

2 Historical Development and Trends in Commercialization

This chapter focuses on the progress toward commercialization by Philippine MFIs as a whole and by institutional type. A historical overview of the establishment and development of the various types of MFIs is provided and their current collective and individual performance is summarized in terms of outreach, financial self-sufficiency, and efficiency. Major government and donor efforts to inculcate sustainable microfinance practices by institutional type are also reviewed as are four related recent trends in MFI commercialization: rural bank downscaling, commercialization of cooperatives, NGO transformation, and new market entry.

In general, rural banks offer enormous microfinance potential because of their local-level ownership and knowledge. Cooperatives have good outreach but need more work on standards and ensuring self-sufficiency. Most microfinance NGOs are small and offer little commercial potential. However, a few of the larger NGOs have demonstrated commercial success and are moving toward more outreach by transforming into regulated financial institutions. These few successes have attracted some new market entrants that have begun microfinance operations as commercial institutions from the outset. Their commercial structure will allow them to grow quickly and become bigger microfinance players in the future.

OVERVIEW

Three main types of retail MFIs currently serve the market: a large proportion of the 2,865 cooperatives registered with the CDA,²⁶ about 500 of approximately 900 microfinance NGOs, and at least 100 of 786 rural banks. The oldest of these suppliers are the cooperatives,²⁷ which

began in the early 1900s. Initiated in 1952, the rural banks continue to be the dominant provider of commercial micro- and small-scale financial services to a wide range of rural entrepreneurs. Since the 1980s, the number of microfinance NGOs has steadily increased, targeting poor populations without access to formal financial services.

Each of these retail MFIs has expanded its provision of microfinance due to numerous recent and ongoing government and donor-supported programs to expand microfinance outreach to the poor on a commercial basis. However, while the rural banks and credit cooperatives have a nationwide delivery system through their unit entities and local branches, relatively few of them are familiar with microfinance technologies and microfinance markets as profitable opportunities. Numerous microfinance NGOs are trying to fill the demand gap, but nearly all are small, capacity-constrained institutions that have more of a social than commercial focus.²⁸

In addition to these three main types of MFIs are various other formal, semiformal, and informal providers of microfinance (Table 2.1). In areas with low population density and little physical infrastructure where few if any formal and semiformal MFIs operate, informal providers, such as moneylenders called “5-6ers”²⁹ or Mumbai,³⁰ provide microcredit for 1–6 months, usually at nominal interest rates ranging between 10% and 30% (flat) per month. Other informal providers include trade creditors and farmer lenders, self-help groups, such as rotating savings and credit associations, and friends and family. The most recent estimates suggest that informal providers supply about two thirds of microcredit loaned outside the handful of urban centers and highly-populated rural areas, where

Table 2. 1: Major Providers of Microfinance in the Philippines

Type	Ownership	Legal Basis	Regulated by	Supervised by	Main Funding Sources	Authorized Activities	Target Market
<i>Formal Institutions</i>							
Thrift Banks	Private investors	Thrift Banks Act, Law on Corporations	BSP, PDIC	BSP, PDIC	Equity, commercial loans, deposits	Savings deposits and loans	General public
Rural Banks	Private investors	Rural Banks Act, Law on Corporations	BSP, PDIC	BSP, PDIC	Equity, commercial loans, deposits	Savings deposits and loans	General public
Pawnshops	Private investors	General Banking Law	BSP, SEC	None	Equity, commercial loans	Pawn loans	General public
Lending Investors	Private investors	General Banking Law, Law on Corporations	SEC	None	Equity, commercial loans	Loans	General public
<i>Semiformal Institutions</i>							
(Savings and Credit) Cooperatives	Individual members	Cooperatives Code	CDA	None	Capital plus member deposits	Saving deposits and loans to members	Members
NGOs	Private trustees	Law on Trusts and Nonprofit Foundations	Annual Reports to SEC and BSP	None	Grants, donations, commercial loans	Loans to individuals and groups	General public

BSP = *Bangko Sentral ng Pilipinas*; CDA = Cooperative Development Authority; NGO = nongovernment organization; PDIC = Philippine Deposit Insurance Corporation; SEC = Securities and Exchange Commission.

Source: Adapted from Gallardo 2001, p.17.

some local competition exists between formal and semiformal MFIs.

The total volume of microcredit from formal and semiformal MFIs combined is unknown, but the estimates of the outstanding balance are in the range of P6 billion to P8 billion (\$121 million to \$161 million). The largest category of poor people served by the formal financial sector comprises agrarian reform beneficiaries and other small agricultural producers who access funds wholesaled by Land Bank of the Philippines (LBP) through some 460 rural banks and 1,700 cooperatives. It is estimated that as of December

2000, P6 billion (\$121 million) of these wholesaled funds were lent to about 600,000 poor borrowers.³¹ Estimates of the total number of poor with access to microfinance services range between 600,000 and 1 million people,³² depending mainly on whether one includes consumer (i.e., salary-based) loans that may be borrowed from rural banks for microenterprise purposes. However, it is clear that even if 1 million people are served by MFIs, outreach is low compared to the estimated 5.8 million poor households;³³ market penetration is slightly less than 20%.

Market penetration is highest around urban centers and highly populated rural areas outside Metro Manila. In general, commercial microfinance has made the most headway in areas with developed physical infrastructure and adequate social service provision. Such areas include San Fernando, Bacolod, and Davao as well as Cagayan de Oro in the three major island regions of Luzon, Visayas, and Mindanao, respectively. There are a few exceptions to this, including VisionBank's expansion in five municipalities within the province of Catanduanes, which has low population density and traditionally no access to microfinance.

Some thrift and rural banks have not been able to automate their operations because of the unreliable supply of electricity in their areas.³⁴ These and other types of MFIs need to computerize their systems to be able to process efficiently numerous small-scale financial transactions in an accurate and timely manner and expand their geographic coverage. Weaknesses in physical infrastructure (power, telecommunications, transport, etc.) as well as basic health and education services will continue to constrain effective demand for microfinance until there are substantial improvements in these areas.

In the areas where MFIs have penetrated, group lending is still predominantly the norm, reflecting the early widespread adoption of the Grameen methodology adopted by the vast majority of early, major microfinance NGO leaders. With an expansion of commercial microfinance, increased individual lending can be expected as successful group borrowers "graduate" to higher levels of debt capacity and as MFIs of all types widen their market base from the entrepreneurial poor as a group to micro and small-scale enterprises. The increased provision of commercial microfinance by formal MFIs, means that deposit mobilization will likely play an increasing role in funding growth. Increasing the access to voluntary saving accounts should become more of a focus for the industry.

There are several plausible reasons for the lack of extensive microfinance outreach. Most obvious are the difficulties associated with the geographic dispersion of clients in an archipelagic nation, and their cultural and language diversity. The United Nations (UN) has recorded a total of 110 regional and ethnic groups in the Philippines and many different dialects exist, even in the same geographic area. Other important factors include the fact that government directed credit programs, although on the wane now, have been historically costly and unsustainable, leading to gross financial sector distortions and inefficiencies and a general weakening of private sector incentives to innovate. The incorporation of microfinance best practices that balance commercial and social missions by rural banks, cooperatives, and microfinance NGOs is relatively new and may also be an explanation for the low levels of outreach.

Despite the relatively low market penetration of MFIs to date, many have made substantial progress toward commercialization and the largest providers of microfinance can be considered to be on a sound commercial footing. Four major trends in the sector support this. First, rural banks and a few thrift banks are increasingly downscaling their services to tap the microenterprise market, largely as a result of focused microfinance technical assistance and training by donors. Second, donor initiatives to commercialize cooperatives are also spurring their introduction or transformation. Third, several microfinance NGOs have recently transformed into microfinance-oriented rural banks or thrift banks. Fourth, the microfinance sector is also attracting new entrants. For example, a microenterprise-oriented thrift bank was established in mid-2001 by a mix of domestic and international institutional investors led by the German consulting firm, *Internationale Projekt Consult* (IPC).

