and cultural communities, women, differently-abled persons, senior citizens, victims of calamities and disasters, youth and students, children, and urban poor. It also defines microenterprise, which is any economic enterprise with a capital of PhP150,000 and below. This does not necessarily conflict with the definition provided under the Magna Carta for Small Enterprises because the latter defines microenterprise in terms of assets inclusive of those arising from loans, whereas the former defines microenterprise in terms of capital.

B. Elements of the Policy Framework and Programs

1. Banking Structure

Banks have the natural tendency to be large to exploit economies of scale and scope. In the process, they tend to shy away from small savers and borrowers because of the high transaction costs they will incur and lack of related businesses they can generate with them. Thus, a banking system that consists of a few large banks will likely force small savers and borrowers to go to the informal financial system. Recognizing this possible consequence, the Philippine authorities have structured a banking system that includes a sub-system that will cater to the needs of small savers and borrowers. The

⁵ When RA 6977 was passed in 1991, the definitions were as follows: micro – less than PhP50,000; cottage – PhP50,001 to PhP500,000; small – PhP500,001 to PhP5,000,000; and medium – PhP5,000,001 to PhP20,000,000.

thrift banks and rural banks are expected to perform such functions. Since most small savers and borrowers are located in areas outside Metro Manila, the Central Bank encourages thrift and rural banks to locate in these areas by requiring them low minimum capital requirements.

To improve the viability and competitiveness of thrift and rural banks that cater mainly to MicSMEs and poor households, the government has provided several incentives. One is that the reserve requirement ratio of their deposits is lower by 2 percentage points than that of commercial banks. Another is that they are exempt from the payment of all taxes, fees and charges of whatever nature and description, except the corporate income tax and local taxes, fees and charges, for a period of 5 years from the date of commencement of operations. These incentives enable thrift and rural banks to give higher interest rate on their deposits and lower interest rate on loans and, at the same time, to build up their capital.

2. Microfinance-friendly Policy and Banking Regulation

The SRPAA provides the policy framework for microfinance services for the poor. More specifically, it sets out the following thrusts:

- (i) Development of a policy environment, especially in the area of savings generation, supportive of basic sector initiatives dedicated to serving the needs of the poor in terms of microfinance services;
- (ii) Rationalization of existing government programs for credit and guarantee;
- (iii) Utilization of existing government financial entities for the provision of microfinance products and services for the poor; and
- (iv) Promotion of mechanisms necessary for the implementation of microfinance services, including indigenous microfinance practices.

One of the lessons of the East Asian financial crisis is that banks must be well-regulated and adequately supervised. However, new prudential regulations, if applied uniformly to all types of banks, could further force banks to ration out small borrowers. Thus, the newly passed General Banking Act tries to achieve a balance between the objectives of tightening up prudential regulations and ensuring the flow of financial services to MicSMEs and poor households. Such law includes 3 provisions that touch on microfinance, especially on issues regarding collateral-based lending, unsecured loans, interest to be paid by microfinance borrowers and amortization on loans. In view of the substantial increase in the non-performing loans in the wake of the East Asian financial crisis, a significant portion of which were unsecured, the new law encourages banks to demand from their credit applicants a statement of assets and liabilities and of income and expenditures and other information. Obviously, microfinance borrowers cannot meet such requirement. Thus, the law exempts them from this regulation and instead encourages banks to lend to them not on the basis of a collateral they can present but on the basis of their cash flows. As regards interest rate, the Central Bank circular clearly spells out the policy that the “interest rate shall not be lower than the prevailing market rates to enable the lending institution to recover the financial and operational costs incidental to this type of microfinance lending.” This runs counter to the previous policy that promoted below-market rate of interest for loans to MicSMEs and poor households.

Banks normally require payment on their loans either on a monthly, quarterly or annual basis. In the microfinance market, however, borrowers usually borrow small amounts and are given a more flexible amortization schedule that reflects their cash flow. Thus, the Central Bank is given authority by the law to formulate more flexible guidelines in so far as loan amortization is concerned. The new guidelines issued by the Central Bank allow microfinance loans to be amortized on a daily, weekly, bi-monthly or monthly basis, depending on the cash flow conditions of borrowers. The Central Bank has issued the “Notes on Microfinance” to guide banks in implementing the new policy on microfinance (see **Annex A**).

The existence of adequate banking offices in all areas in the country can improve access of MicSMEs and poor households to banking services. Beginning in 1989, the Central Bank relaxed the regulation on bank entry and branching. This led to the proliferation of banks and branches in the country. Many of these banks became in distress in the aftermath of the East Asian financial crisis and the El Niño weather phenomenon that struck in 1998. Thus, the Central Bank has declared a moratorium on the opening of new banks and has encouraged merger/consolidation to strengthen their financial position. However, to ensure that microfinance services will not diminish, the Central Bank recently approved a partial lifting of the general moratorium on the licensing of new thrift and rural banks to allow entry of microfinance-oriented banks. A rural bank to be established as a microfinance bank is required to have a minimum paid-in capital of Php5 million while the existing capitalization requirement for thrift banks apply (see **Table 2**).

3. Loan Portfolio Regulations

Loan portfolio regulations pertain to those regulations that require banks to allocate a certain proportion of their loanable funds to specific sectors of the economy. There are 3 existing regulations. First is the deposit retention scheme. Under this scheme, at least 75 percent of the total deposits, net of required reserves against deposit liabilities and total amount of cash in vault, accumulated by branches, agencies, extension officers, units and/or head offices of specialized government banks, in a particular regional grouping outside the National Capital Region, shall be invested therein as a means to develop that region. This policy is used to deal with the problem of funds diversion; that is, banks with nation-wide branch network mobilize deposits in rural areas where most of the MicSMEs and poor households can be found and lend them to large enterprises in urban areas, more specifically, Metro Manila. This is detrimental to the development of MicSMEs and poor households in rural areas because they are denied of badly needed funds. For purposes of this regulation, the country used to be divided into 13 regions. Commercial banks were against this policy because they could hardly find borrowers in rural areas that would pass their credit criteria. As a result, they were

discouraged from intensively mobilizing deposits. Borrowers and savers ultimately stand to lose from this regulation in terms of higher interest rate on loans and lower interest rates on deposits. Thus, in 1990, this regulation was relaxed by reducing the number of regional groupings from 13 to 3, which would allow banks to transfer funds to their branches in a much wider geographical area.

The second loan portfolio regulation is the Presidential Decree No. 717 (PD 717), otherwise known as the “agri/agra law”, that mandates all banking institutions to set aside 25 percent of their net incremental loanable funds for agricultural lending, 10 percent of which is to be lent to agrarian reform beneficiaries and 15 percent for general agricultural lending. Commercial and thrift banks have not found difficulty in complying with the latter because there is a good number of credit-worthy agri-business corporations and plantation farms, some of which are domestic corporate giants and multinational firms. In contrast, they have difficulty in complying with the former simply because their operations are not structured to provide credit to the widely dispersed agrarian reform beneficiaries. In other words, they face severe information problem when it comes to lending to agrarian reform beneficiaries. Worse, the number of agrarian reform beneficiaries has not grown much in recent years due to the delay in the implementation of the comprehensive land reform program while deposits of banks have grown tremendously, thereby complicating further the problems faced by commercial and thrift banks in complying with said requirement. However, the government has provided banks with alternative instruments for complying with the law, such as investing in government securities declared eligible by the Central Bank for the compliance of the law. Examples are the Pag-IBIG Bonds, the proceeds of which will be used by the government for low cost housing projects; investment by banks in the authorized capital stock of Quedancor or loans extended by banks to farmers, fishermen, cooperatives, rural workers and rural enterprises covered by guarantees of Quedancor; investment by banks in NDC Agri-Agra ERAP Bonds the proceeds of which are going to be used exclusively for the development of the agriculture and agrarian sectors and in priority development projects in these sectors identified by the National Development Company, Department of Agrarian Reform, and the Department of Agriculture; and investment by banks in Special Purpose

Treasury Bonds to finance the comprehensive agrarian reform program-related expenditures. The Central Bank has recently increased the penalties for non-compliance/undercompliance of such law.

