The Experience of Financial Institutions in the Delivery of Microcredit in the Philippines

Maria Abigail Carpio

Abstract: This paper identifies the characteristic features of the different financial market players involved in the delivery of microcredit in the Philippines and looks into their experiences in addressing the credit demand of the small-borrower market segment, particularly the microenterprise sector. This paper argues that each group of lenders, specifically commercial banks, rural banks, credit-granting NGOs, and an apex financial institution, allocates its funds by establishing its own criteria for assessing the creditworthiness of borrowers and its own mechanisms to avoid borrower default. The delivery of microcredit takes place within an environment where the different financial market players face their own set of constraints in supplying credit to small-scale borrowers. This is made evident in the experiences of the different institutions in adopting the approaches of downgrading, upgrading, and financial linkage building.

The goals of developing countries to attain increased employment, equitable income levels, and self-sustained economic growth are integrally related to the opportunity of low-income entrepreneurs who have the potential to contribute to overall productivity. Although access to financial services by small and microenterprises is identified as a key requisite in supporting enterprise
growth and development, this is yet to be fully realized in many developing economies. In the Asia-Pacific region, less than 5% of poor households have financial service access, according to the Asia Pacific Development Center (Getubig, Remenyi, & Quinonez, 1997).

This paper looks into the experience of financial institutions in the Philippines in addressing the demand for credit of small-scale borrowers, specifically of microenterprises. It begins with a discussion on the significant role played by the microenterprise sector in the Philippines as an important source of income among poor households. This is followed by a description of the Philippine financial sector, with emphasis on the asymmetry in the allocation of credit among the main financial market players. Within this context of asymmetric credit allocation, the experiences of financial institutions involved in delivering financial services to the low-income market segment is presented in the fourth section, highlighting the institutional approaches of downgrading, upgrading, and linkage building.

The Microenterprise Sector in the Philippines

In the Philippines, microenterprises consist of business activities in industry, agriculture, and/or services, whether by single proprietorships, partnerships, or corporations that have asset sizes amounting to P150,000 ($2,800) or below and a total workforce of one to nine people. These enterprises are lumped together under Small and Medium Enterprises (SMEs), based on the Magna Carta for Small Enterprises (Republic Act No. 8289, Philippine Department of Trade & Industry, 1997). According to the 1993 Integrated Survey of Households Bulletin in the Philippines, half of the persons employed in this sector are wage and salary workers rather than owner-operators or members of the entrepreneur’s family (Philippine National Statistics Office, 1993).

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Many poor Filipino families derive their income from multiple sources. Data from the 1998 Annual Poverty Indicators Survey (APIS) reveal that, of the more than 14.4 million families surveyed, 67% received income in the form of wages, 61% received income from entrepreneurial activities, and 50% augmented their family income by engaging in family sustenance activities (Philippine National Statistics Office, 1998). Among the poorest 40% of the respondents, 70% depended on entrepreneurial activities rather than on wages or salaries for their income. In 1999, the reported share of wages and salaries as a source of income continued to decrease by 0.8%, and entrepreneurial activities ranked third in the distribution of sources of income among families surveyed. Among the families belonging to the first to the third deciles, most of the income came from entrepreneurial activities, while those who belonged to the higher-income strata obtained a bigger share of their income from wages and salaries. Approximately 70.4% of the families in the lowest 40% income group were reported to have businesses, compared to only 54.5% of the families in the higher 60% of income strata.

Table 1. Total income derived and sources, 1998
(in Philippine pesos)

<table>
<thead>
<tr>
<th>Economic Activities</th>
<th>All Families</th>
<th>Income Strata</th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Lowest 40%</td>
<td>Highest 60%</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>868,860,662</td>
<td>92,233,275</td>
<td>776,627,389</td>
<td>89.38%</td>
</tr>
<tr>
<td>Wages and Salaries</td>
<td>419,549,518</td>
<td>30,269,768</td>
<td>389,279,751</td>
<td>50.12%</td>
</tr>
<tr>
<td>Family Sustenance</td>
<td>10,587,079</td>
<td>5,810,681</td>
<td>4,776,398</td>
<td>0.62%</td>
</tr>
<tr>
<td>Net Share of Crops, etc.</td>
<td>5,472,832</td>
<td>1,210,318</td>
<td>4,262,517</td>
<td>0.55%</td>
</tr>
<tr>
<td>Entrepreneurial Activities</td>
<td>214,547,668</td>
<td>34,483,708</td>
<td>179,063,959</td>
<td>23.06%</td>
</tr>
<tr>
<td>Other Sources of Income</td>
<td>218,703,565</td>
<td>19,458,801</td>
<td>199,244,764</td>
<td>25.66%</td>
</tr>
</tbody>
</table>