RURAL BANK DEVELOPMENT AND DOWNSCALING

The roots of commercial microfinance date back to 1952, when a law was passed that allowed for the creation of small regulated banks suitable for providing microfinance on a commercial basis. Based on private ownership and initiatives, the rural banking system was to “promote and expand the rural economy in an orderly and effective manner by providing people of rural communities with the means to facilitate and improve productive activities and to encourage cooperatives.”³⁵ The original target market of the rural banks included low-income, rural entrepreneurs. Rural banks spread quickly in the 1970s, but it was not until the mid-1990s that several of them started engaging in microfinance on a commercial basis, either independently or with assistance from the United States Agency for International Development (USAID)-sponsored Microenterprise Access to Banking Services (MABS) program.

Historical Overview and Recent Performance

The Rural Banking Act of 1952 allowed duly established cooperatives to organize rural banks or subscribe to the shares or stock of any rural bank. Thus, the rural banking system is composed of two subsystems: rural banks, owned and organized by individuals; and cooperative rural banks, owned and organized by cooperatives and other farmer associations.³⁶ To stimulate the proliferation and expansion of both types of rural banks, the Government offered a number of incentives, including exemptions from taxes, charges, and fees that would normally be assessed to formal financial institutions, as long as the bank’s net assets were below a certain level.³⁷ In addition, BSP provided free technical assistance and training as well as access to loans and rediscounting facilities at preferential rates. The system enjoyed rapid growth, with 224 rural banks acquiring over P140 million in assets by 1962. By 1972, there were 591 rural banks and

by 1982, there were 1,033, including more than 25 cooperative rural banks.

Unfortunately, government interference in the rural banking system nearly caused its demise. Through incentives and moral persuasion, the Government convinced rural banks to participate in numerous directed credit programs that encouraged risky lending practices. One of the most extensive agricultural extension programs, *Masagana 99*, wreaked havoc on the rural banking system—rural banks served as the major conduit of unsecured loans to small rice farmers during the 1970s. BSP allowed the banks to rediscount 100% of the loan values at 1% per year; the loans already had low interest rates of 10–12% per annum. Furthermore, BSP allowed the rural banks to exclude arrears under the *Masagana 99* program in their computation of past-due ratios. This allowed the rural banks to continue to borrow from BSP when their past-due ratios had exceeded the normal 25% limit.

The rural banks complied with the Government’s request for their participation partly as a result of the threat that new rural banks would be allowed to open in their geographic territory if they did not participate. In addition to the adverse impact of their participation in several directed credit programs, the rural banks suffered adverse economic conditions including high inflation, a liquidity crisis, trade imbalances, and large fiscal deficits. These difficulties led to tight monetary policies and the partial liberalization of the financial system in the early 1980s. From 1979 to 1982, a few assistance programs were implemented to rehabilitate the rural banks, including capital buildup and loan restructuring, which resulted in minimal relief only. In 1984, the rural banks’ major source of credit funds, BSP’s rediscount window, dried up and rural banks’ real assets dropped substantially. The highest rate of rural bank failures occurred in the 1980s when 182 rural banks closed.³⁸

The Countryside Financial Institutions Enhancement Program of 1991 aimed to rehabilitate the rural banks and restore risk asset ratios to at least 10% for those rural banks that could infuse sufficient additional capital. This program, as well as the passage of the revised

Rural Bank Act of 1992, indicating the Government's commitment to allow the rural banks to compete freely in the market, reversed the negative trends of the past. By 1992, the rural banking system reported positive real growth rates in assets, capital accounts, and net loans, with 787 rural banks reaching 463,000 borrowers. Steady growth has continued and the rural banks are now poised for significant expansion. At present, there are over 790 rural banks with more than 1,800 branches that cover 85% of the municipalities in the Philippines. As a whole, the system of rural banks has the widest branch network of any financial institution in the country. While some rural banks have focused on larger, more traditional collateralized loans, most are now returning to lower-income entrepreneurs as a growth market.

Gauging rural bank financial performance in microfinance operations is extremely difficult because there is very little information on their activities other than from those that are members of the national microfinance network called the Microfinance Council of the Philippines or from the MABS Project. The 41 rural banks that participated in the Microfinance Council's survey reported as of June 2001 a combined 105,739 clients, P553.2 million (\$11.1 million) in outstanding loans, and an average

outstanding loan per client of P5,231 (\$105). This average outstanding loan amount is only slightly higher than that reported by the 22 microfinance NGOs (P3,742 or \$75) and 23 cooperatives (P4,853 or \$98) also reporting to the Microfinance Council.

The rural banks reported value of voluntary and mandatory savings (referred to in the Philippines as "capital buildup" (or CBU) was P184.1 million (\$3.7 million). Table 2.2 demonstrates that as a whole, the banking sector is liquid—all bank types have total deposits in excess of total (gross) outstanding loans, although the rural banking system has the least liquidity, with its deposit-to-loan ratio of just 1.06. Nonetheless, the rural banks mobilize the highest percentage of small deposits. More than 90% of their deposit base is from accounts with P15,000 (\$300) or less. In fact, many rural banks have shown creativity in mobilizing deposits. For example, some require only a minimum of P100 (\$2) to open a savings account.³⁹ A few rural banks offer checking accounts and automatic teller machines (ATM) to their clients. Aggressive marketing campaigns for deposits are implemented by many rural banks through print and broadcast media, by sponsoring important events in the communities, or by conducting raffles and games.

Table 2.2: Asset and Liability Structure of Banks, as of March 2002

Institutional Category	Total Assets (P billion)	Gross Outstanding Loans (P billion)	Total Deposits (P billion)	Total Deposits Valued < P 15,000 (P million)	% Small Deposits of all Deposits (by number)
Commercial Banks	2,961.5	1,615.8	2,005.5 (in 19.4 million accounts)	33,452.0 (in 14.7 million accounts)	76.0
Thrift Banks	243.4	143.0	162.8 (in 2.8 million accounts)	4,640.0 (in 2.2 million accounts)	76.5
Rural Banks	73.6	46.4	49.3 (in 4.7 million accounts)	5,234.8 (in 4.3 million accounts)	90.7
Total	3,278.5	1,805.2	2,217.6 (in 26.9 million accounts)	43,326.8 (in 21.2 million accounts)	78.6

Notes: The institutional category Rural Banks includes rural banks and cooperative rural banks. Total deposits include only domestic deposits.

Source: PDIC 2002.

Rural Bank Downscaling

Feeling competitive pressures from above (commercial and thrift banks) and below (pawnshops, lending investors, and finance companies), many rural banks are expanding their provision of specialized microfinance services (Box 2.1). For instance, some rural banks have adopted various microfinance methodologies, including individual, solidarity, and variants of the Grameen model in order to penetrate high-risk, small borrowers at low cost. 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 provide specialized microfinance services for their clients.⁴⁰

Box 2.1

Rural Bank Attraction to Microfinance Profit Potential

"The success of microfinance for the poor in the Philippines for the past decade has encouraged us to venture into a new field of banking: lending to the extreme poor."

Marilou Genuino
President, BMS Rural Bank

Source: Maekawa 2002.

Given the suitability of rural banks for engaging in the sustainable provision of microfinance (Box 2.2), the USAID-funded MABS program is working to bring about a sizable expansion of loan and deposit banking services to microenterprises and other groups at lower socioeconomic levels by assisting participating rural banks to significantly increase the services they provide to the microenterprise sector. The primary local project partner is the Rural Bankers Association of the Philippines (RBAP), which has developed a MABS Technical Services Unit with technical assistance provided

Box 2.2

Suitability of Rural Banks to Provide Commercial Microfinance

"Of all the banks, it is the rural banks that are the best placed to engage in microfinance. Rural banks are established to meet the credit needs of borrowers who are often outside the catchment areas of commercial banks and/or who may be considered poor risks by other banks...In addition, cooperative (rural) banks may be organized to perform banking and credit services for the cooperatives...The World Bank (1996, p. 64) comments that sufficient evidence exists of the profitable provision of savings and credit services to the poor by cooperative rural banks to suggest that '...these banks offer an interesting possibility for reaching the poor effectively without setting up alternative institutions.'"

Source: McGuire, Conroy, and Thapa 1997, p. 237.

by the international development firm, Chemonics International, Inc. Using what has been called the "MABS approach," the program provides technical assistance, training, and limited resource support to participating rural banks (and cooperative rural banks) so they can profitably and sustainably expand their loan and deposit portfolios to microenterprises.

