

Executive Summary

This report analyzes the progress toward commercialization of the Philippines' heterogeneous microfinance industry. It also explores the remaining challenges and implications for various types of stakeholders including microfinance clients, microfinance practitioners, government officials, and funding agencies. The report recommends positive approaches to the commercialization of microfinance while preserving the traditional social objective of microfinance institutions (MFIs) of expanding access by the poor to financial services.

UNDERSTANDING MICROFINANCE COMMERCIALIZATION

Commercialization of microfinance is a relatively accepted prerequisite to the sustainable expansion of outreach commensurate with demand by the poor in the Philippines. For many stakeholders in the Philippines and microfinance professionals worldwide, the term *commercialization* is associated with the adoption by MFIs of market-based principles in their microfinance activities, regardless of whether they are under prudential or nonprudential government regulations. There is a growing realization that commercialization allows MFIs greater opportunity to fulfill their social objectives of providing the poor with increased access to an array of demand-driven microfinance products and services.

This report considers commercialization of microfinance at both micro and macro levels. At the micro level, MFI commercialization implies progress along a continuum, described as follows.

- Adoption of a professional, business-like approach to MFI administration and operation, such as developing diversified, demand-driven microfinance products and services and applying cost-recovery interest rates.

- Progression toward operational and financial self-sufficiency by increasing cost recovery and efficiency, as well as expanding outreach.
- Use of commercial sources of funds; for example, nonsubsidized loans from apex organizations (wholesale lending institutions) or commercial banks, mobilization of voluntary savings, or other market-based funding sources.
- Operation as a for-profit, formal financial institution that is subject to prudential regulation and supervision and able to attract equity investment.

At the macro level, commercialization of the microfinance industry means the increased provision of microfinance by MFIs sharing the above characteristics in an enabling environment.

Commercialization of the microfinance industry involves several factors, including the degree to which the policy environment and the legal and regulatory framework are conducive to the development and growth of commercialized MFIs, the availability and access of commercialized MFIs to commercial sources of funds, and the existence of institutions that support the industry. Support institutions include credit information bureaus that contain information on microcredit, credit rating agencies, microfinance trade associations and networks, microfinance technical training institutions, and providers of business development services.

PROGRESS TOWARD COMMERCIALIZATION

Until recently, the performance of the microfinance sector in the Philippines has been largely disappointing. Although there are hundreds

of small-scale rural banks, cooperatives, and nongovernment organizations (NGOs) that provide microfinance, total outreach has been quite limited. It is only in the last 5 years or so that significant numbers of rural banks and cooperatives have begun to consider microfinance as a potentially profitable market niche. In addition, only a few microfinance NGOs have achieved scale or become financially viable.

The major providers of microfinance at present include many of the approximately 3,000 cooperatives registered with the Cooperatives Development Authority, at least 100 of the 786 rural banks, and about 500 of approximately 900 microfinance NGOs. In addition, a large number of small, regulated financial institutions—pawnshops and lending investors—serves the upper tier of the microfinance sector. The total volume of microcredit from formal and semiformal MFIs is unknown. Estimates of the outstanding balance are in the range of P6–8 billion (\$121–161 million). The number of poor with access to microfinance services is 600,000–1 million people, 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, only 20% of the estimated 5.8 million poor households have access to microfinance.

Nonetheless, many providers of microfinance in the Philippines have made substantial progress along the commercialization continuum in the last few years, due in large part to several government initiatives and donor-supported projects. The largest MFIs in the industry can be considered to be now on a sound, commercial footing. Four major recent trends in the microfinance sector support this view. First, a few microfinance NGOs have recently transformed into microfinance-oriented rural banks or thrift banks. Second, new microfinance NGOs, such as the ABS-CBN (a national broadcasting company) Bayan Microfinance, are entering the market with a more aggressive and businesslike strategy than many older microfinance NGOs. The microfinance sector is also attracting microfinance-oriented banks. For example, a thrift bank was

established in mid-2001 to focus on the microenterprise market by a mix of domestic and international institutional investors led by the German consulting firm, *Internationale Projekt Consult*. Third, rural banks (and a few thrift banks) are increasingly downscaling their services to provide tailored microfinance products and services due in large part to donor support of focused microfinance technical assistance and training. Fourth, donor initiatives with cooperatives are also spurring the introduction or expansion of microfinance operations.