The third loan portfolio regulation is the mandatory credit to the small enterprises as provided for under Republic Act (RA) 6977, otherwise known as the Magna Carta for Small Enterprises. Under this law, all lending institutions were mandated to lend at least 10 percent of their total loan portfolio to small enterprises. This requirement was tiered and had a time bound: 5 percent of the total loan portfolio by the end of 1991 to rise to 10 percent by end-1992 through 1995 and to decline to 5 percent by the end of 1996 and zero by the end of the 7th year. As expected by many, the law was amended by the 7th year (RA 8289). Thus, for a period of 10 years after the effectivity of such law, all lending institutions are required to set aside at least 6 percent and at least 2 percent for small and medium enterprises, respectively, of their total loan portfolio and make it available for small and medium enterprises credit. Only instruments issued by the Small Business Guarantee and Credit Corporation which do not pay market rates and microfinance loans are deemed alternative compliance to the this loan portfolio regulation.

4. Government's Direct Participation in the Banking System

The government directly participates in the provision of financial services to MicSMEs and poor households through its banking institutions. It currently maintains two banks that perform special functions. These are the Development Bank of the Philippines (DBP) and the Land Bank of the Philippines (LBP).⁶ These banks lend to MicSMEs and poor households including farmers and land reform beneficiaries either directly through their retail lending windows or indirectly through their wholesale lending in windows. Because they have been largely used by the government as

⁶ A third bank, the Philippine National Bank (PNB), has been privatized.

instruments for increasing access of MicSMEs and poor households to financial services, we will describe them lengthily here.

Development Bank of the Philippines (DBP)

Charter/Legal Mandate. DBP was created by virtue of Republic Act (RA) No. 85 in 1947 primarily to provide credit facilities for the rehabilitation, development and expansion of agriculture and industry, the broadening and diversification of the national economy, and to promote the establishment of private development banks in the countryside. Executive Order (EO) 81 issued on December 3, 1986 revised the bank's charter giving it a new development mandate. Under this new charter, DBP's principal objective is to provide banking services particularly to meet the medium and long term financing needs of small and medium-scale agricultural and industrial enterprises. The bank's orientation has similarly been changed to that of a primarily wholesale bank with significant retail presence. Guided by its new mandate, DBP's priority areas for financing include export promotion, new entrepreneurs, and infrastructure including loans for the local government units.

On December 20, 1995, the Bangko Sentral ng Pilipinas (BSP) granted the DBP permit to operate as an expanded commercial bank (EKB). DBP commenced its operation as an EKB on February 7, 1996. As an EKB, it currently offers the following products and services to its clients: a) deposit products and services; b) fund transfer services including provision of telegraphic transfer services and acceptance of PLDT/SSS/BIR payments; c) fund management services including government securities dealership and servicing of foreign currency remittances; d) trust products and services including dealership of blue chips and trusteeship of asset-backed securities; e) merchant banking services including underwriting and loan syndications; f) wholesale lending services; g) retail lending services; h) export financing; and i) guarantee services. At present, DBP has five regional offices and 70 branches nationwide.

Major Policies/Strategies. The DBP was restructured into a predominantly wholesale bank in 1990 following the recommendations of a study conducted under the World Bank Financial Sector Adjustment Loan in 1987. Participating financial institutions (PFIs) were tapped as conduits of DBP's wholesale funds.

In order not to share the same market segment and avoid competition, wholesale and retail banking operations have been distinctly separated such that wholesale resources are not employed to fund its retail activities. Likewise, both operations are also administered separately by two different groups in the DBP. The major functional departments of DBP's retail banking operation are the Institutional Banking Group (IBG), Branch Credit Group (BCG) and branches, and Window III group. Wholesale banking, on the other hand, is handled by the Wholesale Banking Group (WBG) and is still considered centralized.

The DBP maintains three lending modes or windows as part of its retail lending services. Window I (WI) caters to short-term working capital needs with maturities of up to 18 months. The DBP internal funds are usually used for this purpose. Window II (WII) finances the acquisition of fixed assets and permanent working capital with repayment term of up to five years. Lastly, Window III (WIII) assists activities which have catalytic effects on the country's economic development. Loans under this window are for infrastructure, fixed asset acquisition and/or working capital with repayment period of more than 5 years. This window is also noted to be the centerpiece of DBP's retail lending operations that support the government's Social Reform Agenda. Most of the programs under WIII are implemented in cooperation with government line agencies such as the Department of Science and Technology, Department of Agriculture and Department of Agrarian Reform, and Congress. Eligible borrowers under WIII social programs, in general, include cooperatives, associations, non-government or private institutions engaged in developmental activities. Relatedly, DBP is mandated to maintain at least 20 percent of its loan portfolio for WIII. Thirty percent of the net income of DBP after tax is used to fund this window. There are also domestic sources of funds, e.g.

Social Security System (SSS), that finance WIII. In 1996, WIII accounts comprised about 18 percent of its outstanding loan portfolio.

Special credit programs implemented. The DBP currently administers 19 special credit programs that are financed by foreign or domestic borrowings and special funds. These are apart from those that they administer for government line agencies. Of the 19 programs, 10 fall under its wholesale lending operations and use the participating financial institutions (PFIs) as conduits of funds. The remaining nine (9) programs are implemented as part of its retail operations and cater directly to end-borrowers.

Land Bank of the Philippines (LBP)

Charter/Mandate. LBP was established on August 8, 1963 as a government-owned financial institution by virtue of Republic Act 3844 otherwise known as the Agricultural Land Reform Code. LBP was primarily mandated to serve as the financial arm of the land reform program that shall advance payments to landowners and collect amortization from farmer beneficiaries. In 1973, LBP was given a comprehensive commercial or universal banking status through a presidential decree. LBP put up its commercial banking arm to cater to agribusiness projects and rural industries, which since then was known to support its agrarian reform operations.

With the enactment of Republic Act 6657 or the Comprehensive Agrarian Reform Law (CARL) in 1988, LBP expanded its agrarian operations as CARP covered all agricultural lands, both private and public, regardless of tenurial arrangement and commodity produced. Under CARP, cooperatives emerged as the main conduit of LBP support to agrarian reform beneficiaries.

Up until it was given a new charter under RA 7907 on February 23, 1995, LBP utilized a structure that tried to balance its universal banking and countryside development mission through a unique combination of branches and field offices which are scattered throughout the archipelago. Its branch network handled commercial

banking while its field offices were in charge of its developmental or agrarian reform functions. The profits derived from its commercial banking operations finance development initiatives that benefit the small farmers, fisherfolk and other countryside-based small and medium entrepreneurs. However, under its new charter wherein LBP was authorized to pursue a developmental approach in banking, it implemented the Unified Systems Project (USP). While the balancing act remains, the USP merged the field banking and agrarian operations and placed them under one roof in order to operate as a one-stop-shop. USP was meant to enable LBP to cut down on operating expenses and ensure a more efficient delivery of services. Moreover, this was intended to provide more convenience to clients and enable the bank to undertake more ambitious projects for the development of the rural areas and ensure food security for the country.

Major Programs and Lending Strategies. In its bid to address all aspects of progress, LBP implements the Total Development Option-Unified LandBank Approach to Development or TODO-UNLAD program. TODO-UNLAD links cooperatives, farmers' cooperatives, private companies, rural banks, non-government organizations and local government units in specific areas around an integrated area development project through LBP's various lending programs and support services. Each project under the program entails linking producers to markets and processors as well as the strengthening of cooperatives and local government units. TODO-UNLAD prioritizes communities covered by the Comprehensive Agrarian Reform Program and communities belonging to the 20 priority provinces identified under the Social Reform Agenda. Qualified for financing are farm production, farm-to-market roads, rural electrification, telecommunication systems, processing and post-harvest facilities, among others.