Note. Total percentages are computed as a percentage of all families. Percentages for other economic activities (wages, family sustenance, net share of crops, entrepreneurial activities and others) are computed as a percentage of families in the respective income strata.
The 1998 APIS also reveals that out of the 8.5 million surveyed families with businesses, only 25% had the chance to avail themselves of credit to finance their entrepreneurial activities. High interest rates, lack of collateral, and lack of information about where to get loans were among the top three reasons cited by families in the lower 40% income group for their inability to avail themselves of credit for their businesses. In fact, the scarcity of working capital and investment credit has been identified by small and microentrepreneurs as the single greatest difficulty encountered by the SME sector (ADB/OECD, 2000).

As of 2000, the total number of enterprises operating in the Philippines was estimated at 820,960, generating employment of about six million (Philippine National Statistics Office, 2000). Microenterprises dominated this number (91.1%), followed by small enterprises (8.2%). Among the establishments under the wholesale and retail trade sector, 95.2% were microenterprises. On the other hand, while enterprises in the manufacturing sector showed a tendency to be relatively larger in size compared to the wholesale and retail trade sector, microenterprises still dominated the manufacturing sector with a share of 86.9%.

In terms of employment generation, micro, small, and medium enterprises absorbed 69.6% of the workers in the formal sector. Since enterprises in the wholesale and retail trade sector were primarily micro in size, the sector absorbed only 30.3% of the total, 62.2% of which were working in microenterprises. On the other hand, the manufacturing sector employed a total of 1.6 million workers (26.9% of the total), 45.9% of which were working for large enterprises.

The available data in the Philippines on the growth in the number of microenterprises show that these enterprises tend to multiply faster than any other type of enterprise. While small enterprises doubled over the period of 1983–1994, and medium and large enterprises grew by 4% and 27%, respectively, the number of microenterprises grew by as much as 62% (Small & Medium Enterprise Development Council, 1998, cited in Berry, Rodriguez, & Sandee, 1999).
<table>
<thead>
<tr>
<th>Industry</th>
<th>Total</th>
<th>Micro</th>
<th>Small</th>
<th>Medium</th>
<th>Large</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>no. of enterprises</td>
<td>no. of employees</td>
<td>no. of enterprises</td>
<td>no. of employees</td>
<td>no. of enterprises</td>
</tr>
<tr>
<td>Agriculture</td>
<td>3,391</td>
<td>137,340</td>
<td>1,611</td>
<td>6,478</td>
<td>1,527</td>
</tr>
<tr>
<td>Fishing</td>
<td>1,252</td>
<td>31,185</td>
<td>523</td>
<td>2,227</td>
<td>688</td>
</tr>
<tr>
<td>Mining</td>
<td>376</td>
<td>17,328</td>
<td>239</td>
<td>1,209</td>
<td>112</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>125,467</td>
<td>1,589,214</td>
<td>108,998</td>
<td>354,025</td>
<td>14,121</td>
</tr>
<tr>
<td>Electricity, Gas &amp; Water</td>
<td>1,318</td>
<td>80,595</td>
<td>660</td>
<td>2,746</td>
<td>480</td>
</tr>
<tr>
<td>Construction</td>
<td>3,154</td>
<td>161,487</td>
<td>1,724</td>
<td>7,602</td>
<td>1,225</td>
</tr>
<tr>
<td>Wholesale &amp; Retail Trade</td>
<td>437,325</td>
<td>1,785,811</td>
<td>416,519</td>
<td>1,110,683</td>
<td>20,038</td>
</tr>
<tr>
<td>Hotels &amp; Restaurants</td>
<td>89,472</td>
<td>485,098</td>
<td>81,879</td>
<td>267,731</td>
<td>7,377</td>
</tr>
<tr>
<td>Transp’n &amp; Comm’n</td>
<td>15,267</td>
<td>301,035</td>
<td>11,302</td>
<td>42,105</td>
<td>3,622</td>
</tr>
<tr>
<td>Financial Intermediation</td>
<td>24,118</td>
<td>262,165</td>
<td>18,129</td>
<td>75,325</td>
<td>5,801</td>
</tr>
<tr>
<td>Real Estate</td>
<td>40,477</td>
<td>430,884</td>
<td>35,483</td>
<td>106,399</td>
<td>4,348</td>
</tr>
<tr>
<td>Education</td>
<td>9,675</td>
<td>272,202</td>
<td>5,127</td>
<td>21,469</td>
<td>4,032</td>
</tr>
<tr>
<td>Health &amp; Social Work</td>
<td>28,414</td>
<td>158,341</td>
<td>26,795</td>
<td>60,243</td>
<td>1,412</td>
</tr>
<tr>
<td>Other Services</td>
<td>41,254</td>
<td>189,501</td>
<td>38,751</td>
<td>106,858</td>
<td>2,383</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>820,960</td>
<td>5,902,186</td>
<td>747,740</td>
<td>2,165,100</td>
<td>67,166</td>
</tr>
</tbody>
</table>