In addition, the Government has been aggressively working to create an enabling policy environment and legal and regulatory framework for the establishment and growth of sustainable MFIs. Interest rate deregulation (in the early 1980s) and relaxation of bank entry and branching (in the early 1990s) stimulated the increase in the number of banks, particularly rural banks, whose locations, small sizes, and lower minimum capital requirements make them well suited for providing commercial microfinance. The rapid expansion of banks also resulted in the introduction of a larger range of innovative financial products (financial broadening) and the outreach of financial institutions to new groups of customers (financial deepening).

The Government gave formal recognition to microfinance in 1997 and has been steadily improving the environment for MFI commercialization. Executive Order No. 138, issued in 1999, abolished subsidized directed credit programs and laid the framework for all government directed credit programs to be transferred to financial institutions by February 2002, and to be commercially managed following market-based interest rates. Several sections of the 2002 General Banking Law (GBL) paved the way for elaborating more appropriate regulation and supervision of microfinance operations. Some recent Central Bank (*Bangko Sentral ng Pilipinas* or BSP) circulars issued to implement the provisions of the GBL are geared to increasing the provision of microfinance on a commercial basis.

Emphasis on implementation of best practices is improving, with the adoption of microfinance NGO standards by the Microfinance Council of the

Philippines, donor support to rural banks and cooperatives to enable them to reach microfinance markets, and government wholesaling of microfinance through the People's Credit and Finance Corporation (PCFC). These developments have led to rapid expansion in total outreach and the microfinance sector appears poised for further growth.

CHALLENGES TO MICROFINANCE COMMERCIALIZATION

Expanding access by the poor and near-poor to sustainable microfinance is the greatest challenge facing the microfinance industry. Many Philippine microfinance stakeholders see provision of commercial microfinance as the way to address this challenge. However, several impediments to microfinance commercialization exist at the micro (institutional) and macro (environmental) levels. Some of the major impediments are discussed below.

Internal Constraints

Perhaps one of the most pervasive internal constraints to commercial microfinance is the perception problem. Because the microfinance market is not monopolized by microfinance NGOs, one big internal challenge faced by some players or potential players in the commercial microfinance market (e.g., rural banks and cooperatives) is the lack of appreciation of the viability and sustainability of microfinance as a market niche. The perception problem is partially based on the lack of ability or flexibility of the existing systems of rural banks and cooperatives to accommodate the unique features of microfinance technologies (e.g., daily or weekly monitoring of small repayments and small deposits).

Most other internal constraints to microfinance commercialization faced by existing MFIs and potential new entrants differ according to institutional type. Some of these constraints in rural banks, cooperatives, and microfinance NGOs are examined below.

- **Rural Banks**

Rural banks are ideally suited to the provision of commercial microfinance in that they are formal financial intermediaries, operate on a for-profit basis, and have a wide client base over which to diversify risk. Unlike commercial banks where management rotates every 2–3 years, rural banks are locally managed on a continuing basis with the same staff. This helps to keep information costs low for rural banks in selecting micro and small-scale borrowers and to build up trust and confidence among clients who want to deposit their small savings. These relations between customers and the bank, characterized by mutual trust, can even attract clients who could deposit with commercial banks.

Lack of a network is a constraint to rural bank operation of microfinance programs in terms of geographic distribution of credit risk and providing customers with possibilities to withdraw savings or otherwise access their accounts in other areas. In an increasingly competitive environment, the absence of a network constitutes a disadvantage linked to the institutional structure of a rural bank. The only solution to gain access to regional markets is to establish strategic alliances with other financial institutions or to branch out aggressively.