LBP has access to various bilateral and multilateral institutions for special credit facilities whose target beneficiaries belong to the priority sectors: farmers and fisherfolk cooperatives, local government units, small and medium enterprises, agrarian reform beneficiaries and microenterprises. Through these financing programs, LBP is able to address the country's need for long-term loans, dispersal of economic activity, infrastructure and support for agrarian reform beneficiaries. LBP's international partners

include the World Bank (WB), Asian Development Bank (ADB), Overseas Economic Cooperation Fund (OECF) and Kreditanstalt fur Wiederaufbau (KfW) of Germany.

This bank also provides support to the small and medium enterprises (SMEs). In 1996 it launched six new credit programs for SMEs, foremost of which are the “Negosyo Mo, Susuportahan Ko” and the “Todo Kaya: Isulong ang Pagsulong” even as it remained a preferred conduit of the Social Security System and the Development Bank of the Philippines in their SME financing.

LBP continues to tap rural banks as conduits in its credit delivery. It is in fact the major institution which rehabilitated the rural banks through various capital infusion and rediscounting programs.

LBP also attempts to immediately respond to the emergency requirements of the agricultural/agrarian sector. For instance, LBP launched PROGRESS or its Program for Grains Productivity Enhancement and other Support Services in response to the rice crisis that hit the country in 1995. This program makes available appropriate financing schemes to increase rice and corn production while ensuring the profitability of farmers’ cooperatives. PROGRESS integrates all aspects of farm operation from crop production, storage and milling up to marketing. Through the program, LBP finances the production of certified seeds, provision of communal irrigation systems, acquisition of post-harvest facilities, and the extension of marketing assistance.

Special credit programs implemented. LBP currently implements 13 special credit programs. Nine (9) of these are funded by foreign loans while the rest are supported by domestically-sourced special funds. This count excludes those being administered by LBP for government line agencies. Nine (9) of these programs⁷ are briefly described below.

⁷These are the programs which have complete data and hence were evaluated in terms of outreach and efficiency.

IV. Current Status of Bank Lending to MicSMEs and Poor Households

This section presents an overview of the compliance of banks with loan portfolio regulations, specifically those that pertain to the “agri-agra” law and the Magna Carta for Small Business and the status of lending by various types of banks to MicSMEs and poor households.

A. Overview of the Banks’ Compliance with Loan Portfolio Regulations

Private commercial banks usually cater to large and upper medium-sized enterprises. The loans they book under the agri-agra law include loans they extend to large agri-business corporations and plantation farms and investments in substitute instruments for complying such law. Thus, it cannot be said that commercial banks are directly lending to small farmers.

As regards lending to MicSMEs under the Magna Carta for Small enterprises, the Central Bank is required to submit a quarterly report SMEDC with respect to banks’ compliance of said law. **Table 4** shows that the banking system as a whole has greatly exceeded the minimum loan requirement for both small and medium enterprises. As of June 2001, 93 percent of the total credit allocation for small and medium enterprises was directly lent by banks to such enterprises. The bulk of the loans to MicSMEs came from commercial banks (**Table 5**). The data, however, hide a few things. One is that foreign banks and few large domestic banks, which are predominantly wholesale banks, largely comply with the requirement by depositing the required amount with the Central Bank, rather than by exerting effort to look for small and medium enterprises as borrowers. Another is that several rural banks did not submit any report to the Central Bank. A major reason is these banks can hardly find medium enterprises in small towns where they operate. Thus, they find it better to pay the fines rather than set aside non-earning funds for lending to medium enterprises.

B. Government Banks

As already mentioned above, the government has utilized DBP and LBP as instruments for providing financial services to MicSMEs and poor households. For 2000, DBP granted short- and long-term loans to SMEs amounting to almost PhP22 billion. Outstanding exposure of DBP to SMEs stood by year-end at PhP17 billion for both wholesale and various retail lending programs cited above through its 77 branches across the country. Under Window III, which finances innovative and socially desirable projects with high development impact, the total loan outstanding reached PhP1.72 billion. All this comprises only 17 percent of the total loan portfolio of DBP because it also provides large loans to private enterprises for large projects, such as infrastructure projects, acquisition of modern technologies, transport and telecommunications.

LBP extends financial services to its clients through its branches distributed across the country. Its outstanding loans to small farmers and fisherfolk stood at PhP13.5 billion as of end-2000. Loans for this sector were released through 1,797 cooperatives and 464 countryside financial institutions (rural banks, cooperative banks, thrift banks), which serve as LBP's channels of credit to farmers and fisherfolk. Its outstanding loans to MicSMEs for the same period reached PhP12.3 billion. Seventy (70) percent were directly lent by LBP to SMEs and the remaining, through some of its programs that either use wholesale or retail lending.

LBP has a subsidiary – People's Credit and Finance Corporation – that specializes in microcredit with loans ranging from PhP5,000 to PhP10,000. It works closely with NGOs and microfinance institutions to implement its program. As of December 2000, it already granted a total of PhP2.6 loans to 324,108 with a very good repayment rate (**Table 6**).

C. Thrift Banking System

The thrift banking system provides production and commercial loans to SMEs, mortgage loans to households and other retail financial services to small savers and borrowers. Some large commercial banks want their presence to be also felt in the retail market. Thus, they establish wholly owned subsidiaries of commercial banks, which is allowed under existing laws. Thrift banks have lower cost structure than commercial banks. Therefore, they can accommodate small deposits and loans more efficiently than commercial banks. Under this setting, large commercial banks indirectly provide financial services to small savers and borrowers through their subsidiary thrift banks. Thus, the thrift banking system consists of independent thrift banks and subsidiaries of commercial banks.

Table 7 shows that thrift banks' loans granted and outstanding both in nominal and real terms had been rising up until the East Asian financial crisis. As of 1998 when most recent published data became available, loans granted in nominal terms reached PhP342 billion, while loan outstanding in nominal terms stood at PhP104 billion. About half of these loans are short-term for the purpose of financing working capital of MicSMEs. There is no information on the number of borrowers; hence, it is not possible to estimate the average size of loans they grant. Interviews conducted among a few thrift banks in Metro Manila indicate that the minimum loan size ranges from PhP20,000 to PhP100,000 and the maximum loan sizes from PhP5 million to PhP10 million. Most thrift banks have branches operating within a certain region. However, a few large thrift banks have nation-wide branch network.

D. Rural Banking System

The rural banking system truly caters to small savers and borrowers. In 1998, it granted more than one million loans to farmers, fisherfolk, and small non-farm enterprises (**Table 8**). The rural banking system's average loan size rose from PhP4.6 thousand in real terms in 1980 to PhP26 thousand in 1997, but dropped sharply to PhP11

thousand in 1998 as a result of the East Asian financial crisis and the El Niño weather phenomenon that severely affected the rural sector. In nominal terms, the system's average loan size amounted to PhP28 thousand or US\$684 in 1998, which was well below the PhP150,000 loan ceiling for microenterprise under the SRPAA. At present, rural banks grant loans as low as PhP10,000 or US\$200 per borrower.

Aside from increasing geographical diversification, rural banks have been increasingly diversifying their loan portfolio across major economic activities. In the 1980s, rural banks' loans were mostly concentrated in the agricultural sector (**Table 9**). This is understandable because rural banks were merely serving as conduits of government funds most of which were directed to the agricultural sector. In addition, a large chunk of their loan portfolio was supposed to be for the agricultural sector. Over the years, however, rural banks have been able to reduce their exposure to agriculture in relative terms, and increased the shares of other economic activities, such as commercial, industrial and other economic activities in rural areas. Thus, the share of agricultural loans in the total loan portfolio of rural banks went down from 89 percent in 1980 to 46 percent in 1998. In contrast, the shares of commercial, industrial and other loans increased from 6.1 percent, 2.5 percent and 2.3 percent, respectively, in 1980 to 16.7 percent, 5.9 percent and 31.3 percent, respectively, in 1998. This suggests two things. One is that there are some people in rural areas who are engaged in viable non-farm activities needing financial services from banks. Second, if left to themselves, rural banks will find a way of diversifying their loan portfolio as ordinary banks do to manage risks in lending.