The MABS approach includes intensive one-on-one technical assistance, workshops, seminars, on-the-job coaching, and exposure and training visits to participant banks. Each bank is assigned a technical advisor who checks that the training and technical assistance are being delivered properly and efficiently. Each participating bank receives focused attention and support, which includes institutional assessment, senior management orientation, market survey, product development/enhancement, improvement of management information systems, business planning, on-the-job training (including sessions on cash-flow lending and zero tolerance toward delinquency), and development of in-house training capacity.

Since its inception in 1998, the MABS program has helped 81 rural banks/branches, most of which are in Mindanao, to expand their microfinance operations. As of March 2002, MABS rural banks had 23,965 active loan clients, with a total outstanding loan portfolio of P144.8 million (Table 2.3). Since the program started, microdeposit balances (accounts with balances of P15,000 [\$300] or less) of MABS partner banks increased by P128.8 million, corresponding to 96,185 additional depositors' accounts. More than 96,000 microdepositors have also opened savings accounts at MABS participating rural banks.

Having successfully assisted rural banks in Mindanao to achieve profitable microfinance departments, RBAP formed the Microfinance Technical Services Unit in November 2000 to replicate the introduction of the MABS approach in the Luzon and Visayas regions. The RBAP-MABS Technical Services Unit currently works with eight pilot participating rural banks in Luzon and the Visayas and also provides support to the 20 participating banks in Mindanao.

COOPERATIVE DEVELOPMENT AND COMMERCIALIZATION

Cooperatives have been actively providing micro- and small-scale financial services to poor and low-income households since the early 1900s, but most have only recently begun to commercialize their operations and make headway in the sustainable provision of specialized microfinance based on best practices.

Historical Overview

The cooperative movement was initially sponsored by civic and regional groups that registered the earliest cooperatives under the first Corporation Law enacted in 1906, followed by the Agricultural Credit Associations Act of 1915, and the Cooperative Marketing Law enacted in 1927. In the late 1960s and early 1970s, the cooperative movement had two major influences that would dramatically expand it and shape its culture.

Table 2.3: Performance Highlights for MABS Rural Banks, as of March 2002

Indicator	Pilot Banks	1st Rollout Banks	2nd Rollout Banks	3rd Rollout Banks	Total/Average
Number of Bank Branches	4	37	23	16	80
Number of Active Borrowers	1,991	14,147	5,348	780	22,266
Number of Loan Officers	19	140	117	43	319
Value of Loans Outstanding (P million)	14.2	79.7	37.9	12.9	144.7
Average Loan Balance (P)	7,141	5,634	7,092	16,557	9,106
Average Loan Portfolio per Loan Officer (P)	748,282	569,300	324,154	300,337	485,518
Portfolio at Risk More Than 30 Days (%)	3.20	3.37	3.50	0.19	2.57
Depth of Outreach (Average Loan Balance/ Gross National Product Per Capita, %)	13	10	13	31	16.75

Notes: Pilot banks started operations in October 1998. First rollout banks started operations in September 1999. Second rollout banks started operations in March 2000. Third rollout banks started operations in July 2001.

Source: Data from RBAP-MABS Program as of 31 March 2002.

First, responding to the call of the Second Vatican Council for direct participation in the solution of poverty and social injustice, the Catholic Church in the Philippines passed a resolution in 1967 recognizing the need to organize cooperatives in parishes. Church efforts resulted in the organization of thousands of cooperatives that stressed education as a tool for economic liberation and on voluntarism and self-reliance as the motivating forces for leadership and membership in cooperatives.

Second, to support the agrarian reform program, former President Marcos repealed the Cooperative Marketing Law and issued a new decree on cooperatives in 1973. Cooperatives were directed to prepare tenant farmers for their new role as landowners and to provide them with basic economic and social services. Many new cooperatives were organized overnight with government sponsorship. These laws governed the cooperatives along with some other sectoral regulation until all of them were brought under one law, the "Cooperative Code of the Philippines," in 1989. In 1997, the National Confederation of Cooperatives (NATCCO) was organized with the main objective of providing improved education and training components for the primary and secondary member-affiliates.

The movement has historically had a much stronger social orientation than commercial focus because of the influence of church and government use of cooperatives as conduits for agricultural credit. While social values are very important, they are often used as an excuse for poor business management. This lack of commitment to a commercial approach, added to the fact that there is virtually no regulation or supervision of cooperatives and they can be started with less than \$100 equivalent and 15 members, has resulted in a large percentage of cooperative failure. Of some 42,000 cooperatives registered under the Cooperative Code in 1997, half were inoperative.⁴¹ Lack of prudential standards has resulted in high delinquency, low capital accumulation, and little or no savings mobilization, which, in turn, has resulted in very high external dependency. Donor efforts to improve the viability of cooperatives have

also allowed a few of them to expand their microfinance operations in a sustainable manner.

As with the rural banks, measuring the performance of cooperatives' microfinance operations is extremely difficult given the little available information on their activities other than data captured by those cooperatives participating in the Microfinance Council or donor-funded projects. The 24 cooperatives that participated in the Microfinance Council's survey reported a combined 41,248 clients and P200.2 million (\$4.0 million) in outstanding loans, with an average outstanding loan per client of P4,853 (\$98) as of June 2001. The participating cooperatives also reported the value of savings and capital buildup combined to be P85.0 million (\$1.7 million).

The cooperative movement has demonstrated its potential for mobilizing deposits and providing financial services to small savers and borrowers, and it has been able to finance its lending from share capital and deposits, quite apart from its role as a conduit for government funding.⁴² Many well-run cooperatives in the Philippines are sustainable and show positive financial performance, although the limited financial reporting required of them by the CDA and their poor supervision make it difficult to determine how many fall under this category.

Commercialization of Cooperatives

The focus on the commercialization of cooperatives and their provision of specialized microfinance products and services is relatively recent. It is actively promoted by various government and donor efforts, including technical assistance, training, and funding support. Commercialization is being addressed at two levels: the national federation and selected primary cooperatives.

The largest of the four national federations of cooperatives is NATCCO, which was formed primarily to coordinate the provision of training and educational services at the national level, and serve as the voice of cooperatives belonging to its network. Today, NATCCO is the strongest such national federation in terms of geographic reach, membership, financial capacity, and array

of services. At the core of the NATCCO network are the 1,200 affiliated primary cooperatives located in both rural (75%) and urban areas (25%). Membership is composed of various types of cooperatives: 18% are pure credit cooperatives; 71% are multipurpose cooperatives, with savings and credit as the bulk of their business; 5% are consumer or marketing cooperatives; and the rest (6%) are service and producers' cooperatives and a few cooperative rural banks. Members total more than 1 million individuals: farmers and fishers (24%), self-employed (21%), salaried workers (29%), housekeepers (16%), and students and other groups (10%).

Efforts to strengthen the cooperative movement as a whole are being supported by a number of donor-funded projects. Through the financial intermediation component of the Socio-Economic Development of Cooperatives in the Philippines (SEDCOP) project, international banking standards are being introduced to the cooperatives (Box 2.3). The project aims to professionalize the cooperatives' operations and to build their confidence in undertaking financial intermediation. Through capacity-building assistance, the NATCCO-Financial Intermediation (FI) project is attempting to raise the overall professional capability and profitability of participating cooperatives by improving their accounting and reporting transparency, management information systems, operating efficiency, product diversification including the development of microfinance products and services based on local and international best practices, and marketing.

As part of SEDCOP's strategy to improve cooperative financial intermediation, it has identified (using the software MASS-SPECC; as of May 2002) 29 primary cooperatives in the Northern Luzon, Mindanao, and Visayas regions for technical support designed to improve efficiency in operations and their ability to meet their members' need for loans and capital and, therefore, improve their profitability as well.

These cooperatives have experienced reduction in their delinquency ratios, increases in assets, and professionalization of their staff. Delinquency rates of the Mindanao and Northern

Box 2.3

Efforts to Commercialize Cooperative Microfinance

"We are trying to professionalize our savings and credit operations to raise our level of competitiveness and competence to be at par with big commercial and international banks. We do this through the use of internationally accepted prudential ratios, common standard chart of accounts, computerization, and capability-building. We continue to test, develop viable and innovative enterprises that provide livelihood, income opportunities and basic products and social services to families and individuals."