Access to support services is also a constraint for rural banks because of their largely unit-based structure. The development of new microfinance products and services, the training of staff, and the enforcement of effective auditing and control mechanisms are expensive. The costs involved are too large for a single rural bank. To compete over the long term, financial institutions of this type need effective support services that can be provided by a national apex organization, regional federations or, again, by alliances with other financial institutions.

- **Cooperatives**

Cooperatives are also well suited to the provision of microfinance. As with rural banks, they are close to their communities and have good access to information on their members. Member-clients also have a stake in the continued financial success of their cooperative, which helps to reinforce discipline in management and operations.

However, unlike rural banks, cooperatives are considered semiformal institutions because they are regulated and supervised by the Cooperative Development Authority (CDA), which is known to be weak. Lack of transparency has historically been a major difficulty in assessing cooperative performance, but there has been recent agreement by the National Credit Council (NCC) in coordination with the CDA and major credit cooperatives on a Standard Chart of Accounts and its accompanying Manual of Accounts, as well as the COOP (Compliance to administrative and legal requirements, Organizational structure, Operation and management, and Plans and programs) administrative standards and PESOS (Portfolio quality, Efficiency, Stability, Operations, and Structure of assets) financial standards. The remaining challenge lies in their widespread adoption and use. (The CDA Board of Administrators recently issued a circular requiring all cooperatives engaged in credit activities to use the standards by January 2003.)

The cooperatives, like rural banks, suffer from the lack of an effective network, although this is improving through the Canadian International Development Agency-funded National Confederation of Cooperatives–Financial Intermediation (NATCCO-FI) project. Access by cooperatives to support services also remains weak. Further strengthening of NATCCO will be necessary for the national federation to assist the cooperatives in many important areas, including improved management information systems, internal audit and control, human resource development, market research, and product development.

- **Microfinance NGOs**

Microfinance NGOs have weak ownership and governance structures. Their boards of directors lack true owners with a financial stake in the business. This can result in an overemphasis on the MFI's social agenda and hinder microfinance commercialization. In the Philippines, many of these boards lack members with sound background in finance and banking to guide the MFI through financial challenges. This becomes an especially

important issue if the NGO is mobilizing deposits and placing client savings at risk by onlending them. While NGOs are not legally authorized to mobilize deposits, many do so as a way to substitute donor funds and to fund their loan portfolios.

Commitment to balancing social with commercial objectives is also an important internal challenge faced by most microfinance NGOs. The vast majority of small microfinance NGOs has an inordinate focus on providing microcredit as a social service without adequate attention or commitment to sustaining the organization. Most microfinance NGOs, therefore, remain small and weak as institutions, and dependent on fresh infusions of subsidized funds for their survival. Those that have taken a more balanced approach in their provision of microfinance, such as the Center for Agriculture and Rural Development (CARD) and *Tulay sa Pag-unlad, Inc.* (TSPI), provide ample evidence that a commercial approach to microfinance can reinforce their desire and ability to assist the poor.

Constraints in the Operating Environment

- **“Crowding out” of the Private Sector by Government Microcredit Programs**

Executive Order No. 138 abolished subsidized directed credit programs and laid the framework for all government directed credit programs to be transferred to financial institutions. These phaseout and transfer processes began in 1999 and were supposed to be completed by February 2002, but they are still ongoing. In addition, several new government programs on poverty reduction have begun, giving what are essentially grants thinly disguised as interest-free loans. Such continued access to subsidized government credit programs “crowds out” provision of sustainable microfinance services by the private sector.

- **Mandatory Lending and Investment**

Presidential Decree 717, otherwise known as the Agri/Agra Law, mandates that all banks set aside 25% of their net loanable funds for agricultural lending, of which 10% is supposed to be lent to agrarian

reform beneficiaries and 15% for agricultural lending. While minimum lending requirements have been easily exceeded for the latter client group given the good number of creditworthy agribusinesses, compliance has not historically been met in terms of lending to the agrarian reform beneficiaries. The main reason is that banks are not structured to manage profitably the provision of small loans to widely dispersed beneficiaries.