There has also been a substantial change in the way rural banks finance their lending operations over the years. In 1980, deposits comprised only 43 percent of their total liabilities (**Table 10**). A big chunk of their liabilities comprised borrowings from the Central Bank and other special credit programs of the government. The radical change in rediscounting and interest rate policies in the mid-1980s has encouraged banks to mobilize deposits and to rely less on the rediscounting window of the Central Bank. Thus, by 1998, the share of deposits in the total liabilities of rural banks rose to 74 percent.

Another way of looking at it is to take the ratio of deposits to loans, which shows the extent to which deposits have financed loans. In 1980, deposits financed 45 percent of every peso lent by rural banks. This rose to 88 percent in 1998.

The significant change in the structure of the sources of funds of rural banks supported the loan diversification effort of rural banks. In this regard, it can be said that the relaxation of restrictions on the loan portfolio of rural banks and the change in the rediscounting and interest rate policies of the Central Bank were definitely a step in the right direction.

Most rural banks are now increasing their capital to strengthen their balance sheets and hence, their competitive position. Most of them can easily meet the recent increase in the minimum capital requirement. An interesting development in the last few years is the broadening in the ownership of cooperative rural banks. More specifically, cooperative rural banks are no longer exclusively owned by farmer associations but also by other types of non-farm associations, such as market vendors. A cooperative rural bank services an average of 5,000 individual borrowers (Guanlao 1999).

A number of rural banks have adopted variants of the Grameen Bank technology so that they can penetrate high-risk, small borrowers at very low cost. One example is CARD Rural Bank's modified Grameen Bank project. The bank's target clients are landless women rural workers who have no regular jobs and have total marketable assets of less than PhP50,000 or a little less than US\$1,000. In 1997, it was able to organize 1,654 groups with a total of 9,968 members (Hossain and Diaz 1997). Access to CARD's loans, despite an effective loan rate of 44 percent per annum, has yielded some benefits to the borrowers in terms of higher income, employment, productivity and capital accumulation. Many rural banks have also created special credit windows for salaried people in rural areas whose families are engaged in small and cottage enterprises. All this indicates that rural banks are steadily enhancing their capabilities to assess credit risks as they seek to build good relationship with their clients.

Many rural banks have shown some creativity in mobilizing deposits. For instance, they require only a minimum of PhP100 or US\$2.00 to open a savings account and a modest minimum average daily balance for deposits to earn interest, which could be as low as PhP100.⁸ They offer different types of deposits that suit the varying tastes of their clients at rates much more attractive than commercial and thrift banks. Some rural banks already offer checking accounts to their clients. Most rural banks are now aggressively campaigning for deposits through print and broadcast media, by sponsoring important events in the communities, or by conducting raffles, bingo, etc.

Most rural banks have now automated their operations to bring down the cost of processing numerous, small transactions. The rapid decline in the cost of computer hardware and software development has become a boon to rural banks. A highly computerized rural bank can process so many small deposit and loan accounts in a very short time – a development that would favor small savers and borrowers.

E. Commercial Banks' Credit Programs for MicSMEs

Although commercial banks mainly cater to large borrowers, however, they have tried to formulate innovative lending programs to address the credit needs of small borrowers. In 1991, the commercial banks' Bankers Association of the Philippines (BAP) established the BAP Credit Guaranty Corporation (BCGC) funded by contributions of its members. Its paid-up capital is more than PhP100 million. Legally, BCGC is considered a lending investor, not a bank. It provides loans to those who do not normally qualify under the regular loan windows of its member banks. It has greater flexibility than commercial banks because it can grant loans not on the basis of the quantity and quality of the collateral and established credit track record of borrowers but on the basis of the viability of the projects to be funded and the potential repayment capacity of borrowers. Loans are mostly for short-term working capital requirement of microenterprises. The minimum size of the loan is PhP50,000. It charges the usual commercial bank rate on its loans, which is much lower than the interest rate charged by

⁸ Commercial and thrift banks usually require at least P1,000 to open a savings account.

lending investors, pawnshops and informal money lenders. Some of its borrowers already graduated to the regular loan windows of commercial banks. To increase its outreach, BCGC has decided to also go into wholesale lending by tapping existing NGOs that have a good track record in managing credit programs.

BCGC is currently facing the problem of lack of funds. Being classified as a lending investor, it is not allowed to mobilize deposits or to borrow from more than 19 individuals/corporations including BAP members.

Aside from the BCGC, which is a collaborative effort among commercial banks, some commercial banks came up with certain initiatives on their own to meet the credit demands of small borrowers who do not have access to their regular lending facilities. These special lending windows are funded out of their own resources, not from the special credit programs of the government. One example is the Equitable-PCI Bank's successful lending programs to small footwear manufacturers in Marikina, a city within Metro Manila. Another example is the Export Dragon Fund of the Rizal Commercial Banking Corporation (RCBC). This facility provides loans for working capital to small exporters who have little or no hard collateral like real estate to offer to banks.

V. Constraints and Issues of Bank Lending to MicSME and Poor Households

The current policy environment (e.g., no interest rate ceiling) is already conducive for banks to expand their services to MicSMEs and poor households. In fact, there are already signs that small banks are favorably responding to this. For instance, the number of offices of thrift and rural banks together have increased from 2,685 in 1996 to 3,285 in 2001 (June) despite the fact that many of them had failed during the same period. The recent decision of the Central Bank to exempt microfinance-oriented banks, such as thrift and rural banks, from the moratorium on the licensing of new banks supports the effort of expanding financial services to MicSMEs and poor households. Recently, a microfinance-oriented bank was set up by a thrift bank jointly with foreign partners in the

southern part of the Philippines. A large commercial bank followed suit by establishing a wholly-owned microfinance-oriented bank. Based on the criteria formulated by the Central Bank for giving a license to microfinance-oriented banks, these banks are not like ordinary rural bank or thrift bank.⁹

Notwithstanding this favorable policy environment, still banks face some constraints in expanding their financial services to MicSMEs and poor households. We will discuss them below and also recommend some measures to address them.

Macroeconomic instability. Lending to MicSMEs and poor households is a very risky venture, especially if lenders base their lending decisions solely on the strength of the cash flow position and character of borrowers. Instability of the economy can make those loans much riskier because cash flows can easily dry up during sudden downturn of the economy. This can lead to the collapse of banks, especially small ones, and undermines the public's confidence in the banking system. Such confidence is not easy to restore especially if a large number of savers lose their money and otherwise good borrowers become known delinquent borrowers. The experience of the Philippines in the last 25 years clearly demonstrates this point. From 1998 to 2000 alone, 12 thrift banks and 83 rural banks were closed by the Philippine Deposit Insurance Corporation, thereby reducing the number of potential providers of financial services to MicSMEs and poor households. Indeed, a stable macroeconomic environment is conducive to the expansion of financial services to these sectors of the society.

Inadequate infrastructure. Poor infrastructure increases the cost of bank lending to MicSMEs and poor households. In particular, some thrift and rural banks are prevented from computerizing their operations because of lack of adequate and reliable supply of electricity in their area. They badly need to computerize their system to be able

⁹ For example, Section 1.4 of the BSP (Central Bank) Circular No. 273 that organizers must have the capacity to engage in microfinancing, which may be indicated by the following: (a) At least 20 percent of the paid-in capital of the proposed bank must be owned by persons or entities with track record in microfinancing; (b) Majority of the members of the board of directors have experience in microfinancing with at least on member having actual banking experience; and (c) The proposed bank must have as a minimum, an adequate loan tracking system that allows daily monitoring of loan releases, collection and arrearages, and any restructuring and refinancing.

to accurately process numerous small deposits and loans in so short a time. The government, therefore, should put improvement in infrastructure system in rural areas high priority in its development agenda.