Microenterprises, given their characteristically small size of operations, have very low start-up capital requirements. Although they operate on short-term planning cycles, sometimes daily or weekly, their requirements for working capital are relatively large, covering the cost of raw materials and inventory. Their credit requirements, apart from assuming characteristics which differ from those of large, more established firms, also vary widely according to the developmental stage of the enterprise. Therefore, supplying credit to microenterprises is an undertaking that many financial institutions in the Philippines, especially those in the formal sector, still consider as unfamiliar territory.

The Challenge of Supplying Credit to Microenterprises in the Philippines

An Overview of the Philippine Financial Sector

The Philippine financial sector consists of a relatively large network of banking and nonbanking organizations performing various financial intermediation services. The country’s financial system may be classified into the following: (1) a formal sector under the regulation and supervision of the Central Bank (Bangko Sentral ng Pilipinas [BSP]) and the Insurance Commission; (2) a semiformal sector composed of organizations under the supervision of the Cooperative Development Authority (CDA), and non-government organizations (NGOs) registered with the Securities and Exchange Commission (SEC) but not subject to any regulation of their financial operations by any government agency; and (3) a purely informal sector composed of unregistered individual operators or organizations neither supervised nor regulated by any government entity.

The formal sector is composed of commercial banks, thrift banks, rural banks, and nonbank financial institutions. In the Philippines, the formal sector lies at the center of the general banking system, accounting for 81% of the entire assets, as of the end of 1998 (Llanto, 2000). According to Llanto (2000), within the banking system, more than 50 commercial banks account for the bulk of the volume of finance, including as much as 90% of the sector’s
assets, while the resources of the 117 thrift banks and more than 800 rural banks make up only 7.7% and 2% of the banking system, respectively. The semiformal sector is composed of credit unions, cooperatives, and a number of NGOs. The informal sector, on the other hand, is composed of individual operators such as money lenders and traders. The unregistered local rotating savings and credit associations (ROSCAs), which are referred to in the localities as the paluwagan, also form part of the informal sector.

Asymmetry in the Allocation of Credit

The credit requirements of microenterprises in the Philippines are met by a variety of organizations belonging to the formal, semiformal, and informal financial sectors. The institutions that cater to the needs of microenterprises include rural banks, cooperatives, credit unions, and an estimated 500–600 credit-granting NGOs (Llanto, Garcia, & Callanta, 1996). Within this roster of organizations, the main institutions engaged in the delivery of micro-credit are the NGOs operating as retail microfinance institutions. While comparatively small in terms of size and outreach, NGOs tend to concentrate their services on the needs of marginalized groups in the country. On the other hand, the small rural banks serve a cross section of small-scale borrowers and savers at the local level.

As in the corporate sector, the banking system is highly concentrated, with the six largest banks controlling close to 60% of the assets of the banking system (World Bank, 2000). They are owned and controlled by large domestic groups. The other 40% are highly fragmented across the remaining 47 commercial banks, 117 thrift banks, and about 800 rural banks. Vos and Yap (1996) point out that the structural problems in the Philippine financial system are caused in part by the wide-ranging interlocking directorates and ownership patterns of the banking industry. Furthermore, the distribution of bank offices is skewed towards the National Capital Region, making banking services less accessible to those in less-developed regions.