Although the Government has provided other means for complying with this law, such as investment in various types of bonds and securities, the regulation essentially acts as an unnecessary tax, particularly on large banks, without addressing the root causes of lack of lending to small farmers.

Another regulatory measure, Republic Act 6977, or the so-called Magna Carta for Small Enterprises, acts as a similar drain on lending institutions.

- **Threat of Policy Reversal**

The very convenient nature of direct credit provision by government makes it politically expedient and tempting for policymakers to revert to the previous policy of regulating interest rates and supporting directed credit programs. The challenge to prevent such a reversal lies not only with the Government but with private sector MFI practitioners as well. It is imperative for all types of MFIs to close ranks and advocate actively that the Government continue moving away from direct credit provision and focus its interventions where it has distinct comparative advantage, such as provision of basic support infrastructure and an appropriate policy and regulatory environment, social preparation, and capacity-building activities.

- **Unclear Regulation and Supervision of Microfinance Operations**

Although significant improvements have been made in the last few years by the Government and BSP in recognizing microfinance and adapting regulation and supervision to the specialized nature of microfinance operations, the process of implementing several sections of the GBL of 2000 is still in progress. Until the rules of engagement of formal financial institutions in microfinance are complete,

uncertainties regarding the final form of regulation and supervision of microfinance-oriented banks may curtail efforts by formal institutions to downscale their operations.

- **Illegal Deposit Mobilization by Microfinance NGOs**

A 2001 survey of 23 of the largest microfinance NGOs showed that almost half of their combined outstanding loan portfolio was funded by a combination of savings or capital build up, despite legal prohibition of such mobilization from the general public except with BSP licensure. Under the GBL, nonstock and nonprofit organizations are not permitted to accept savings and deposits in any form. So far, BSP has ignored the practice because the savings are mobilized from microfinance NGO members only and mainly on the basis of compulsory deposits, making the vast majority of members net borrowers.

- **Inadequate Access to Commercial Sources of Funds**

One of the consequences for microfinance NGOs of not being able to visibly mobilize deposits is that many remain highly dependent on external funding that has historically come from donors. In recent years, PCFC has grown to become the largest single provider of wholesale funds to the microfinance sector. The interest rate that PCFC charges borrowers can be considered commercial in the current interest rate environment; in 2001 it was lending at 12% based on a declining balance (via its investment credit line) whereas the average prime lending rate by commercial banks was around 8%.

However, PCFC funds have been mostly directed toward participating organizations following the Grameen Bank approach, hindering use of the funds by MFIs using other models. Commercial bank loans to MFIs have been extremely rare, mainly because of the lack of transparency in the operational and financial performance of microfinance NGOs and cooperatives. Where commercial loans have been issued, they were sometimes backed by collateral, such as real estate, and always facilitated by personal relationships.

- **No Credit Information Bureau that Captures Microcredit Information**

A private, nationwide credit bureau run by the Bankers Association of the Philippines (BAP) has been in operation since 1990 and as of January 2002 contained data on more than 1.4 million borrowers. However, it is accessible to commercial banks only and does not capture microcredit information that would be useful to all MFIs. With increasing microcredit provision by NGOs, rural banks, and cooperatives, the presence of a credit bureau that captures microcredit information from these actors is becoming increasingly vital to the continued health of the industry.

- **Lack of Microfinance Training Centers**

There is a variety of microfinance training programs in the Philippines. However, no “one-stop shop” yet exists for the provision of regularly scheduled, demand-driven, and affordable technical courses on microfinance program management and operation. CARD’s microfinance training center is perhaps the best known and most widely used microfinance training center to date, but cannot be considered a wholly professional training institution for microfinance that would attract a wide variety of regular students from different types of MFIs. The Asian Institute of Management (AIM) Center for Development Management and Asian Center for Entrepreneurship, with its leadership and creativity program, offer advanced training and certificate programs in such areas as project management, social development, and entrepreneurship. However, AIM has not yet designed public training programs for MFI managers that exclusively address microfinance issues.