Regulation of deposit mobilization. The key to expanding financial services to MicSMEs and poor households is for banks to mobilize more deposits. Several studies have shown that even poor households save, and if properly compensated, they place their savings in banks. Many of them reside in areas quite far from where banks are located and transport cost is very high. Microfinance-oriented banks can mobilize more deposits at lesser cost only if they are allowed to make house-to-house visits to pick up deposits. The Central Bank, therefore, has to rethink the circular it issued in 1999 prohibiting banks from doing it (Llanto 2000).

Shortage of capital. Although small banks can mobilize more deposits, as many of them have already demonstrated, their limited capital sets a ceiling as to how much they can mobilize. There are ways of dealing with this problem. One is to encourage large commercial banks to infuse equity into small banks, such as rural banks, by including such investment as an alternative instrument for complying with the existing loan portfolio regulation so long as they remain minority stakeholders.¹⁰ Such arrangement can pave the way for correspondent banking relationship between small and large banks in the country. This definitely a better option than compelling large commercial banks to lend to small enterprises.

In the case of cooperative rural banks, the expansion of their capital is constrained by the limited number of cooperatives that have the financial capability to invest in cooperative banks.¹¹ The Rural Banking Act must, therefore, be amended to allow cooperative rural banks to accept individual members as preferred shareholders.

¹⁰ Commercial banks seem to prefer to have a wholly-owned thrift bank.

¹¹ Under the existing law, only cooperatives can own shares in cooperative rural banks.

The establishment of a microfinance-oriented bank by a large commercial bank is a welcome development. The Central Bank may look into possibilities of encouraging other commercial banks to venture into microfinance business. Perhaps, it can organize training programs for commercial banks to expose them to microfinance lending technologies.

Competition with government banks. It has been the policy of the government to give private financial institutions a greater role in the provision of financial services especially to small farm and non-farm enterprises. The government financial institution's role, therefore, is to fill up some gaps left out by private financial institutions and provide support to them in areas where they have comparative advantage. However, the number of offices of government banks has increased from less than 100 in before 1990 to more than 200 today. Because of the policy of the government to make these banks self-sufficient, they are currently intensely competing with private banks in mobilizing deposits. Although the two government banks are engaged in wholesaling, they also do retail lending, which directly competes with private banks. Unless the orientation of government banks is changed, private banks will always find a serious constraint to the expansion of their services since they will be facing undue competition from those banks.¹²

Aside from competing with government banks, private banks also compete with non-bank financial institutions, such as the Small Business Credit and Guarantee Corporation, the People's Credit and Finance Corporation, etc., and a host of special credit programs for MicSMEs and poor households implemented by non-financial government agencies. Many of these special credit programs have performed badly; hence, they have undermined the discipline needed to promote market-based microfinance institutions.

¹² Government banks are also designated depository banks of all government agencies and corporations. Hence, they maintain a large pool of cheap deposits. See Lamberte (2000) for a proposal to re-orient the LBP.

Inadequate supervision. While the Central Bank encourages private banks to engage in microfinance, it must ensure that banks that do so remain safe and sound at all times so that financial services to MicSMEs and poor households will not be disrupted due to massive bank failure. Indeed, some banks are hesitant to venture into microfinance because the possibility that the failure of poorly managed, ill-supervised microfinance-oriented banks can undermine otherwise soundly managed microfinance-oriented banks.¹³ In this regard, the Central Bank must adopt a risk-based supervision approach for microfinance and upgrade the capability of its staff to effectively utilize such approach.

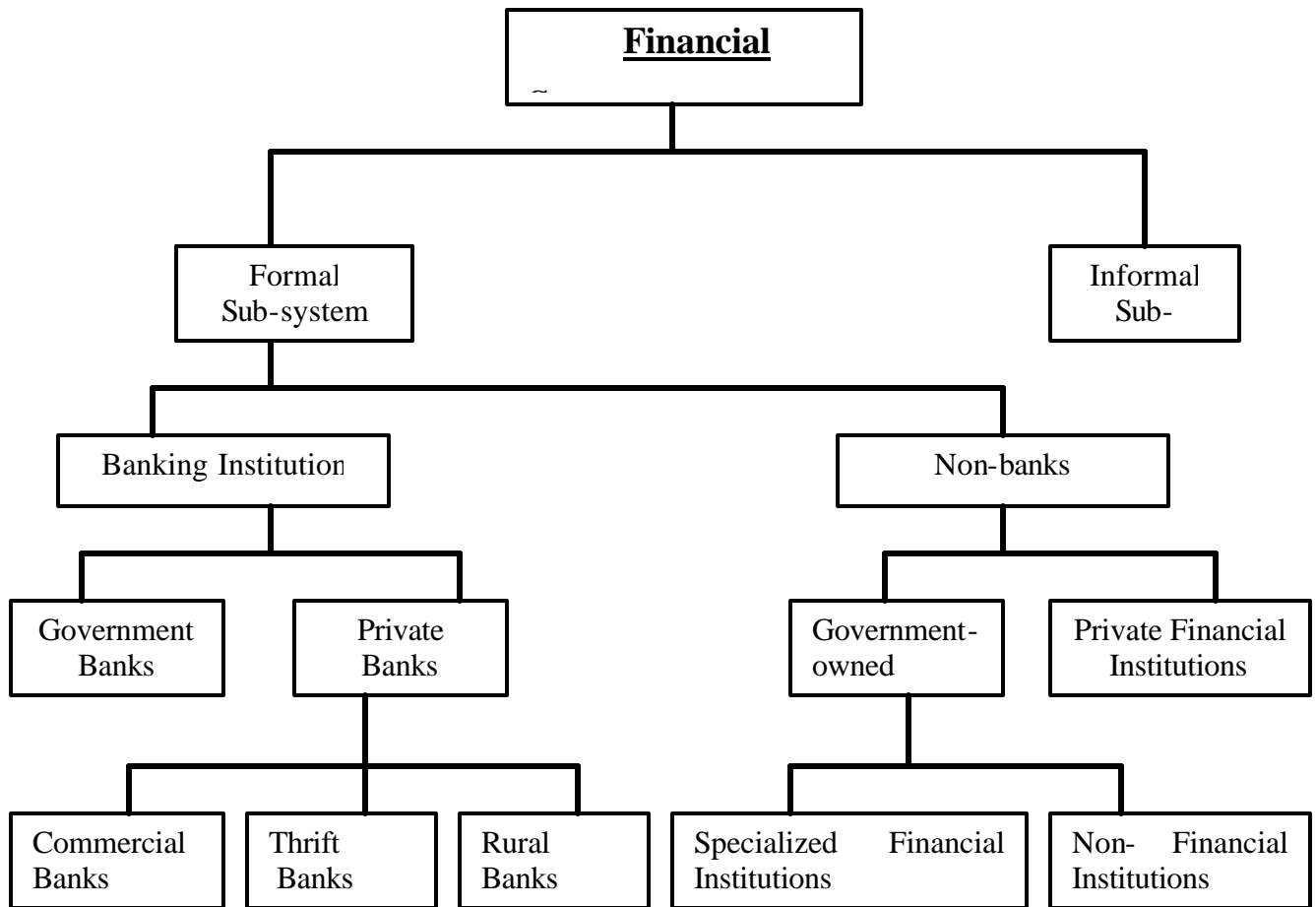
Loan portfolio regulations. Most rural banks and some thrift banks are not able to meet the requirement to allocate at least 2 percent of their total loan portfolio to medium enterprises, but they can easily meet the requirement to allocate at least 6 percent of their loan portfolio to small enterprises because of the nature and size of their operation. The government should, therefore, review this law to give rural banks and small thrift banks more flexibility in selecting their own clients.

¹³ This is part of the information asymmetry problem wherein bank depositors and other creditors are not able to distinguish between good and bad banks in times of severe financial distress.