Source: NATCCO 2002.

Luzon cooperatives, for example, were reduced from around 40% at the start of the project (31 December 2000) to around 20% by end-2001 (Table 2.4).

Among SEDCOP's initiatives with the pilot cooperatives is improvement in the accounting and management information systems. The software MASS-SPECC is able to computerize the savings and credit operations of the cooperatives using the MASS-SPECC Standard Run-time Edition. The software consolidates the database of the cooperative so that if a member's account is called up, all the information required to evaluate a loan application, for example, is immediately available. This information includes outstanding obligations from previous loans as well as the size of the member's capital share and account balance. An important feature of the software is its ranking of a member based on the frequency of deposits and settlement of previous loans. Such ranking guides the loan officer's appraisal of a loan, which is an incentive for management to collect information on delinquent loans and react rapidly to any adverse changes.

The other major donor-funded effort aimed at commercializing cooperatives, the Philippine Credit Union Empowerment and Strengthening (CUES) program was a \$3.7 million project

Table 2.4: Delinquency Reduction at NATCCO-FI Cooperatives

	Delinquency Rate at Project Start (%)	Delinquency as at End-2001 (%)
Northern Luzon		
Galimuyod MPC	47	13
Suyo MPC	48	22
Alilem MPC	63	10
Sta. Cruz	16	12
BAMARVEMCO	36	38
La Trinidad	41	24
BABUDEMCO	46	15
FATIMA	19	10
Average	40	18
Mindanao		
AIMPC	78	33
BUGEMCO	5	5
MCC	76	35
MSUIIT MPC	5	2
OIC	37	21
PMPC	26	16
SAFRAGEMC	28	16
TCMPC	78	41
Average	42	21

FI = Financial Intermediation; MPC = multipurpose cooperative; NATCCO = National Confederation of Cooperatives.

Notes: Initial delinquency rates (project start) were as of end-2000. Delinquency is based on maturity except for Alilem MPC, which uses a portfolio-at-risk greater than 30 days percentage.

Source: NATCCO 2002.

(1996–2002) funded by USAID’s Office of Microenterprise Development and implemented by the World Council of Credit Unions (WOCCU) to extend microfinance services to men and women in Mindanao. This program aimed to improve financial discipline and savings-driven growth utilizing the Model Credit Union Building (MCUB) methodology and the PEARLS (Protection, Effective financial structure, Asset quality, Rates of return, Liquidity, and Signs of growth) evaluation and monitoring system. CUES worked with 18 Mindanao credit cooperatives.

As of 30 April 2002, all cooperatives participating in the MCUB program were submitting quarterly PEARLS ratio reports and understood the implications of the financial ratios in decision making. From December 1998 to December 2002, loan loss provisions for loans delinquent more than 12 months increased from 10.3% to 100.0%, while delinquency decreased from 63.0% to 9.6%. In the same time period, member-client outreach increased 499.3% from 36,443 to 218,354. Three quarters of these member-clients were women. Voluntary savings deposits increased by 540.8% from \$3.4 million in December 1998 to \$21.6 million in December 2002. These and other performance highlights are shared in Table 2.5.

A unique element of the program was a partnership between WOCCU and Freedom From Hunger that enabled credit unions to offer a village banking product, Savings and Credit with Education (SCWE), to poor rural women, in addition to their regular savings and credit services. SCWE is a microfinance program designed specifically to meet the needs of the very poor rural women in the communities of the credit unions with demand-driven, commercially-priced financial services. Along with saving and lending activities, trained field agents provide education on such topics as breast-feeding, rehydration therapy, and nutrition. For some of the women, this is the first access to credit and educational information they have ever received.

Of the 18 Mindanao cooperatives participating in the MCUB program, 11 were also participating in the SCWE program. As of June 2002, cooperatives participating in the SCWE Program had mobilized a total of over 900 active savings and credit associations with 24,300 women members receiving access to financial services. As of 30 April 2002, a total of 21,432 borrowers had P63 million (\$1.3 million) in outstanding loans and the membership had deposited P10.6 million (\$213,000) in savings. Portfolio at risk (30-days overdue) was 3.78%.

In 2002, CUES was selected to receive the Herb Wegner Memorial Award for Outstanding Organization/Program from the National Credit Union Foundation. The project was honored for

Table 2.5: Outreach and Financial Performance Indicators of the 11 (Batch One) and 5 (Batch Two) CUES Philippine Credit Unions

Indicator	End-1998	End-2002	% Change
Number of Members	36,433	218,354	499.3
% of Women Members	65.7	74.7	13.7
Number of Outstanding Loans	0	107,744	
Average Outstanding Loan Amount (\$)		271	
Total Outstanding Loans (\$)	5,936,546	29,247,584	392.7
Average Deposit Size (\$)	92	90	-2.2
Total Deposits (\$)	3,366,164	21,571,135	540.8
Average Share Size (\$)	110	42	-61.8
Total Shares (\$)	3,147,164	10,202,805	224.2
Total Assets (\$)	9,588,614	40,329,441	320.6
Deposits / Total Assets (%)	35.1	53.5	52.4
Operating Expense / Average Assets (%)	8.1	10.3	27.2
Net Income / Average Assets (Unadjusted Return on Assets, %)	2.1	6.1	190.5

Notes: Exchange rate used in Table: end-1998: \$1 = P40.2; end-2002: \$1 = P50.0. Blank entry means data not available.

Source: WOCCU 2002a.

its success as an innovative effort to provide affordable financial services to people, especially women, in some of the poorest areas of the Philippines. The CUES project plans to continue conducting training to incorporate the recommended financial disciplines and prudential standards in an increasing number of cooperatives.

DEVELOPMENT AND TRANSFORMATION OF MICROFINANCE NGOS

Historical Overview and Recent Performance

A few NGOs began microfinance activities in the 1980s and hundreds more have incorporated microfinance as part of their service menu since the early 1990s due to substantial government, donor, and international NGO financial and nonfinancial support. The influence of the Grameen model of service delivery has been very strong among microfinance NGOs due in large part to various forms of support available to Grameen replicators. Expansion of microfinance NGOs following the Grameen model has been bolstered since 1996 when a \$35

million Asian Development Bank (ADB)–International Fund for Agricultural Development (IFAD) project started, allowing funds to be wholesaled through the government apex organization, People’s Credit and Finance Corporation (PCFC), to Grameen replicators for onlending by microfinance NGOs to groups of women borrowers. Also since the mid-1990s, other models, such as the Association for Social Advancement (ASA) in Bangladesh, have been promoted among microfinance NGOs with technical assistance provided by UNDP and other donors.

Since 1997, the Government has been explicitly incorporating microfinance into its poverty reduction strategies and encouraging microfinance NGOs to develop sustainable microfinance programs. High educational levels and exposure of MFI managers to international best practices in microfinance have helped a few of these NGOs to progress toward making their operations commercially viable. In addition, the existence of several networks and donor-funded projects has strengthened the ability of the microfinance NGO industry to grow over time.

However, the vast majority of microfinance NGOs is neither viable nor sustainable. While

microfinance NGOs effectively target and reach poor clientele (due in large part to widespread use of means testing associated with the Grameen model), they are not efficient intermediaries because of their weaknesses in ownership and governance, and institutional capacity. As nonstock, nonprofit organizations, microfinance NGOs have difficulty accessing loan capital from commercial sources. Considered individually, however, a few of the older microfinance NGOs have achieved financial self-sufficiency and have efficient operations. Data from the Center for Agriculture and Rural Development (CARD) and *Tulay sa Pag-unlad, Inc.* (TSPI), which both began as NGOs in the 1980s, are indicative (Table 2.6).

Large-scale Microfinance NGOs

CARD and TSPI are two of only three MFIs that had loan portfolios exceeding P100 million (\$2.0 million) as of end-2001. The third was the Negros Women for Tomorrow Foundation (NUTF) (Table 2.7). The Foundation's combined loan portfolio of P754 million (\$15.2 million) accounts for an estimated two thirds of all microfinance NGOs' combined portfolios. Its combined outreach of 158,425 clients accounts for about half of the total of all microfinance NGOs. With plans for large-scale expansion, these three large microfinance NGOs are expected to continue dominating the microfinance NGO sector in terms of outreach, sustainability, and efficiency over the next 3 years. CARD and TSPI, in particular, are regarded by the NGO sector as pioneers in microfinance commercialization in the Philippines, in that they have achieved full financial self-sufficiency and charge interest rates that more than cover their costs.