The institution that seems most suitable for offering additional microfinance training on a regular basis is the *Punla sa Tao* Foundation (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. However, Punla will need to direct its focus more toward serving the complex and varied needs of commercial microfinance providers.

IMPLICATIONS OF COMMERCIALIZATION

The four major trends toward commercialization of the Philippines microfinance industry, outlined above, continue to have implications for the mix of providers, products and services offered, technologies employed, and different types of clients. Commercialization also has implications for increased competition, access to commercial sources of funds including private equity investment, and mission drift.

- **Increased Outreach and Competition between MFIs**

As more microfinance providers demonstrate the profit potential of microfinance, more entrants will be attracted to the market. In this sense, increased commercialization is likely to have a positive impact on outreach in the future, resulting in more clients served and increased competition among MFIs. However, because only about 20% of the market is currently served, few negative repercussions of such competition are likely to result in the next 5–10 years, except in a few urban and highly-populated rural areas where some localized competition is already growing.

Growth in the sector is not likely to come from the gradual expansion of the vast majority of existing microfinance NGOs. It is probable that other types of organizations (rural banks, cooperatives, lending investors, etc.) will increasingly enter the sector, as it becomes clear that the poor can be bankable and as methods for reaching the poor become better understood.

- **Improved Efficiency of MFIs**

As competition increases and MFIs strive to achieve financial self-sufficiency, the industry as a whole is being driven to reduce costs, lower interest rates, and improve productivity. Cooperatives, rural banks, and microfinance NGOs have all shown improvements in operating efficiency, indicating a positive trend in microfinance commercialization.

- **Increased Access to Commercial Sources of Funds**

Increased commercialization has already demonstrated its role in improving access to commercial sources of funds, especially in terms of savings mobilization, but also through private equity investment. As more and more rural banks and cooperative savings and credit banks enter the market, they bring with them the ability to mobilize savings deposits, including microsavings from low-income people in a cost-effective way. Rural banks mobilize a significant amount of microsavings deposits (amounts less than P15,000 [\$300]). These banks had P5.3 billion (\$106.6 million) in 4.3 million accounts as of March 2002. CUES-supported cooperatives nearly tripled their microsavings in just 3 years from \$3.3 million at the end of 1998 to \$9.3 million, the end of 2001, although the average savings balance declined from \$92 to \$86 over the same period. In this way, commercial MFIs serve an underserved market for small savings accounts while satisfying their need for funds for onlending.

Commercialization often paves the way for the entry of private capital, which, in turn, allows expansion into untapped markets and more diverse microfinance products. For example, as part of its transformation, CARD Bank tapped into another private source of funds by selling shares to clients and staff alike. At least one MFI, as part of its transformation, is accessing loans from a global social investment fund at what are arguably commercial interest rates. The formation of the Micro Enterprise Bank with a mix of donor and social investor capital also portends the future increased flow of private risk capital to formal MFIs in the Philippines.

- **Expanded Set of Microfinance Products**

Despite the historical emphasis on the Grameen model of microfinance delivery in the Philippines, other models are increasingly being adapted and local innovations are emerging from recent formal entrants into microfinance. Most microlending has been through group loans, but many MFIs are now introducing individual loan products. In addition to microcredit product diversification, different types of flexible savings services have been designed

specifically to attract microdeposits in a cost-effective way.

Microinsurance is another area attracting increasing interest. In addition, remittance services are being tried and leasing services may soon be offered by MFIs. New technologies are also helping to expand the array of microfinance products offered. All these trends should help increase access to microfinance dramatically over the next few years.