The unincorporated businesses and cooperatives are among the types of borrowers that the commercial banking sector is not
able to extend loans to (Vos & Yap, 1996, p. 99). In contrast, private corporations in the Philippines, on average, receive 68–70% of the loans coming from commercial bank establishments. This asymmetry in the allocation of credit by the commercial banking sector in the Philippines means that the credit needs of low-income households must be supplied by other types of lenders. Thus, within this financial environment, different institutional approaches are adopted by various financial institutions designed to better address the needs of this unserved market segment.

**Institutional Approaches Adopted by Financial Institutions in the Delivery of Microcredit**

*The Downgrading Approach: The Experience of Commercial and Rural Banks*

The notable increase in the involvement of formal financial institutions in the delivery of microfinance services comes as a result of the expansion of the scope of formal institutions through downscaling and developing linkage programs with the different organizations in the semiformal sector. This setup allows formal financial players to get acquainted with the practices of those directly involved in lending to small-scale borrowers. The perceived presence of competition among these banks has forced a number of them to diversify into new markets. Some have sought a new public image, while others, who have heard of the profits of successful microfinance institutions, have developed an interest in this unexplored market. In the last five years, the exploration of this new market has been facilitated by donor-funded loan guarantees, central bank rediscount lines, and specialized technical assistance.

In the Philippines, the government exerts pressure on banks to pay attention to the credit requirements of specific unserved sections of the economy through such instruments as the Magna Carta for Small and Medium Enterprises, which mandates the banking system to allocate 6% of its loans to small enterprises and another 2% to medium enterprises. In March 2001, the Central Bank (BSP) reported that the banking system as a whole complied...
with both the 6% and 2% mandatory credit allocation requirement. Table 3 shows that commercial banks accounted for 81% of the total credit allocation for SMEs, illustrating the impact of its size of operations. However, the banks’ response to small borrowers’ demand for financial services was limited to granting wholesale funds retailed to NGOs and other MFIs operating under the semiformal sector, or to purchasing government securities as an alternative compliance with the loan quota (G. Aquino, personal communication, 6 September 2001). The commercial banks allocated as much as ten times the mandated amount for medium enterprises, while thrift banks posted even higher percentages of credit allocation (21.39%) to the same sector. These figures help illustrate which groups of enterprises within the SME sector are preferred to be serviced by the different banks.

Table 3. Distribution of mandated credit allocation by bank category

<table>
<thead>
<tr>
<th></th>
<th>6% Allocation for Small Ent.</th>
<th>2% Allocation for Medium Ent.</th>
<th>Percentage of Compliance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>% Dist.</td>
<td>Amount</td>
</tr>
<tr>
<td>Commercial Banks</td>
<td>102.7</td>
<td>80.4</td>
<td>82.7</td>
</tr>
<tr>
<td>(incl. foreign banks)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Thrift Banks</td>
<td>17.4</td>
<td>13.6</td>
<td>15.9</td>
</tr>
<tr>
<td>Rural Banks</td>
<td>7.7</td>
<td>6.0</td>
<td>2.4</td>
</tr>
<tr>
<td>Total Banking System</td>
<td>127.8</td>
<td>100.0</td>
<td>101.0</td>
</tr>
</tbody>
</table>

Note. Mandated 8% credit allocation requirement for the SME Sector. From Bangko Sentral ng Philipinas (BSP), 2001.

The size of the banks and their specialization heavily determine how they cater to the financial needs of the low-income market segment and their ability to resolve the key constraints encountered in dealing with this market. The Rizal Banking Corporation (RCBC), one of the top five commercial banks in the Philippines, for example, offers a minimum savings account balance of P5,000 ($91) and a minimum loanable amount of P500,000 ($9,100). Its asset writing policy is very strict with collateral, and it requires a
20%–30% nominal return on investments. It has a small and medium business unit within the bank office, which is, however, not very profitable and is only maintained in order to meet the government credit-allocation requirement. Without this mandate, RCBC acknowledges that it would not even think of lending to small business, much less to microenterprises (Goodwin-Groen, 1998).