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Figure 1
The Philippine Financial System



| TABLE 1. AUTHORIZED ACTIVITIES OF VARIOUS BANK CATEGORIES | | | | |
|--|------------------|----------|-----------------|------------------|
| Authorized Activities | Commercial Banks | | Thrift Banks | Rural Banks |
| | Universal | Ordinary | | |
| A. Commercial Banking Services | | | | |
| 1 Accept Deposits | 1 | 1 | 1 | 1 |
| 2 Issue LC's and accept drafts | 1 | 1 | 1 ^{a/} | 11 ^{a/} |
| 3 Discounting of promissory notes and commercial papers | 1 | 1 | 1 | 1 |
| 4 Foreign exchange transactions | 1 | 1 | 11 | * |
| 5 Lend money against security | 1 | 1 | 1 | 1 |
| B. Nationwide Branching Operations | 1 | 1 | 1 | 1 |
| C. Equity Investments in Allied Undertakings | 11 | 11 | 11 | 11 |
| D. Equity Investments in Non-Allied Undertakings | 1 | * | * | * |
| E. Trust Operation | 11 | 11 | 11 | 11 |
| F. Issue Real Estate and Chattel Mortgage, Bonds Buy and Sell these for its own Account, Accept/Receive in Payment or as Amortization of Loan | 1 | 1 | 1 | 1 |
| G. Direct Borrowing With Central Bank | 1 | 1 | 1 | 1 |
| H. Activities of Investment Houses | | | | |
| 1 Securities underwriting | 1 | * | * | * |
| 2 Syndication activities | 1 | 1 | 1 | 1 |
| 3 Business development and project implementation | 1 | 1 | 1 | 1 |
| 4 Financial Consultancy and Investment | 1 | 1 | 1 | 1 |
| 5 Mergers and consolidation | 1 | 1 | 1 | 1 |
| 6 Research and studies | 1 | 1 | 1 | 1 |
| 7 Lease real and/or personal properties | * | * | * | * |
| Money Market Operation | 1 | 1 | * | * |

1 - Authorized Activities

11 - Authorized but subject to Monetary Board Approval

* - Not authorized/Prohibited

^{a/} Limited only to domestic LCs and drafts.

Source: Lamberte, Mario B. (1992), "Assessment of the Financial Market Reforms in the Philippines 1980-1992."

Table 2
Minimum Level of Capitalization for New Entrants
As of August 2000

| Bank Category | Minimum Capital (In Million Pesos) |
|---|---|
| Expanded commercial banks (universal banks) | 4,950.0 |
| Non-expanded commercial banks (ordinary commercial banks) | 2,400.0 |
| Thrift banks | |
| With head office within Metro Manila | 325.0 |
| With head office outside Metro Manila | 52.0 |
| Rural banks | |
| Within Metro Manila | 26.0 |
| Cities of Cebu and Davao | 13.0 |
| 1 st /2 nd /3 rd class cities and 1 st class municipalities | 6.6 |
| 4 th /5 th /6 th class cities and 2 nd /3 rd /4 th class municipalities | 3.9 |
| 5 th and 6 th class municipalities | 2.6 |

Source: Circular No. 257, Bangko Sentral ng Pilipinas, 15 August 2000.

Table 3
Total Resources and Offices of the Financial System, 2000

| Type | Resources | | Offices | |
|--------------------------------|----------------|---------------|---------------|---------------|
| | Amount (P B) | % | No. | % |
| A. Banking Institutions | 3326.80 | 81.83 | 7,553 | 45.29 |
| 1. Commercial banks | 3013.60 | 74.12 | 4,250 | 25.49 |
| 2. Thrift banks | 245.80 | 6.05 | 1,391 | 8.34 |
| 3. Rural banks | 67.40 | 1.66 | 1,912 | 11.47 |
| B. Non-banks | 738.80 | 18.17 | 9,123 | 54.71 |
| Total | 4065.60 | 100.00 | 16,676 | 100.00 |

Source: Bangko Sentral ng Pilipinas

Table 4
Distribution of Credit Allocation
For Small and Medium Enterprise Credit
(In Billion Pesos)

| | Small Enterprise - 6% | | | | Medium Enterprise - 2% | | | |
|---------------------------------|-----------------------|------------|------------|------------|------------------------|------------|------------|------------|
| | June 2001 | | March 2001 | | June 2001 | | March 2001 | |
| | Amount | % to Total | Amount | % to Total | Amount | % to Total | Amount | % to Total |
| Direct Compliance | 137.0 | 93.1 | 117.7 | 92.1 | 84.4 | 93.4 | 95.6 | 94.7 |
| Indirect Compliance | 4.2 | 2.8 | 4.6 | 3.6 | 3.9 | 4.3 | 3.6 | 3.6 |
| Funds Set Aside: | 6.0 | 4.1 | 5.5 | 4.3 | 2.1 | 2.3 | 1.8 | 1.8 |
| Cash on Hand | 0.6 | 0.4 | 0.5 | 0.4 | 0.3 | 0.3 | 0.2 | 0.2 |
| Due from BSP | 5.4 | 3.7 | 5.0 | 3.9 | 1.8 | 2.0 | 1.6 | 1.6 |
| Total Credit Allocation | 147.2 | 100.0 | 127.8 | 100.0 | 90.4 | 100.0 | 101.0 | 100.0 |
| Net Loan Portfolio | 962.1 | | 1,007.5 | | 962.1 | | 1,007.5 | |
| Min. Amt. Required to Set Aside | 57.7 | | 60.4 | | 19.2 | | 20.1 | |
| Excess (Deficiency) | 89.5 | | 67.4 | | 71.2 | | 80.9 | |
| Rate of Compliance | 15.3 | | 12.7 | | 9.4 | | 10.0 | |

Table 5
Distribution of Credit Allocation
By Bank Category

| | 6% | | 2% | | Total | |
|---------------------------------|--------|---------|--------|---------|--------|---------|
| | Amount | % Dist. | Amount | % Dist. | Amount | % Dist. |
| Total Banking System | 147.2 | 100.0 | 90.4 | 100.0 | 237.6 | 100.0 |
| Commercial Banks | 119.6 | 81.2 | 75.7 | 83.7 | 195.3 | 82.2 |
| Expanded KBs | 104.5 | 71.0 | 61.5 | 68.0 | 166.0 | 69.9 |
| Non-Expanded KBs | 11.1 | 7.5 | 12.7 | 14.0 | 23.8 | 10.0 |
| Branches of FX Banks | 4.0 | 2.7 | 1.5 | 1.7 | 5.5 | 2.3 |
| Thrift Banks | 19.0 | 12.9 | 12.0 | 13.3 | 31.0 | 13.0 |
| Savings & Mortgage | 8.7 | 5.9 | 4.5 | 5.0 | 13.2 | 5.5 |
| Private Devt. Banks | 9.0 | 6.1 | 6.7 | 7.4 | 15.7 | 6.6 |
| Stock Savings & Loan | 1.3 | 0.9 | 0.8 | 0.9 | 2.1 | 0.9 |
| Rural Banks | 8.6 | 5.9 | 2.7 | 3.0 | 11.3 | 4.8 |

Table 6
People' Credit and Finance Corporation
Summary of Performance

| | For the Year 1999 | As of Dec. 31, 1999 | For the Year 2000 | As of Dec. 31, 2000 |
|---------------------------------|----------------------|------------------------|----------------------|------------------------|
| Loans granted (PM) | 775,578 | 1,661.3 | 693.6 | 2,564.1 |
| Loans outstanding (P M) | | 769.7 | | |
| Current | | 756 | | |
| Past Due | | 12.1 | | |
| Restructured | | 1.6 | | |
| Repayment rate (%) | | 98.5 | | |
| Past due ratio (%) | | 1.6 | | |
| No. of borrowers / no. of loans | 105,084 | 217,239 | 106,869 | 324,108 |
| No. of program partners | 49 | 143 | 35 | 178 |
| NGOs | 6 | 24 | 3 | 27 |
| Cooperatives | 17 | 42 | 14 | 56 |
| Rural Banks | 20 | 51 | 15 | 66 |
| Cooperative Banks | 5 | 23 | 1 | 24 |
| Thrift Banks | | 2 | 2 | 4 |
| Lending Investors | 1 | 1 | | 1 |

Source: People's Credit and Finance Corporation.

