

6 Positive Approaches to Microfinance Commercialization

Commercialization of microfinance in the Philippines holds the promise of capitalizing on the achievements in outreach that MFIs have made to date. General improvements in MFIs' financial self-sufficiency are promising, but the industry is far from reaching all the potential benefits of microfinance commercialization. Many stakeholders have a role in moving microfinance commercialization further in the Philippines, including the Government, donors, MFIs, and support institutions. This chapter draws conclusions from the study and makes recommendations for each of these key stakeholders.

ROLES OF THE GOVERNMENT

The main roles the Government should play in commercialization of microfinance are to create and maintain an enabling macroeconomic and sectoral policy environment and an appropriate legal and regulatory framework for microfinance. The Government is key to the successful advancement of microfinance commercialization, which requires the following actions.

Complete the Phaseout of Government Directed Credit Programs

Progress with abolishing subsidized, directed credit programs and transfer of the remaining credit programs to financial institutions are behind schedule; the process was to have been completed by February 2002. This process should be accelerated. In addition, new government programs that employ subsidized or interest-free loans instead of grants are hurting the repayment culture necessary for commercial microfinance.

Even though these new programs are understood to be of limited scale, the damage that they do in terms of damaging the culture of repayment may take significant time and effort on the part of MFIs to overcome.

Remove Mandatory Lending and Investment

Regulations under the Agri/Agra Law and the Magna Carta for Small Enterprises act as an implicit tax on banks and should be removed. As mentioned earlier, the Government has provided means other than direct lending for complying with these laws, such as investments in various types of bonds and securities. But the regulations act unnecessarily as a tax, particularly on large banks, without addressing the root causes of lack of lending to small farmers and enterprises. Ample experience worldwide over the last 30 years has proven the failure of similar measures to accomplish their aims of greater bank lending to farmers or small businesses in an efficient and sustainable manner.

Continue to Adopt Appropriate Regulation and Supervision for Microfinance

BSP has taken several very positive steps toward adopting appropriate regulation and supervision of microfinance through its issuance of several circulars implementing provisions of the GBL of 2000. It should continue to balance carefully the need to adapt regulation and supervision to account for the specialized nature of microfinance operations with the need to protect the financial health of banks. The integration of risk-based supervision techniques, especially for microfinance operations, promises to be effective both for supervision and risk management.

Clarify Deposit Mobilization by NGOs

BSP cannot ignore for much longer the practice by microfinance NGOs of accepting deposits illegally. If a single microfinance NGO fails and runs away with its member-clients savings, the whole microfinance industry could be affected and negatively affect MFIs legally authorized to accept savings. Consideration should be given to allowing microfinance NGOs to accept savings if these will only be for the purpose of compensating any outstanding loans the clients have with the microfinance NGO. Such deposits are often technically referred to in other sectors as cash collateral or hold-out deposits.⁹⁵ Microfinance NGOs are not currently regulated by any authority and the Government is currently considering requiring standardized financial reporting by NGOs to ensure that deposits do not exceed outstanding loan balances. The adoption of a Standard Chart of Accounts for microfinance NGOs is, therefore, imperative, along with the widespread use of uniform disclosure guidelines for microfinance NGOs to report on operating and financial performance.

Strengthen the Regulation and Supervision of Cooperatives

Consistent with the recent circular issued by the CDA to have all cooperatives use the newly approved Standard Chart of Accounts and its accompanying Manual of Accounts, the CDA should transform itself from a purely developmental entity to an effective regulatory agency. The regulatory framework for microfinance⁹⁶ recommends the creation of a special regulatory unit within CDA. BSP should assist CDA in developing the appropriate prudential rules and regulations based on the agreed COOP and PESOS standards for cooperatives undertaking savings and credit activities.

Develop Microfinance Performance Standards that Cut Across Institutional Types

As part of the rules to be established for minimizing risks in microfinance, the Government should also initiate the establishment of performance standards that cut across all types of MFIs.⁹⁷ The ingredients for such generalized performance standards could be PESOS, the CAMEL⁹⁸ rating system for banks, and the microfinance NGO performance standards developed by the Microfinance Council. Establishment of these standards would allow MFIs to compare their performance against each other objectively. Also, the adoption of these standards to gauge the performance of MFIs is especially important for private investors and wholesale lenders who would like to invest in an MFI. Commercialization involving the entry of private risk capital will only be possible if investors have sufficient and reliable transparent information for making their investment decisions. Such standards may also form the basis for ensuring in the future a level playing field for access to deposit insurance, based on meeting certain criteria.

Allow Expanded Use of PCFC Funds and its Privatization

Currently, due mainly to stipulations associated with the bulk of its funding, PCFC provides wholesale funds to Grameen and ASA replicators only. Ideally, access to wholesale funds should depend more on the financial health of the participating organization and not the methodology it employs. PCFC should work to streamline its lending criteria while adequately containing its credit risks.