Another example is the Philippine Commercial and Industrial Bank (PCIB), which initiated the PCIB Moneyshop in 1973. The moneyshop was put up among the many stalls in public markets and offered working capital to different market vendors. It provided easy access to established on-site banking facilities where money could be borrowed conveniently. The operations were adjusted to the business patterns in the market place, such as ensuring that the moneyshop’s operations began in the early hours of the morning. Collectors went to the individual borrowers instead of waiting for payment at the moneyshop window. Despite the daily collection system adopted, however, a significant percentage of loans in arrears incurred or held in litigation remained considerably high, higher at any rate than the levels usually tolerated by the banking system. Moreover, it was not as successful as the credit unions in attracting savings among its clientele. While PCIB may have deviated from its traditional banking procedures in order to meet client demands, it was not able to establish with its clients a kind of “personalistic relationship,” which is characteristic of the ties that exist among different actors in the informal financial sector. In this case, moneyshop collectors may have gone to the individual borrowers to collect payment and still faced borrower-default partly because they are still perceived as “outsiders.”

The experience of large commercial banks directly involved with microfinance activities generally tends to show that (1) there is still a strong perception among commercial bank managers that banking with small-scale clients is not a viable venture to undertake and (2) large commercial banks are not equipped with the skills and technology necessary to profitably engage in providing microcredit and other microfinance services. Although the BSP is pushing the banking sector to get more involved in microfinance
activities, it is aware of the difficulties and limitations faced by large commercial banks in serving this market.

On the other hand, the rural banks in the Philippines have been traditionally more involved in microlending than their counterparts in the commercial banking sector. The relative size of their operations and the location of their offices and branches in the municipalities help minimize the operational constraints and the physical limitations encountered by other commercial banks. A number of rural banks, for example, accepted deposits as small as P100 ($1.90) and provided loans as low as P1,000 ($19) (Llanto, Garcia, & Callanta, 1996). With reference to the SME credit allocation requirement, the rural banks posted a higher share (28.69%) in allocating credit to small enterprises, compared to what the commercial banking sector contributed (11.34%).

Rural banks show a greater propensity to serve low-income borrowers. However, even given these figures, a considerable number of rural banks are still adamant about positively responding to the BSP’s call for increased lending to microenterprises and SMEs. This is born out of a group-banking trauma that the rural banking sector suffered from its experience in the late 1970s and 1980s with the targeted credit schemes of the government, most notably the Masagana ’99. The medium-term effect of this experience was a strong negative sentiment against group lending and a conservative, risk-averse lending practice by rural banks.

The successful experience of credit-granting NGOs and credit cooperatives, however, has drawn attention to the profit potential from serving the low-income market segment. This success has encouraged many rural bankers, especially those faced with less opportunity to tap into the higher end of the credit market in the localities where they operate, to reconsider their involvement in microlending. With encouragement from the government and technical support from international donors, the number of rural banks involved in microfinance is reported to be gradually increasing.

Microcredit delivery among rural banks is being vigorously supported by both government and donors in view of the rural banks’ comparative advantage over other players in the financial
sector. Their location in the municipalities and smaller towns affords them the opportunity of personally knowing the target clientele. Besides, small-scale borrowers may find it more comfortable to deal with rural banks, as poor clients have a tendency to perceive commercial banks to be more oriented towards the higher end of the credit market. The existing physical infrastructure of rural banks also provides them with an advantage over other microfinance institutions (MFIs) such as cooperatives and credit-granting NGOs, making it more practicable for rural banks to expand and reach out to a substantial number of small-scale clients. Moreover, rural banks also have the legal capacity to mobilize deposits, which does not make them dependent on donor resources in capitalizing their lending operations.

However, many rural bankers agree that doing microfinance takes more than just opening a special microlending window or unit within the bank. The experience of the New Rural Bank of San Leonardo (NRBSL) in Nueva Ecija shows that getting into microfinance successfully was very much a matter of building the right image among its target clients. Its CEO and owner had to join his staff in launching a massive small deposit campaign within the town by going from door to door of every household. This helped establish the bank’s image of being friendly to the low-end market (A. Panganiban, NRBSL CEO, personal communication, 25 September 2001).