The size of CARD's loan portfolio in 2001 grew by 58% over the previous year. This high growth rate was made possible in large part by its creation of a rural bank and ability to mobilize savings. Repayment rates continued to be maintained at close to 100% with a portfolio-at-risk ratio of less than 0.5%. CARD independently reported an operational self-sufficiency ratio of 140% and a financial self-sufficiency ratio of 118% at end-2001.

CARD employs a variety of microfinance methodologies, but the bulk of its microlending is based on a modified Grameen model. Its target clients are landless female rural workers who have no regular jobs and have total marketable assets of less than P50,000 (about \$1,000). CARD provides initial membership training, including value formation and leadership development. CARD also offers its mature clients the CARD Loan Acceleration Program, a credit line of up to P120,000 (about \$2,400). Effective interest charges of 44% per annum are built into the weekly amortization plans. CARD's formalization and its operational and financial performance continue to make it a leading commercial player in the microfinance sector. Almost all of CARD's clients live below the poverty line in rural parts of the country. About 50% of the clients are in agriculture, 30% in commerce, 15% in manufacturing, and 5% in services.

Established in 1981, TSPI was the first Philippine NGO to specialize entirely in providing microfinance. In contrast to the combined loan growth rate for CARD (Bank and NGO) of nearly 60%, TSPI's loan portfolio increased by 15% in 2001. Repayment rates continue to be high and stable at 98.5% while the portfolio-at-risk ratio is a reasonable 3.0%.⁴³ Improvements in TSPI's operational and financial performance are reflected in its self-reported operational self-sufficiency (OSS⁴⁴) ratio of 126.6% and financial self-sufficiency (FSS⁴⁵) ratio of 102%.

As of April 2002, TSPI's total loan portfolio was P206.9 million (\$4.2 million) with 44,044 active clients. TSPI offers three loan products: (i) the *Kabuhayan* (Livelihood) Program, which uses Grameen methodology to deliver loans of P3,000–20,000 (\$60–400) to poor women in groups of 20 and carries a flat interest rate of 18% for 6 months; (ii) the *Sasakyan ng Bayan* (tricycle) loan product, which also uses group guarantees, but with only six members, for loans of P75,000–85,000 (\$1,500–1,700) that carry a 36% flat interest rate per annum with a term of 30 months; and (iii) individual loans for business expansion to successful microenterprises that are not yet ready

Table 2.6: Selected MicroBanking Bulletin Indicators

Indicator	CARD ^{a, b}	TSPI ^c	Asia-Pacific	All MFIs
Outreach and Institutional Indicators				
Age of Institution (year)	13	19	10	8
Number of Offices	21	21	7	13
Number of Active Borrowers	28,531	18,344	9,266	10,710
Women Borrowers (%)	100	88	77	62
Profitability				
Portfolio Yield (%)	39.0	43.0	44.0	38.1
Adjusted Return on Assets (%)	-1.4	-2.5	2.4	-3.7
Adjusted Return on Equity (%)	-4.0	-5.3	7.3	-8.6
Operational Self-Sufficiency ^d (%)	102.0	96.0	116.0	102.0
Financial Self-Sufficiency ^e (%)	95.0	92.0	110.0	90.0
Efficiency				
Total Admin. Expenses/Avg. Gross Loan Portfolio (%)	30.6	35.8	28.3	30.4
Salary Expenses/Avg. Gross Loan Portfolio (%)	16.9	21.7	15.5	16.2
Productivity				
Average Salary (Multiple of GNP/Capita)	1.6	3.0	2.8	5.1
Staff Productivity	102.0	83.0	86.0	114.0
Portfolio				
Portfolio at Risk > 90 Days (%)	0.0	3.7	1.9	2.1
Average Loan Balance (\$)	129.0	194.0	261.0	466.0
Depth (Loans as % of GNP/Capita)	12.3	18.5	40.7	46.0

CARD = Center for Agriculture and Rural Development; GNP = gross national product; MFI = microfinance institution; TSPI = *Tulay sa Pag-unlad*, Inc.

^a CARD operates a rural bank and an NGO and combines the operating results of the two organizations for reporting purposes (Microfinance Council of the Philippines 2002b, p.7).

^b CARD's MBB-adjusted data presented here (with permission from the MFI) is as of end-1999, the most recent MBB data available at the time of the study.

^c TSPI's MBB-adjusted data presented here (with permission from the MFI) is as of July 2000. The data for Asia-Pacific and All MFIs are also as of this date. It should be noted that TSPI independently reports its number of active borrowers as of end-2001 as 25,939, its OSS as 126.6%, and its FSS as 102%.

^d Operational self-sufficiency (OSS) = operating revenue/(loan loss provision expense + operating expense + financial expense). OSS measures how well an MFI can cover its costs through operating revenues.

^e Financial self-sufficiency (FSS) = adjusted operating revenue/(loan loss provision expense + financial expense + adjusted operating expense). FSS measures how well an MFI can cover its costs taking into account a number of adjustments to operating revenues and expenses for subsidies, inflation, and nonperforming loans. The purpose of most of these adjustments is to model how well the MFI could cover its costs if its operations were not subsidized, and if it were following international accounting standards and funding its expansion with commercial-cost liabilities.

Source: MicroBanking Standards Project Finance Performance Reports prepared for each institution for inclusion in the MicroBanking Bulletin (MBB).

to access loans from commercial banks. Loan sizes under this program are in the range of P50,000–400,000 (\$1,000–8,000) and carry a flat interest rate of 36% per year with terms of 6–12 months.

About half of TSPI's funds are derived from client deposits and most of the remainder is composed of loans borrowed at what can be

considered fully commercial interest rates—the interest rate of their borrowings exceeds the prevailing prime rate by more than 5 percentage points on average. Given its good operational and financial performance and its significant reliance on commercial sources of funds, TSPI continues to be a major player in the microfinance market and its level of commercialization can be

Table 2.7: Status of Large Microfinance NGOs, as of End-2001 (more than P100 million in outstanding loans)

Indicator	CARD	TSPI	NWTF
Number of Branches	30	26	15
Number of Borrowers and Savers	84,037	39,378	35,010
Total Number of Staff	337	309	224
Number of Field Staff	307	249	163
Value of Loans Outstanding (P)	378,991,438	195,630,587	179,429,318
Value of Collateral Savings (P)	156,042,718	85,626,502	54,408,927
Average Loan Balance (P)	4,110	5,984	5,125
Average Portfolio per Field Staff (P)	1,234,500	785,665	1,100,793
Repayment Rate (%)	99.9	98.5	99.2
Portfolio at Risk (%)	0.43	3.0	2.1
Operating Cost Ratio (%)	24.0	35.8	34.4
Operational Self-Sufficiency (%)	139.5	122.7	102.4
Financial Self-Sufficiency (%)	118.5	100.8	85.7
Equity to Asset Ratio (%)	30.4	44.6	32.0
Current Ratio	2.3	1.7	2.8
Collateral Savings to Loan Ratio (%)	41.1	43.8	30.3

CARD = Center for Agriculture and Rural Development; NGO = nongovernment organization; NWTF = Negros Women for Tomorrow Foundation; TSPI = *Tulay sa Pag-unlad*, Inc.

Source: Microfinance Council of the Philippines 2002b, p 8.

expected to increase because it plans to obtain approval for the operation of a microfinance-oriented thrift bank in the near future.

Founded in 1984, NWTF was incorporated in March 1986 as a nonstock corporation (i.e., NGO) with the mission to create opportunities for the self-employed by providing poor people with access to integrated credit facilities, and to reduce the exploitation of the poor by moneylenders through a comprehensive credit program. NWTF's loan portfolio increased in 2001 by almost 60% over that in the previous year and is reported at P179.4 million (\$3.6 million). NWTF continues to maintain repayment rates of 99.2% and a portfolio-at-risk ratio of 2.1%. At the end of 2001, NWTF reported OSS and FSS ratios of 102% and 86%, respectively.