In addition, to support microfinance commercialization, PCFC should allow its wholesale lending interest rate to vary according to the interest rate environment, at a spread that will ensure institutional viability and require that the onlending interest rate employed by a borrowing MFI is high enough to cover the MFI's cost of lending as well. Finally, PCFC's privatization is overdue because of inappropriate

implementation arrangements. Consideration should be given to allowing partial privatization (given PCFC's large capitalization) and opening the bidding beyond cooperatives, NGOs, and people's organizations. Privatizing the PCFC should increase its emphasis on lending to sustainable institutions and reward financially healthy institutions with lower interest rates. This will support the commercialization of microfinance by allocating funding sources to the most efficient MFIs rather than to donor-dependent MFIs.

ROLES OF FUNDING AGENCIES

The donor community has several major roles to play in the commercialization of microfinance in the Philippines, in close coordination with the Government. These are discussed below.

Support an Effective Policy Environment and Legal and Regulatory Framework

First, donors should work with the Government to ensure an enabling environment for microfinance conducive to MFIs' progress toward financial self-sufficiency. This includes advising on macroeconomic and sectoral policies as well as the legal and regulatory framework. Donors should continue building the capacity of BSP and CDA to implement effectively the evolving regulatory and supervisory framework for microfinance. In addition, donors should support the adoption, installation, and implementation of the appropriate information systems needed by regulatory authorities in their off-site and on-site supervision of MFIs.

An important element in the regulation and supervision of all types of MFIs will be donor support to establish a system of accreditation of external auditors for use by government regulatory agencies and MFIs. Assistance will also be required in the development of commonly-accepted organizational, operating, financial, and reporting standards, especially to support effective self-regulation by the Microfinance Council of member microfinance NGOs.

Build MFI Institutional Capacity

Donors should help to build institutional capacity by providing exposure to and training in microfinance best practices. In addition to training, donors should offer performance-based technical assistance support so that MFIs can expand their outreach and develop cost-effective, sustainable operations (through the use of fee-based assistance channeled through local providers). In other words, donors should provide technical assistance rather than direct capital subsidies to MFIs to avoid creating distortions in the market.

If onlending funds are provided by donors at all, they should be coupled with time-bound, quantitative performance indicators, the achievement of which determines the timing and amount of subsequent funding within a maximum 2–3-year time horizon on continued funding access.

With regard to building institutional capacity, it will be especially important for donors to focus on increasing the domestic availability of microfinance training courses and programs, such as helping Punla to become a veritable one-stop shop for affordable, demand-driven courses on microfinance management and operations.

Assist in the Development/Dissemination of Management Information Systems

There are several management information systems currently on the market for MFIs. However, there still appears to be a supply problem in terms of affordable, commercially available, off-the-shelf software packages that suit the system and information requirements of MFIs. There are a few programs that are somewhat adaptable to the varying needs of microfinance, including MicroBanker and Rural Banker 2000 (RB2000), which was developed under the MABS program and has already been introduced into more than 50 rural banks. MicroBanker operates very similarly to a traditional bank platform, but has been simplified and adapted for microfinance operations. RB2000 is a windows-based system that has been specifically designed for rural banks to manage

microfinance group and individual loan products as well as manage savings and other services.

Donors should support an objective evaluation by the Microfinance Council of existing systems including RB2000, using the evaluation criteria already developed by the CGAP. Such an evaluation could serve as a useful starting point for MFIs considering the positive and negative attributes of different systems in their quest to improve their management information systems.

Encourage Innovation in Enterprise Development

Donors should promote the development of innovative microfinance methodologies and products as well as complementary, grant-based social-service and business development service programs in cooperation with the Government. This is especially important in the areas of social mobilization (group formation and amalgamation), basic skills development, business training, and building physical infrastructure, especially in rural areas. In addition, assistance from the donor community will be important for developing and piloting new or adapted delivery methods and products that can be used to increase access by underserved groups to financial services.

Promote Linkage Development

Finally, donors should promote development of linkages between commercial banks and microfinance NGOs as a means to increase the latter's access to more commercial sources of funds. Efforts by donors to improve transparency of MFI operations and financial performance, as discussed above, may assist in removing some of the obstacles between MFIs and commercial banks so that mutually beneficial business relationships can develop between them.

ROLES OF MICROFINANCE INSTITUTIONS

MFIs have several roles to play in their own commercialization and that of the industry. Common to all MFIs, whether they be rural banks, cooperatives, or microfinance NGOs, is the need to improve their institutional capacity to reach scale in their microfinance operations (through increasing depth and breath of outreach as well as financial self-sufficiency) and to strive continually to reduce transaction costs and to increase operational efficiency. Some roles, however, can be segregated by institutional type and a few of these are elaborated below.

Rural Banks

Explore Opportunities to Expand Geographic Coverage and Access Support Services

In an increasingly competitive financial market, community-based banks must explore possibilities of linking to regional networks in order to allow their customers to access their accounts in other areas of the country. One possibility may be the opening an apex bank for the system of rural banks. Investments in human resource development and product development are very costly and cannot be covered in the long term by a single bank with a small capital base. Thus, access to support services is crucial for a rural bank involved in microfinance. Active participation in RBAP or the development of strategic alliances with other financial institutions could be means to access these services at low cost.