The experience of rural banks in serving the low-income market segment shows the following: (1) Microlending by rural banks necessitates having a “champion” who will ensure the success of the microlending operation. In the case of the NRBSL, the personal commitment of the owner and managers of the bank to help introduce and sustain its microlending operations was pivotal in establishing credibility among their targeted clientele. (2) The rural banks also have the opportunity to treat their microlending operations as an adjunct to their other banking functions. This means that these banks are not solely dependent on the gains from its microfinance operations. Initially, they may experience high transaction costs associated with dealing with low-income clients,
and thus the return on their microlending programs will require a certain volume to achieve economies of scale. Within this phase of building up their pool of clients, rural banks may also benefit from the gains realized from their other operations. (3) Another ingredient in the success of microlending by rural banks is the environment where they operate. The presence, for example, of an existing sizeable group of microentrepreneurs within the locality, as in the case of NRBSL, provides banks with the necessary demand requirement. The Microenterprise Access to Banking Services (MABS) Program reports that rural banks applying for training in microfinance have been those concentrated in areas where a growing number of businesses may be found, such as the more densely populated provinces of Laguna in central Luzon and Cebu in the southern part of the Philippines. While many banks must still face a number of constraints in dealing with the low-income market segment, the comparative advantage that comes with their status as banks lures a number of credit-granting NGOs to explore the prospects of transforming into regulated financial institutions.

The Upgrading of Credit-Granting NGOs into Banks

The upgrading of credit-granting NGOs provides a promising means by which many of these organizations are able to mobilize savings or refinance their lending operations directly on the market. According to a monitoring study conducted by the Philippine National Economic Development Authority (NEDA), as of 1996, there were already as many as 600 NGOs involved in microfinance throughout the country, with combined total assets of P45.5 million (equivalent to almost $1 million). Their loan portfolio was estimated at approximately P920 million (approximately $17 million), which is equivalent to 2.5% of that of rural banks. Notwithstanding this, mature credit-granting NGOs in the Philippines are still observed to suffer from limited outreach. Llanto and Chua (1998) point out that these NGOs have an outreach capacity of only 1,000 on average. Moreover, NGOs are hampered by
their weak institutional capacity, especially in the areas of financial management, resource mobilization, and product development.

The marked increase in the capitalization requirement for the establishment of banks clearly makes it harder for credit-granting NGOs to transform themselves even into small banks. By 1996, two of the best-performing credit-granting NGOs in the country were already applying for rural banking licenses with the BSP. However, when the BSP raised the minimum capital requirement, one of the applicants was forced to withdraw. The remaining applicant, the Center for Agriculture and Rural Development (CARD), was the only NGO able to meet the said capitalization requirement and received its license to operate as a rural bank in December 1996.\(^9\) Given this constraint, credit-granting NGOs either turn to international donors for capitalization support or merge with other NGOs in order to raise the necessary capital to put up a bank. The Alliance of Philippine Partners in Enterprise Development (APPEND), a group of six NGOs, recognized that it had to capitalize on the collective strength of their networks and establish a partnership with a foreign donor, Opportunity International, in order to open up a microfinance bank in Antipolo City (north of the capital) called the Opportunity Microfinance Bank (OMB) in August 2001.

The impact of transforming credit-granting NGOs into formal financial institutions can be felt in many areas of the organizations’ microfinance operations. The case of CARD shows that its transformation into a bank helped facilitate its growth in outreach, which soared to 10,868 in 1997 and more than doubled (26,369) by June 1999 (Seibel & Torres, 1999). The transformation subjects MFIs to certain performance standards imposed upon them by the regulatory agency for the maintenance of their license. The discipline that develops from their obligation to meet these standards strengthens their drive towards sustainability and supports their determination to broaden and deepen their outreach. As observed by the proponents of CARD Rural Bank, such performance standards were missing prior to their transformation, as they were not always enforced by the donors from whom their lending funds
were sourced. This is affirmed by Tulay sa Pag-unlad Development Corporation (TSPI), the leading credit-granting NGO in the country, which is planning to set up the TSPI Thrift Bank soon. Its executive director considers the regulation and supervision of the BSP as a safeguard against funds-mismanagement and evidence of the credibility of an NGO as a viable credit-granting institution (R. De Lara, TSPI Executive Director, personal communication, 26 September 2001).

While transformation presents many MFIs the opportunity to mobilize cheaper sources of finance through deposits and may help strengthen their credibility as viable financial players, transforming into regulated financial institutions may not be every MFI’s cup of tea. As transformation into banks may be deemed cumbersome for some NGOs, a number of them opt for establishing linkage relationships with bigger commercial banks. This approach, as we will see in the succeeding section, allows credit-granting NGOs and formal financial institutions to capitalize on each other’s strength and specialization in the delivery of financial services.