NWTF started Project Dungganan in October 1989 using the Grameen model to serve women in rural households belonging to the poorest 30% of the population. Loans are provided based on joint liability to group members at a flat 32% interest rate per annum. Although this interest rate has allowed NWTF to reach OSS, the

organization has not yet attained FSS, which is, however, a priority. An NWTF senior manager noted that they are striving to achieve FSS by "lowering operational costs, increasing outreach, improving client retention, repackaging loan products to suit client needs, improving funds management, leveraging equity, and providing staff incentives." In line with its clients' needs, loan sizes are small, ranging between P1,500 and P2,000 (\$30–40) for the first loan with stepped lending on subsequent loans to a maximum of P7,000 (\$140).

NWTF has other credit products, such as education loans, utility loans (for electricity and water), and family loans (flexible loans for any consumer or business purpose). Most of the clients (77%) engage in commerce, with 14% in agriculture, 6% in services, and 3% in manufacturing/production. NWTF's strong client orientation, balanced with its focus on achieving FSS, suggests that this microfinance NGO will progress along the commercialization continuum, albeit more slowly than CARD or TSPI, because NWTF is not yet ready to formalize its operations

in an effort to fuel further growth via deposit mobilization.

Three microfinance NGOs are classified as medium-sized MFIs: *Taytay sa Kauswagan*, Inc. (TSKI), Agricultural and Rural Development for Catanduanes, Inc. (ARDCI), and *Alalay sa Kaunlaran sa Gitnang Luzon*, Inc. (ASKI) (Table 2.8). They have not yet achieved financial self-sufficiency, but planned to focus on efficiency and productivity of their operations in 2002 while continuing their present growth path. It is expected that these three MFIs will continue to grow and report improved performance in 2003 and beyond.

Small-scale Microfinance NGOs

Six of the leading small-scale microfinance NGOs are members of the Microfinance Council and their summary performance data are in Table 2.9. *Ahon sa Hira* Foundation, Inc. (ASHI) and First Consolidated Bank Foundation Inc. (FCBFI) appear to have consolidated their operations with only minor increases both in outreach and size

of loan portfolios. The other four microfinance NGOs—Norfil Foundation, Inc. (NORFIL), Milamdec Foundation, Inc. (MILAMDEC), Cebu Micro-Enterprise Development Foundation, Inc. (CMEDFI), and Jaime V. Ongpin Foundation, Inc. (JVOFI)—experienced substantial increases in number of clients and loan portfolio size in 2001. All six MFIs are experiencing repayment rates exceeding 90% and three of them have repayment rates of at least 97%; however the portfolio-at-risk rates of 10% or higher for three of them indicate that growth may be coming at the cost of declining repayment performance. Only three are nearing 10,000 clients. In terms of OSS ratios, three of the six reported ratios exceeding 100%, meaning that they are covering operational costs from revenues derived from microcredit activities. While a few of these small microfinance NGOs offer some potential for sustainable growth in the future, the vast majority of the hundreds of such microfinance NGOs is not commercially viable and would be forced to close in the absence of donor funds.

Table 2.8: Medium-sized Microfinance NGOs, as of end-2001 (between P30 million and P100 million in outstanding loans)

Indicator	TSKI	ARDCI	ASKI
Number of Branches	8	4	6
Number of Borrowers and Savers	32,036	13,304	12,479
Total Number of Staff	209	78	102
Number of Field Staff	126	62	85
Value of Loans Outstanding	90,390,116	63,256,221	43,287,351
Value of Collateral Savings	30,446,713	21,861,063	10,197,217
Average Loan Balance	3,515	9,260	3,469
Average Portfolio per Field Staff	717,382	1,032,000	901,820
Repayment Rate (%)	97.3	99.5	85.0
Portfolio at Risk (%)	7.31	2.4	18.0
Operating Cost Ratio (%)	33.3	28.1	41.0
Operational Self-Sufficiency (%)	110.6	119.0	85.6
Financial Self-Sufficiency (%)	88.7	84.0	82.1
Equity to Asset Ratio (%)	28.4	62.1	21.0
Current Ratio	3.5	2.5	2.0
Collateral Savings to Loan Ratio (%)	33.7	34.0	23.0

ARDCI = Agricultural and Rural Development for Catanduanes, Inc.; ASKI = *Alalay sa Kaunlaran sa Gitnang Luzon*, Inc.; TSKI = *Taytay sa Kauswagan*, Inc.

Source: Microfinance Council of the Philippines 2002b, p 7.

Table 2.9: Small-scale Microfinance NGOs, as of End-2001 (less than P30 million in outstanding loans)

Indicator	ASHI	FCBFI	NORFIL	MILAMDEC	CMEDFI	JVOFI
Number of Branches	9	1	9	8	4	1
Number of Borrowers and Savers	9,044	3,793	9,778	8,595	3,066	691
Total Number of Staff	68	19	53	46	22	8
Number of Field Staff	61	14	51	36	18	5
Value of Loans Outstanding	28,537,539	23,397,390	19,880,846	17,489,545	7,567,227	1,856,800
Value of Collateral Savings	16,999,427	6,221,001	10,287,936	6,854,541	2,741,633	806,401
Average Loan Balance	3,155	6,169	2,140	2,495	2,702	3,774
Average Portfolio per Field Staff	713,438	1,799,799	389,821	485,821	420,401	372,115
Repayment Rate (%)	97.4	91.0	94.0	94.0	97.0	99.8
Portfolio at Risk (%)	2.3	15.0	24.0	2.4	12.0	1.1
Operating Cost Ratio (%)	43.0	10.0	93.0	34.0	14.0	
Operational Self-Sufficiency (%)	76.0	124.0	77.0	110.0	86.0	102.6
Financial Self-Sufficiency (%)	65.0	104.0			74.0	
Equity to Asset Ratio (%)	55.0	26.0	43.9	21.0	47.0	-4.7
Current Ratio	4.9	2.6	1.8	2.7	3.3	0.08
Collateral Savings to Loan Ratio (%)	59.6	27.0	51.7	39.0	36.0	43.4

ASHI = *Ahon sa Hirap* Foundation, Inc.; CMEDFI = Cebu Micro-Enterprise Development Foundation, Inc.; FCBFI = First Consolidated Bank Foundation Inc.; JVOFI = Jaime V. Ongpin Foundation, Inc.; NORFIL = Norfil Foundation, Inc.; MILAMDEC = Milamdec Foundation, Inc.

Source: Microfinance Council of the Philippines 2002b, p 7.

Microfinance NGOs cannot legally accept deposits but are mobilizing substantial savings, as can be seen in the Tables above. Collectively, almost half their loan portfolios is funded from savings deposited by members or funds collected via capital buildup programs (both are largely made up of mandatory deposits). Transformed NGOs, such as CARD, are having better success at tapping voluntary savings. The savings of all BSP-regulated entities (including, for example, the thrift banks and rural banks that are active in microfinance) are insured up to P100,000 (about \$2,000) by PDIC. This insurance is generally sufficient to protect formal MFIs' deposits but not the savings in microfinance NGOs or cooperatives, which also raise funds via member deposits.

NGO Transformation

Diminishing access by microfinance NGOs to government- or donor-subsidized funds and grants is increasingly motivating microfinance NGOs to transform into regulated rural banks or thrift banks to gain access to consumer deposits

as a reliable source of funds. Although apex funds are available through the government apex organization (PCFC), many microfinance NGOs find the terms too restrictive (because most of their funds must be used strictly in accordance with their prescribed Grameen or ASA methodologies) or the terms are too short (PCFC's lending terms are further described in Chapter 3). The graduated or tiered licensing system has been an indispensable element in substantially expanding the ability of MFIs to mobilize financial resources beyond traditional grants and donations.⁴⁶ There have been four cases of NGO transformation to date: CARD Bank in 1997, Opportunity Microfinance Bank (OMB) in 2001, ARDCI's Vision Bank in April 2002, and most recently, *Banco ng Masa* in mid-2002.