- **Potential for Mission Drift**

Two issues associated with NGO transformation are likely to cause mission drift: the requirement to include at least two independent members on the board of directors; and the requirement to reduce NGO ownership in the new bank to no more than 40% within 5 years of transformation.

How much mission drift occurs in various microfinance NGOs and the microfinance industry as a whole depends on a variety of factors. One is the extent to which microfinance NGOs seek to transform into regulated entities as a prerequisite to mobilization of significant voluntary savings deposits that would help them increase outreach substantially and sustainably. Becoming a formal, regulated financial institution can result in targeting higher-income clients with larger loans because of profit pressures from equity shareholders.

Mission drift ultimately depends on the nature of the regulatory and supervisory framework. For example, certain prudential standards applied to banks are not appropriate for formal MFIs, such as reporting requirements, limits on unsecured loans, requirements concerning loan documentation, supervision methods, and branching restrictions. Formal MFIs might target larger loans to ensure compliance with these standards.

However, mission drift may remain low in microfinance NGOs that are content with serving a localized market on a competitive basis. Such institutions will likely enjoy fewer opportunities to diversify their risks and not be able to take advantage of economies of scale in their operations. Despite having the advantage of being close to their target market, these institutions can be expected to remain weaker than formal MFIs. In other words,

diversification of target markets can be beneficial to MFIs in order to minimize risks and improve their ability to recover costs.

POSITIVE APPROACHES TO COMMERCIALIZATION

The array of challenges inhibiting the commercialization of microfinance implies specific roles for major stakeholders—the Government, the donor community, the MFIs themselves, and microfinance support institutions.

Roles of the Government

The main role that the Government should play in commercialization of microfinance is to create and maintain an enabling macroeconomic and sectoral policy environment and an appropriate legal and regulatory framework for microfinance. Detailed recommendations follow.

- **Complete the Phaseout of Government Directed Credit Programs**

The process to abolish subsidized directed credit programs and transfer remaining credit programs to financial institutions should be accelerated. In addition, new government programs that employ subsidized or interest-free loans instead of grants hurt the repayment culture necessary for commercial microfinance and should be discontinued. Although these new programs are understood to be of only limited scale, the damage that they do in terms of deteriorating a 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, the Government has provided other means than direct lending for complying with these laws, such as investments in various types of bonds and securities. However, 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.

- **Continue to Adopt Appropriate Regulation and Supervision for Microfinance**

BSP 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 effective risk management.

- **Clarify the Conditions when Microfinance NGOs may Mobilize Deposits**

BSP cannot for much longer ignore the practice by microfinance NGOs of accepting deposits illegally. If one microfinance NGO fails and loses its member-clients savings, the whole microfinance industry could be affected, negatively affecting commercial 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. The Government is considering requiring standardized financial reporting by NGOs to ensure that deposits do not exceed outstanding loan balances.

- **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 by January 2003, the CDA should change from a purely developmental entity to an effective regulatory agency. The regulatory framework for microfinance, which recommends the creation of a special regulatory unit within CDA, was approved by the NCC Executive Committee regulatory on 9 July 2002. 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 for minimizing risks in microfinance, the Government should also initiate the establishment of performance standards for all types of MFIs. The ingredients for such generalized performance standards could be PESOS, the CAMEL 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 and encourage their drive to improve efficiency and financial self-sufficiency.

- **Allow Expanded Use of PCFC Funds and its Privatization**

Access to PCFC funds should depend more on the financial health of the participating organization and not the methodology it employs. The 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 that the onlending interest rate employed by borrowing MFIs is high enough to cover their cost of lending. Privatizing the PCFC would increase its emphasis on lending to sustainable institutions and rewarding financially healthy institutions with lower interest rates. This would 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, in close coordination with the Government, has several major roles to play in the commercialization of microfinance. These are discussed below.

- **Support an Effective Policy Environment and Legal and Regulatory Framework**

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 and on the legal and regulatory framework. Donors should continue building the capacity of BSP and CDA to implement the evolving regulatory and supervisory framework for microfinance effectively.