Table 7
Loans Granted and Outstanding of Thrift Banks
(In Million Pesos)

| Year | Loans Granted | | Loans Outstanding | |
|------|---------------|----------|-------------------|----------|
| | Nominal | Real* | Nominal | Real |
| 1990 | 65069.8 | 135115.9 | 17,842.8 | 37050.2 |
| 1991 | 65585.6 | 114773.4 | 24,646.8 | 43131.4 |
| 1992 | 124919.5 | 200653.2 | 25,440.5 | 40864.1 |
| 1993 | 180843.5 | 269942.6 | 36,461.5 | 54425.6 |
| 1994 | 252235.3 | 345310.1 | 70,391.0 | 96365.3 |
| 1995 | 338479.4 | 428921.7 | 69,590.9 | 88185.7 |
| 1996 | 342589.9 | 398249.7 | 92,893.1 | 107985.2 |
| 1997 | 467615.3 | 513089.9 | 110,478.3 | 121222.1 |
| 1998 | 341510.5 | 341510.5 | 104,616.2 | 104616.2 |

Notes:

CPI Base Year: 1998=1.00

Source: Bangko Sentral ng Pilipinas

Table 8
Total Loans Granted by Rural Banks

| Year | No. of Loans | Amount (in M P) | Average Loan Size (in Thousand Pesos) | | Exchange Rate (P/US \$) (Prd. average) |
|------|--------------|--------------------|--|-------|--|
| | | | Nominal | Real | |
| 1980 | 923,229 | 3,775 | 4.09 | 4.63 | 7.51 |
| 1981 | 942,671 | 4,389 | 4.66 | 5.13 | 7.90 |
| 1982 | 947,201 | 5,204 | 5.49 | 6.04 | 8.54 |
| 1983 | 895,065 | 5,721 | 6.39 | 9.61 | 11.11 |
| 1984 | 666,001 | 4,429 | 6.65 | 9.17 | 16.70 |
| 1985 | 519,230 | 3,891 | 7.49 | 8.37 | 18.61 |
| 1986 | 498,818 | 4,467 | 8.95 | 10.05 | 20.39 |
| 1987 | 531,997 | 5,650 | 10.62 | 11.57 | 20.57 |
| 1988 | 558,807 | 6,516 | 11.66 | 11.66 | 21.09 |
| 1989 | 739,257 | 9,884 | 13.37 | 11.92 | 21.74 |
| 1990 | 684,991 | 9,349 | 13.65 | 10.65 | 24.31 |
| 1991 | 537,788 | 10,519 | 19.56 | 12.87 | 27.48 |
| 1992 | 564,939 | 12,708 | 22.50 | 13.58 | 25.51 |
| 1993 | 747,759 | 18,548 | 24.81 | 13.92 | 27.12 |
| 1994 | 505,880 | 15,187 | 30.02 | 15.45 | 26.42 |
| 1995 | 892,303 | 27,770 | 31.12 | 14.82 | 25.71 |
| 1996 | 1,138,791 | 35,944 | 31.56 | 13.86 | 26.22 |
| 1997 | 300,923 | 18,743 | 62.28 | 26.05 | 29.47 |
| 1998 | 1,368,063 | 38,291 | 27.99 | 10.74 | 40.90 |

Notes:

CPI Base Year: 1988=1.00

1997 data consist of non-supervised credits only.

Source: Bangko Sentral ng Pilipinas

| TABLE 9. DISTRIBUTION OF LOANS OF THE RURAL BANKING SYSTEM BY PURPOSE In Million Pesos | | | | | | | | | |
|---|----------|--------------|---------|------------|---------|------------|---------|-------------|---------|
| Year | Total | Agricultural | | Commercial | | Industrial | | Other Loans | |
| | | Amount | % Share | Amount | % Share | Amount | % Share | Amount | % Share |
| 1980 | 4,762.7 | 4,241.2 | 89.05 | 291.2 | 6.11 | 120.5 | 2.53 | 109.8 | 2.31 |
| 1981 | 5,488.1 | 4,876.6 | 88.86 | 269.8 | 4.92 | 147.6 | 2.69 | 194.1 | 3.54 |
| 1982 | 6,669.0 | 5,770.7 | 86.53 | 383.8 | 5.75 | 208.9 | 3.13 | 305.6 | 4.58 |
| 1983 | 7,648.0 | 6,514.9 | 85.18 | 484.6 | 6.34 | 226.8 | 2.97 | 421.7 | 5.51 |
| 1984 | 7,022.5 | 6,039.7 | 86.00 | 444.0 | 6.32 | 197.1 | 2.81 | 341.7 | 4.87 |
| 1985 | 6,636.3 | 5,555.7 | 83.72 | 449.0 | 6.77 | 160.5 | 2.42 | 471.1 | 7.10 |
| 1986 | 6,790.5 | 5,471.7 | 80.58 | 566.6 | 8.34 | 187.7 | 2.76 | 564.5 | 8.31 |
| 1987 | 7,227.0 | 5,504.0 | 76.16 | 712.8 | 9.86 | 219.3 | 3.03 | 790.9 | 10.94 |
| 1988 | 7,970.2 | 5,769.6 | 72.39 | 864.0 | 10.84 | 253.4 | 3.18 | 1,083.2 | 13.59 |
| 1989 | 8,859.0 | 6,086.6 | 68.71 | 1,106.8 | 12.49 | 323.5 | 3.65 | 1,342.1 | 15.15 |
| 1990 | 9,735.7 | 6,429.1 | 66.04 | 1,274.3 | 13.09 | 358.2 | 3.68 | 1,674.1 | 17.20 |
| 1991 | 10,744.1 | 6,826.1 | 63.53 | 1,416.6 | 13.18 | 387.8 | 3.61 | 2,113.6 | 19.67 |
| 1992 | 12,671.1 | 7,855.6 | 62.00 | 1,691.9 | 13.35 | 512.2 | 4.04 | 2,611.4 | 20.61 |
| 1993 | 15,543.8 | 8,859.6 | 57.00 | 2,196.9 | 14.13 | 745.6 | 4.80 | 3,741.7 | 24.07 |
| 1994 | 19,135.6 | 10,246.0 | 53.54 | 2,805.7 | 14.66 | 978.8 | 5.12 | 5,105.1 | 26.68 |
| 1995 | 24,874.0 | 12,381.6 | 49.78 | 3,822.0 | 15.37 | 1,415.0 | 5.69 | 7,255.4 | 29.17 |
| 1996 | 33,403.2 | 15,230.2 | 45.60 | 5,530.3 | 16.56 | 1,917.4 | 5.74 | 10,725.3 | 32.11 |
| 1997 | 40,803.7 | 18,674.2 | 45.77 | 7,007.0 | 17.17 | 2,408.6 | 5.90 | 12,713.9 | 31.16 |
| 1998 ^{1/} | 41,176.3 | 18,964.5 | 46.06 | 6,894.8 | 16.74 | 2,417.1 | 5.87 | 12,899.9 | 31.33 |