An October 2001 survey of institutional plans conducted by the Microfinance Council⁴⁷ indicated that although most respondent rural banks are content to maintain their institutional form, 14 of 23 respondent microfinance NGOs, which arguably represent most of leading microfinance NGOs in the industry, were

planning to establish a bank. Interestingly, there were also 12 cooperatives that expressed intent to transform into a bank.

CARD Bank

A group of 15 rural development practitioners organized CARD as an NGO in 1986 with the basic objective of improving the quality of life of the landless rural poor. Part of that original mission was to establish a bank created for, owned, and managed by the landless rural poor. In 1997, CARD Rural Bank received its operating license from BSP. With an initial capitalization of P5 million (\$167,000 equivalent at the time), 12 of CARD's 25 branches were converted into CARD Bank; the remaining branches continued to operate as CARD NGO.

Initially, CARD Bank was owned by CARD NGO (27%), a few members of the board of directors, and management staff (73%). This ownership has shifted over time away from the board and staff ownership and to client ownership through the issuance of stock—a process that started in 2000 (Box 2.4). At the end of 2001, CARD Bank's ownership structure was CARD NGO (44%), CARD Bank and NGO staff and board membership (26.5%), and clients (29.3%). CARD's transformation experience has resulted in substantial increases in scale because it has been able to diversify and expand the funding base. Transformation is also expected to result in eventual, full private ownership through additional issuance of preferred stock shares to qualified clients-investors. CARD plans to transfer full ownership to the landless poor, consistent with the CARD vision. While the empowerment of landless poor women is a noble aim, one concern is that such owner-investors lack the "deep pockets" that may be necessary to access additional sources of funds should CARD Bank have financial hardship.⁴⁸

Opportunity Microfinance Bank

Opportunity Microfinance Bank (OMB) was established in May 2001 to provide a range of financial products and services to the enterprising

Box 2.4

CARD Bank: Creating a Vehicle for Asset Ownership by the Poor

"Day by day, the vision that we set for CARD that aims ultimately to empower the poor people, especially women, serves as our guiding light and inspiration in everything that we do. Currently, we have two women members who are representing our more than 50,000 client-members on the Board of Directors of CARD Bank...[and] more than 1,500 members have been issued Certificates of Stocks of CARD Bank, a certificate that says that they are not just borrowers but they are now owners and stockholders of a bank that is dedicated to eradicating poverty."

Dolores Torres
President and CEO, CARD Bank

CARD = Center for Agriculture and Rural Development

Source: Grameen Foundation USA, 2002, p.1.

poor. As the first microfinance-oriented thrift bank in the Philippines, OMB is able to supplement traditional microfinance loan products, such as group loans and forced savings, with individual loans, voluntary savings accounts, and certificates of deposit. The structure of the bank allows it to access diverse capital resources (including deposit mobilization) and allows both commercial and private investors to purchase shares, so as to ensure a deep outreach to those most in need (Box 2.5). As of August 2002, OMB had 19,000 active borrowers under its group lending program and 291 active borrowers under its individual lending program. OMB's total lending portfolio was P57.0 million (\$1.2 million). Its deposits amounted to P29.5 million (\$0.6 million).⁴⁹

OMB was formed initially as a small bank venture under the Philippine Scale-up project managed by the Alliance of Philippine Partners in Enterprise Development, Inc. (APPEND), a network of microfinance NGOs. With financial assistance from the Opportunity International

Box 2.5

OMB's Drive for Deposits

As a microfinance-oriented (thrift) bank, OMB can accept deposits, the lifeblood of regular banking, and thereby broaden its funding base. The new bank is trying to recruit wealthier citizens to open savings accounts by offering higher interest rates on government-guaranteed deposits. While most Philippine banks currently [in 2001] pay about 6% a year on deposits, "we're offering a 10% interest rate if (customers) keep it there for a year," says Ricardo Jumawan, the OMB's chairman. "This isn't just charity, it's good business. We'll even tell depositors who we are lending to, so they know that good use is being made of their deposits."

OMB = Opportunity Microfinance Bank

Source: Hookway 2001.

second, by utilizing the strengths of the partner NGOs to develop and run branches in new regions until they are sustainable, at which time they will be bought by OMB, either for cash paid directly to the NGO or as equity in the thrift bank. This arrangement appears to be viable but only time will tell if the incentives are properly aligned to induce the NGOs to continue turning over their best performing branches to the bank for cash or equity.⁵¹ OMB's aim is to establish 75 new branches with the ability to support 1 million poor families within 5 years.⁵²

From its inception, OMB has been unique in that it is the first Christian bank to be established by a network of MFIs, expressly for the purpose of providing the entrepreneurial poor with greater access to microfinance services. The process of its establishment will also be used as a model in the organization of other formal MFIs around the world under the leadership of the OIN, one of the largest international NGO providers of microfinance in the world.

*Agricultural and Rural Development for
Catanduanes, Inc. VisionBank*

To assist poor farmers and micro and small-scale entrepreneurs in accessing much needed capital and provide an option to traditional moneylenders, the microfinance NGO Agricultural and Rural Development for Catanduanes, Inc. (ARDCI) initiated the establishment of a microfinance-oriented rural bank in Bato (Box 2.6). The Monetary Board of BSP approved the establishment of VisionBank, Inc. in April 2002, the first microfinance-oriented rural bank established under BSP Circular 273, which partially lifted the general moratorium on the licensing of new thrift and rural banks and allows the entry of microfinance-oriented banks.

The bank is 87% owned by ARDCI and is complemented by conversion of savings into shares of stock, and mobilization of quasi-equity and private investment. The capital position of VisionBank is P80 million (\$1.6 million) authorized capital, P20 million (\$400,000) subscribed, and P9 million (\$180,000) paid-up capital. P32 million (\$640,000) have been made

Network (OIN), APPEND began forming a "network" bank in consultation with its partner NGOs. OMB was created when these parties and member-investors including *Kabalikat Para sa Maunlad na Buhay, Inc.* (KMBI), TSKI, and ASKI signed a Memorandum of Understanding in December 2000. However, it was not until the BSP Monetary Board lifted a ban on issuing new bank licenses in January 2001 that OMB was able to apply to conduct business. The application was approved on 17 May 2001 and OMB began operation as a formal financial institution with an authorized capital stock of P800 million (\$16.1 million) and an initial paid-in capital of P58.1 million (\$1.2 million).⁵⁰

OMB, APPEND, and APPEND's partner NGOs are working closely together in this venture to ensure its successful operation. Although OMB will assume control of the front-line microfinance services, APPEND and the NGOs will continue to coexist with the bank and will play an important role in helping the bank's network grow. New branches will be formed in two ways: first, by integrating the branches of the four partners into the OMB structure; and

Box 2.6

ARDCI's Quick Path to Sustainability

Catanduanes, the province in which ARDCI operates, has very poor road conditions and a dispersed population of 200,000. Despite having a clientele comprised of over 90% of the poorest families in this rural province, the microfinance NGO managed to attain full OSS after just five years of operation.

ARDCI senior management attributes this in part to having its vision clearly articulated from the board to the management and staff to the membership, to "increase incomes through the provision of financial services to the enterprising poor delivered by a viable rural financial institution" (ARDCI 2001). Other factors include strong human resource development and market research.

Recognizing ARDCI's good performance, the BSP (2002d) noted, "ARDCI is a member in good standing of the Microfinance Council...and has a performance rating of 'Very Satisfactory.' As a young microfinance NGO, ARDCI was able to achieve relatively fast growth in terms of assets and outreach. At present, there is no other bank in Bato or in other municipalities of the province."

ARDCI = Agriculture and Rural Development for Catanduanes, Inc.

available through grant funds from the European Union, but will only be infused gradually to the bank from the paid-up loan portfolio of ARDCI's four existing branches. P38 million (\$760,000) will come from the retained profits of the ARDCI microfinance NGO infused to VisionBank gradually. A further P10 million (\$200,000) will be from preferred shares of stock, which will be converted to common shares as shares are sold to individual ARDCI microfinance NGO members using their savings, and to private investors.⁵³ To encourage deposit mobilization as a major source of funds, Vision Bank will become a member of the PDIC. VisionBank was expected to commence operations in October 2002.