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, along with performance-based technical assistance so that MFIs can expand their outreach and develop cost-effective sustainable operations (through the use of fee-based assistance providers).

- **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. Donors should support an objective evaluation of existing systems, using the evaluation criteria already developed by the Consultative Group to Assist the Poorest

(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 systems.

- **Encourage Innovation in Enterprise Development**

Donors, in cooperation with the Government, should promote the development of innovative microfinance methodologies and products as well as complementary, grant-based social service and business development service programs.

- **Promote Linkage Development**

Finally, donors should promote the development of linkages between commercial banks and microfinance NGOs as a means to increase the latter's access to more commercial sources of funds.

Roles of Microfinance Institutions

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

Rural Banks

- **Expand Geographic Coverage and Access Support Services**

In an increasingly competitive financial market, community-based banks must explore the possibilities of access to regional networks to allow their customers to access their accounts in other areas of the country. One way may be establishing an apex bank for the system of rural banks. In addition, because investments in human resource or product development are very costly and cannot be covered in the long-term by a single bank with a

small capital base, access to support services is crucial for a rural bank involved in microfinance. Active participation in the Rural Bankers Association of the Philippines (RBAP) or the development of strategic alliances with other financial institutions could be the means to access these services at low cost.

- **Maintain Liquidity above the Average for Commercial Banks**

Financial institutions with a small capital base engaged in mobilizing microdeposits, such as rural banks, should maintain a high liquidity ratio. This means maintaining liquidity at least above the banking industry's average. In the Philippines context, a 20% liquidity ratio for microfinance institutions appears to be sufficient to meet unexpected situations.

Cooperatives

- **Explore Opportunities to Access Support Services**

Similar to the rationale for rural banks, cooperatives with microcredit and savings services should consider actively participating in NATCCO or the development of strategic alliances with other financial institutions.

- **Improve Transparency of Operational and Financial Performance**

Internal regulations and supervisory mechanisms are crucial at present, because external regulation and supervision remain weak and under development within the CDA. Adoption of the Standard Chart of Accounts and the accompanying Manual of Accounts should take place as soon as possible. Tracking and use of the COOP and PESOS standards should begin thereafter.

Microfinance NGOs

- **Overcome Weaknesses in Ownership and Governance**

Ownership and governance weaknesses 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 professional management culture. Improving boards of directors by including members with understanding of business and finance is crucial. Preparing standard income statements and balance sheets and having them audited will increase the transparency of microfinance NGOs' operations and enable performance improvements. Ultimately, these improvements should improve 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**

Missions should be clarified and 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. 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 Efficiency**

Efficiency in operations should be made an institutional priority for accountability to a microfinance NGOs' funders as well as its clients. The emphasis on cost efficiency is in line with the social objectives of such organizations in that increases in cost efficiency allow for commensurate reduction 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 as key in the development and growth of a microfinance industry.

- **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 its members, as should other MFIs. PCFC's efforts in spreading acceptance of established performance standards for microfinance NGOs (standardized accounting practices, subjectivity to external audit, and standard presentation of financials with a view 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, commercial bank credit.

- **A Credit Information Bureau that includes Microcredit**

The credit bureau run by BAP was recently expanded to include microcredit information and holds promise in terms of further expansion to include a greater number and type of MFIs. This private sector credit information bureau could play an increasingly important role in stabilizing the microcredit market in a few highly competitive areas and in discouraging client over-indebtedness.

- **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 necessary technical capacity for further professionalization and commercialization. However, Punla will need to make a stronger commitment to serve the specific needs of commercial MFIs if it is to become their microfinance training center of choice in the future.

Punla should conduct market research to explore what types of managerial and operational courses

would be most attractive to microfinance professionals at various levels within different types of institutions, and to determine willingness to pay. It should also build on its relationship with 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 in order to leverage their significant investments in developing microfinance training modules.