Maintain Liquidity above the Average for Commercial Banks

Financial institutions with a small capital base, such as rural banks, engaged in mobilizing microdeposits should maintain a high liquidity ratio. This means maintaining liquidity at least above the banking industry's average. In the Philippine context, a 20% liquidity ratio for

microfinance institutions appears to be sufficient⁹⁹ to meet unexpected situations.

Cooperatives

Explore Opportunities to Access Support Services

Similar to the rationale used for the rural banks, cooperatives with microcredit and savings services should consider actively participating in NATCCO or develop strategic alliances with other financial institutions. Participation will help to ensure the standardization of cooperative operations and help them to improve their sustainability.

Improve Transparency of Operational and Financial Performance

External regulation and supervision remain weak and are under development within the CDA; thus, internal regulations and supervisory mechanisms are crucial. Adoption of the Standard Chart of Accounts and the accompanying Manual of Accounts was to take place as soon as possible. Tracking and use of the COOP and PESOS standards should begin thereafter. Close cooperation with NATCCO during this transition period will also be especially important.

Microfinance NGOs

Overcome Weaknesses in Ownership and Governance

Weaknesses in ownership and governance should be acknowledged and minimized through the establishment of clear lines of responsibility, staff incentives that promote sustainable outreach, and adequate systems to monitor progress toward commercialization. Accountability and transparency need to be built in through integrated systems and practices and a culture of professional management.

Ensuring that boards of directors include members who understand business and finance is crucial. Preparing standard income statements and balance sheets and having them audited will

increase the transparency of operations of microfinance NGOs and enable improvements in their performance. Ultimately, these improvements should facilitate access to commercial sources of capital. Transformation into a regulated entity should also be considered as a means to access deposits as a source of funds and to become a bona fide part of the formal financial system.

Improve Institutional Capacity

Given that institutional and management capacity in the majority of microfinance NGOs is weak, improvements in several areas should take top priority. Missions should be clarified to incorporate a sustainable view of microfinance provision, balancing the social mission with a commercial approach. Increased attention should be given to building human resource strength in financial analysis and banking at least to the extent that strategic planning and business plans to operationalize such planning can take place. Active participation in the Microfinance Council should also take priority in order to exchange positive and negative experiences, learn about local and international best practices, and access various types of professional microfinance training services, such as the recently completed market research courses.

Increase Cost Efficiency

An emphasis on cost efficiency is in line with the social objectives of microfinance NGOs in that increases in cost efficiency allow for commensurate reductions in the interest rate that needs to be charged for cost recovery. CARD Bank's achievements in this regard are proof that dramatic cost efficiency can be attained, even when serving poor clients. All MFIs have a responsibility to reduce costs in order to provide their clients with the most affordable, demand-driven microfinance services possible.

ROLES OF KEY SUPPORT INSTITUTIONS

Several types of support institutions can be considered to be vital in the development and growth of a microfinance industry. The roles of a few support institutions, such as PCFC, have been addressed above, based on their government ownership or close ties with funding agencies. Roles for other, key, stand-alone support institutions include the following.

Microfinance Networks

The three microfinance networks, in cooperation with PCFC and other microfinance stakeholders, should continue to work toward introducing a Standard Chart of Accounts and reporting among members. Other MFIs should do the same. The efforts of PCFC related to spreading acceptance of established performance standards for microfinance NGOs (standardized accounting practices, subjectivity to external audit, and standard presentation of financials with an eye toward eventual ratings) are commendable and should also be continued. The networks should continue to play a role in linking their members with PCFC funds and, whenever possible, with commercial bank credit.

With donor assistance, the Microfinance Council may also consider conducting the objective assessment of various management information systems described earlier as one of its services for members. This is especially important because the bulk of members listed these systems as their main constraint to expanding their microfinance operations in a sustainable manner.

Support Expansion of a Credit Information Bureau Including Microcredit

With increasing microcredit provision by microfinance NGOs, rural banks, and cooperatives, there is increasing need for a credit bureau that captures microcredit from these actors. The credit bureau run by BAP was recently expanded to include microcredit

information and could expand to include a greater number and additional types of MFIs. An expanded private sector credit bureau could play an increasingly important role in stabilizing the microcredit market in a few highly competitive areas and in discouraging client over-indebtedness.¹⁰⁰ Instead of potentially creating new credit information bureaus to support expansion of the microfinance industry in the Philippines, donor support to increase user friendliness of this system and its accessibility is merited.

Microfinance Training Centers

The training institution that has arguably provided the most specialized microfinance training on a regular basis is Punla. It has the potential to serve as the one-stop shop that could help the microfinance industry build the technical capacity it needs for further professionalization and commercialization. It should conduct market research to explore what managerial and operational courses would be most attractive to microfinance professionals at various levels within different types of institutions and to determine their willingness to pay.

Punla should also build on its relationship with the CGAP to seek additional strategic linkages with national, regional, or international networks, such as the Microfinance Council or the Small Enterprise Education and Promotion Network based in Washington, D.C., to expand its course offerings based on market research results. Building local linkages with existing, smaller microfinance training programs, such as those run by RBAP and CARD Bank, would be ideal for developing microfinance training modules in the Philippines.