*Banco ng Masa*⁵⁴

The Monetary Board of BSP approved the establishment of the *Banco Ng Masa* in Calatagan, Batangas, in May 2002, the second microfinance-oriented rural bank established under BSP Circular 273. The newly-approved bank has an authorized capital stock of P80 million (\$1.6 million) with an initial paid-in capital of P5 million (\$100,000). The majority shareholder is the E. Zobel Foundation (EZF), an NGO headed by its chairperson, Enrique Zobel, which implies that the *Banco ng Masa* will not reap the full benefits of commercial ownership; it will be guided by an NGO representative rather than an investor with his or her own assets at risk.

EZF is driven by a social mission, established in 1986 primarily to help people with disabilities. In 1988, however, EZF shifted to helping microentrepreneurs without access to financial services. EZF provided microcredit within the range P3,000–30,000 (\$60–600) at annual effective interest rates lower than those offered by local moneylenders. *Banco ng Masa* was conceptualized and organized to take over the EZF *Palabra de Honor* (PDH) microfinance program based on the Grameen model. The PDH program was started by EZF in 1998 with 14 members, mostly women market vendors, with an initial loan of P165,000. As of 15 April 2002, PDH had cumulatively disbursed P29.2 million in loans to 1,500 microentrepreneurs. During the first quarter of 2002, PDH disbursed slightly more than P4.2 million (\$84,000) in loans and as of 15 April 2002, there were close to 1,000 active members.

As a relatively new microfinance NGO, EZF has made commendable progress in outreach and financial self-sufficiency. With the establishment of a rural bank, prospects for continued good performance are even more improved. Despite its formal structure, however, *Banco ng Masa* will have to shift ownership progressively from the NGO toward private ownership in order for true commercial incentives to be in place and for the bank to operate on a fully commercial basis.

TSPI

Although TSPI has not yet transformed itself from a microfinance NGO into a rural or thrift bank, its process of considering and moving toward transformation is one of the longest in the history of microfinance NGOs in the Philippines and sheds light on some the difficulties usually associated with transformation. As the first microfinance NGO in the country, TSPI initially considered transformation in the mid-1990s as a means to enlarge its operations and expand its services to the poor. At the time, however, senior management and members of the TSPI board were ideologically tied to the poverty lending approach to microfinance and were wary that transformation could lead to mission drift away from the poor toward higher-income clients. In addition, virtually no NGO transformation cases were available at that time to prove that mission drift was not a necessary byproduct of formalization.

Following the Asian financial and economic crisis of 1997–1998, the issue of TSPI transformation again came to the fore, as part of a consortium of microfinance NGOs making up the APPEND network that were aspiring to create a bank with the help of OIN. Although more cases were available by 1999 to provide evidence that transformation did not necessarily result in mission drift away from the poor, the TSPI board saw that the original mission of TSPI might also suffer, because many other organizations were involved in the formation of the thrift bank that was eventually to become OMB. TSPI's former Executive Director, Dr. Ricardo B. Jumawan, moved from TSPI to OMB to become its Chairperson and the TSPI Board of Trustees appointed Mr. Ruben C. de Lara to succeed him effective 1 February 2001. Although he is strongly aligned with the original mission of TSPI, Mr. de Lara brings a decidedly commercial approach to TSPI's microfinance operations, having served as a senior manager with multinational corporations for much of his professional life. Dr. Jumawan continues to serve as a member of TSPI's board, under Mr. de Lara's leadership.

TSPI has applied for a thrift bank license and is expecting approval. Both the strong financial and other support that TSPI has enjoyed based on its good performance over the last several years and the successful track record that CARD Bank has created in keeping to its original mission, bode well for TSPI's microfinance bank.

NEW MARKET ENTRANTS

In addition to the transformation of microfinance NGOs into formal banks, the microfinance market has attracted new entrants. The new market entrants are microfinance NGOs and a microfinance-oriented bank that employs a commercial approach to microfinance. Both types of MFIs are entering the market with a more aggressive and businesslike strategy than many older institutions.

Bayan Microfinance

Bayan Microfinance is a program run by the corporation ABS-CBN, well known in the Philippines as a leading broadcasting and media firm. The company's social service institution, the ABS-CBN Foundation, which mainly carries out relief activities, began a small microcredit project in 1993. In 1997, it decided to make the project into a major program. Bayan Microfinance runs on a business-like basis, without need for major subsidies from the company. Its financial statements show OSS, with interest income on loans exceeding operating expenses. It has good portfolio control with portfolio at risk (over 30 days) less than 5%. The MFI has grown aggressively from 1,500 clients at the end of 1998 to 20,450 by September 2001, with the intent to reach 50,000 by the end of 2005.

Micro Enterprise Bank

The Micro Enterprise Bank (MEB) was established as a microfinance-oriented, thrift bank in October 2001 on the initiative of several multilateral, bilateral, and local institutions. It was founded with the objective of providing financial

services that are specifically tailored to private microenterprises in the Philippines, a sector neglected by the formal financial institutions. Therefore, MEB will effectively compete with moneylenders and will reduce the reliance of microenterprises on self-financing. The shareholders are convinced that microlending can and should be conducted on a profitable basis (Box 2.7). MEB management supports the view that by creating a lasting and reliable supply of microfinance in a supportive institutional setting, target group-oriented lending can eventually become donor independent and have a significant ongoing developmental impact.

MEB was incorporated with a total authorized share capital of P100 million (\$2.0 million), with an initial capitalization of P60 million (\$1.2 million) to be followed by a second capital subscription of P40 million (\$0.8 million). The international shareholders, which together hold 60% of the total share capital, are the Doen Foundation and Netherlands Development Finance Company; the International Finance Corporation (IFC), which is a member of the World Bank Group; and IMI, an investment company based in Germany. Planters Development Bank, a reputable commercial bank based in Manila with experience in lending to medium-sized enterprises, is the bank's local investor, holding the remaining 40% of the shares. MEB plans to expand the shareholder structure by adding a local investor from Mindanao, who will provide invaluable knowledge of that local environment.

The shareholders designed a management team with extensive experience in the establishment and management of MFIs. The management team is backed by IPC, which has more than 20 years of experience in microfinance and promotes a commercial approach. While not all of MEB's shareholders are true commercial investors, IMI is primarily owned by individuals who work for IPC. Because several of IPC's consultants also have a stake in IMI and, therefore, the performance of MEB, strong incentives exist for the management of MEB to develop a commercially viable microfinance operation. As with other IMI investments, it is

Box 2.7

The Commercial Microfinance Corporate Philosophy of MEB

"Good intentions alone do not bring about the desired social impact... A commercial approach to microfinance is needed. Essentially this means that institutions lending to the target group should charge cost-covering interest rates... By charging its clients commercial interest rates through an appropriate lending technology, by continuously striving to improve its efficiency and streamline its operations, and by establishing a large branch network and thus exploiting economies of scale, MEB will achieve its other goal: financial self-sufficiency. This implies a rate of return on capital that accommodates the level of risk incurred and a modest profit sufficient to enable the institution to grow. Striving to achieve the twin goals of profitability and target-group orientation is the key factor that will ensure the bank's future success."

MEB plans to turn a profit after 11 months and break even during its third year of operations. The bank plans to attain an average return on equity (ROE) of almost 15% by the end of the third year. Management believes this is attainable by "lending at commercial rates, applying an appropriate credit methodology, employing a customized MIS, offering attractive products, and achieving economies of scale by expanding the branch network."

MEB = Micro Enterprise Bank

Source: MEB 2001, p.2-3.

expected that MEB's reliance on IPC consultants will be phased out over time to be replaced by local professionals equally committed to following a commercial approach to microfinance.

Microcredit is the main focus of the new institution's business activities. MEB will issue business loans only in amounts according to demand, currently in the range P2,000-300,000 (\$40-6,000), for expansion of inventory and acquisition of fixed assets. Initially, loans will be

short term, with maturities gradually increasing over time. First-time loans have terms of 6 months and subsequent loans have a maximum maturity of 1–2 years. Repayment is in regular equal installments in amounts depending on the cash flows of the economic enterprise undertaken with the loan. After MEB has been

in operation for one year, future loan products may include long-term investment loans, agricultural loans, salary loans, and loans to small-scale enterprises (in addition to microenterprises). MEB estimates that the net loan portfolio will yield an average of 4.5% per month.