^{1/} As of June 1998

Source: Bangko Sentral ng Pilipinas

TABLE 10. SELECTED BALANCE SHEET ITEMS OF THE RURAL BANKING

| Year | ASSETS | | LOANS | | DEPOSITS | | | | CAPITAL | |
|------|--------|----------|--------|-------------------|----------|------------------------|------------------------------------|-----------------------|---------|---|
| | (P M) | % of GNP | (P M) | % of Total Assets | (P M) | % of Total Liabilities | % of Total Liabilities and Capital | Deposit to Loan Ratio | (P M) | Total Liabilities to Capital Accounts Ratio |
| 1980 | 5,524 | 2.27 | 4,572 | 82.77 | 2,051 | 43.00 | 37.12 | 0.45 | 755 | 6.32 |
| 1981 | 6,490 | 2.31 | 5,347 | 82.39 | 2,427 | 43.30 | 37.40 | 0.45 | 884 | 6.34 |
| 1982 | 7,978 | 2.54 | 6,510 | 81.60 | 2,996 | 43.01 | 37.55 | 0.46 | 1,013 | 6.88 |
| 1983 | 9,324 | 2.57 | 7,472 | 80.14 | 3,591 | 44.29 | 38.52 | 0.48 | 1,216 | 6.67 |
| 1984 | 8,819 | 1.73 | 6,818 | 77.31 | 3,316 | 44.14 | 37.60 | 0.49 | 1,306 | 5.75 |
| 1985 | 8,822 | 1.59 | 6,636 | 75.22 | 3,019 | 41.69 | 35.10 | 0.45 | 1,360 | 5.32 |
| 1986 | 9,351 | 1.57 | 6,790 | 72.62 | 3,626 | 47.38 | 39.83 | 0.53 | 1,452 | 5.27 |
| 1987 | 9,961 | 1.48 | 7,143 | 71.71 | 4,516 | 55.75 | 46.68 | 0.63 | 1,575 | 5.14 |
| 1988 | 11,018 | 1.39 | 7,970 | 72.33 | 5,269 | 58.67 | 49.27 | 0.66 | 1,713 | 5.24 |
| 1989 | 12,522 | 1.37 | 8,659 | 69.15 | 6,254 | 49.94 | 43.25 | 0.72 | 1,939 | 6.46 |
| 1990 | 13,862 | 1.28 | 9,736 | 70.23 | 7,067 | 50.98 | 43.78 | 0.73 | 2,280 | 6.08 |
| 1991 | 15,936 | 1.26 | 10,744 | 67.42 | 8,547 | 53.64 | 45.93 | 0.80 | 2,674 | 5.96 |
| 1992 | 18,641 | 1.35 | 12,671 | 67.97 | 10,512 | 70.29 | 57.87 | 0.83 | 3,209 | 4.66 |
| 1993 | 22,667 | 1.51 | 15,544 | 68.58 | 13,422 | 73.49 | 60.57 | 0.86 | 3,893 | 4.69 |
| 1994 | 28,191 | 1.62 | 19,135 | 67.88 | 17,553 | 76.06 | 63.48 | 0.92 | 4,576 | 5.04 |
| 1995 | 36,653 | 1.87 | 24,875 | 67.87 | 23,347 | 76.70 | 64.76 | 0.94 | 5,611 | 5.43 |
| 1996 | 48,039 | 2.12 | 33,403 | 69.53 | 30,279 | 75.57 | 63.94 | 0.91 | 7,290 | 5.50 |
| 1997 | 57,635 | 2.28 | 40,804 | 70.80 | 36,667 | 76.08 | 64.51 | 0.90 | 8,644 | 5.58 |
| 1998 | 56,838 | 2.03 | 41,831 | 73.60 | 36,615 | 74.04 | 62.34 | 0.88 | 9,274 | 5.33 |
| 1999 | 61,500 | 1.96 | - | - | - | - | - | - | - | - |

Source: *Bangko Sentral ng*

NOTES ON MICROFINANCE

A. Definition of Microfinance

Microfinance is the provision of a broad range of financial services such as – deposits, loans, payment services, money transfers and insurance products – to the poor and low-income households, for their microenterprises and small businesses, to enable them to raise their income levels and improve their living standards.

B. Core Principles for Microfinance

- ? The poor needs access to appropriate financial services
- ? The poor has the capability to repay loans, pay the real cost of loans and generate savings
- ? Microfinance is an effective tool for poverty alleviation
- ? Microfinance institutions must aim to provide financial services to an increasing number of disadvantaged people
- ? Microfinance can and should be undertaken on a sustainable basis
- ? Microfinance NGOs and programs must develop performance standards that will help define and govern the microfinance industry toward greater reach and sustainability

Characteristics and Features of Microfinance

| Characteristics | Distinguishing Features |
|------------------------|---|
| Type of Client | ? Low Income ? Employment in informal sector; low wage bracket ? Lack of physical collateral ? Closely interlinked household/business activities |
| Lending Technology | ? Prompt approval and disbursement of micro loans ? Lack of extensive loan records ? Collateral substitutes; group-based guarantees ? Conditional access to further micro-credits ? Information-intensive character-based lending linked to cash flow analysis and group-based borrower selection |

| | |
|-------------------------|--|
| Loan Portfolio | ? Highly volatile ? Risk heavily dependent on potfolio management skills |
| Organizational Ideology | ? Remote from/non-dependent on government ? Cost recovery objective vs. profit maximizing |
| Institutional Structure | ? Decentralized ? Insufficient external control and regulation ? Capital base is quasi-equity (grants, soft loans) |

C. Definition of Microfinance Loans

Microfinancing loans are small loans granted to the basic sectors, on the basis of the borrower’s cash flow and other loans granted to the poor and the low-income households for their microenterprises and small businesses to enable them to raise their income levels and improve their living standards. These loans are typically unsecured but may also be secured in some cases.

D. Level of Microfinance Loan

Average microfinance loan of an NGO microfinance institution or of a cooperative bank or credit union in the Philippine case is about ₱25,000 (from a low of ₱2,000 to ₱5,000). To be realistic, the maximum principal amount of a microfinance loan can be pegged at ₱150,000. This is equivalent to the maximum capitalization of a microenterprise under RA 8425.

E. Collateralization of Microfinance Loan

A microfinance borrower is not likely to be able to borrow from a large commercial, thrift or rural bank but from an NGO microfinance institution or perhaps from a small rural or cooperative bank. Thus, microfinance loans are *typically unsecured*, for relatively short periods of time (180 days) with monthly (or more frequent) amortizations of interest and principal, and often featuring a joint and several guarantee of one or more persons and, certainly, seldom with tangible collateral. But in some cases, they can also be secured, depending on the capacity of the borrower to offer collaterals acceptable to the lending institution.

F. Interest on Microfinance loans

Old Approach

The old (and by now highly discredited as ineffective) approach to loans for low-income borrowers emphasized subsidized interest rates. It did not recognize that subsidized below-market interest rates do not necessarily result in opening up access to financial services for low-income households and microenterprises.

New Approach

The new approach which has been demonstrated by global experience is characterized by a market-based interest rate regime which permits the institution providing microfinance services to cover administrative costs, provisions for loan losses and intermediation/funding costs. This basis is consistent with financially sustainable rural finance and microfinance. Invariably, the global experience continues to validate the proposition that what matters most to the poor and undeserved segments is access to financial services rather than their interest-rate cost – most especially because microenterprise and small business borrowers will take a microfinance loan whose repayment periods match the additional cash flows they hope to generate.

Therefore, interest on such microfinancing loans shall be reasonable but shall not be lower than the prevailing market rates. This is to enable the lending institution not only to recover the financial and operational costs incidental to this type of microfinance lending but also to realize some bottom line gains.

G. Segments of Demand for Micro-credit

- (1) The landless who are engaged in agricultural work on a seasonal basis and manual laborers in forestry, mining, household industries, construction and transport; requires credit for consumption needs and also for acquiring small productive assets, such as livestock.
- (2) Small and marginal farmers, rural artisans, weavers and those self-employed in the urban informal sector as hawkers, vendors and workers in household micro-enterprises: requires credit for working capital, including a small part for consumption needs. *This segment largely comprises the poor but not the poorest.*
- (3) Medium farmers/small entrepreneurs who have gone in for commercial crops and others engaged in dairy, poultry.... Among non-farm activities this segment includes those in villages and slums engaged in processing or manufacturing activity. *These persons live barely above the poverty line and also suffer from inadequate access to formal credit.*