**Linking Credit-Granting NGOs and the Formal Financial Sector**

The linkage model used in the Philippines utilizes credit-granting NGOs to fulfill a financial intermediary function between the bank or a wholesale financial institution and organized self-help groups or individual borrowers. This role requires NGOs to accept the contractual responsibility for the repayment of the line of credit extended to it by the bank. The final lending to end borrowers is done through the use of self-help groups or on an individual borrower basis. In many cases, the NGO also assumes the responsibility for the extension of consultancy services to and the training of the different groups of end clients.

Such a linkage model is illustrated in the case of the People’s Credit and Finance Corporation (PCFC) which was established by the Philippine government to wholesale resources to credit-granting NGOs following the Grameen model. As an apex financial institution, PCFC works with a number of retailers and
conduits such as credit-granting NGOs, cooperatives, and rural banks. By August 2001, its number of retailers had hit 185, 100 of which were banks. PCFC sources its funds mainly from local and international agencies at concessional rates and lends these funds out to its retailers effectively at 12%, with a 1% fee for processing. No collateral is required on the part of its conduits, although security is established through the assignment of promissory notes from the conduit’s end borrowers. PCFC has no direct linkage with the end borrowers of its conduits and only specifies that loanable amounts to end clients should not exceed P25,000 ($460).

Figure 1. The linkage model adopted by the People’s Credit & Financial Corporation (PCFC)

Another example of financial linkages established is that between the Bank of the Philippine Islands (BPI), a commercial bank, and the Project Linking Banks and Self-Help Groups (PLBS), an initiative conceived in 1987 with the support of the German Office for Technical Cooperation (GTZ). The PLBS was an initiative covering four project phases, linking NGOs, cooperatives, and self-help groups to credit and savings facilities established by the Landbank of the Philippines (LBP) and a number of participating rural banks.

Through the BPI Foundation, BPI has provided TSPI with a line of credit initially amounting to P1.5 million ($28,000) at 8% per annum, and two other lines of credit to be further on-lent to
two other NGOs which TSPI collaborates with. BPI’s initial total engagement as of 1997 reached P3.5million ($64,000), forming part of its pilot program of banking with the poor (Goodwin-Groen, 1998). The credit lines are provided for an original term of 12 months but are renewable annually subject to credit review and evaluation. For security and collateral, BPI requires promissory notes executed by the microentrepreneur clients of the credit-granting NGOs, or promissory notes executed by the primary NGO (TSPI), which acts as an agent between BPI and its two other partner-NGOs on a with-recourse basis. The NGOs are expected to submit quarterly reports on the status of the assigned notes and charges 2% per month on the overdue and defaulted amounts. By early 1997, BPI had accumulated 11 loans outstanding to MFIs for a total value of P11.1million ($202,000).
By establishing links with formal financial institutions which are constrained in directly dealing with the small-borrower market segment, NGOs have the opportunity to increase their capital base. The advantage of mobilizing NGOs as credit-conduits is that many of them have been organized primarily to serve the poor sectors of society. The experience of NGOs in dealing with the small-borrower segment over the years has endowed them with the capacity to know the target clientele and become familiar with their needs. Thus, given their practical experience and their social orientation, which put them on good standing among the many end borrowers they serve, NGOs play a vital role as intermediaries between the banks and the end borrowers.

The problem that arises from this financial linkage approach, however, is that many formal financial institutions engaged in this approach already observe that a saturation level is being reached on the number of possible NGO candidate conduits. PCFC, for example, observed that among its roster of partners, many were already showing signs of organizational deficiency (J. Medina, personal communication, 26 September 2001). Moreover, among the 54 members of the Philippine Microfinance Coalition and the approximately 500 existing credit-granting NGOs in the country, only a handful of NGOs are able to meet the requirements of the leading commercial banks in the establishment of linkage relationships (E. Garcia, personal communication, 13 September 2001). In the experience of PLBS, it was recognized during the early stages of the project that the institutional capacity of many NGOs was keeping them from effectively linking with banks (A. Almendral, personal communication, 19 September 2001). Hence, the team endeavored to reorient the direction of the project during the latter phases and explored working with the cooperative sector instead. More importantly, unlike PCFC and LBP, which are partly government-owned entities, commercial banks are not in a position to assist these organizations in building their institutional capacities for more effective engagement in financial intermediation. In contrast, PCFC and LBP are in a more advantageous position to make use of the support extended by international
donors to assist partner NGOs in building up the latter’s institutional capacity.

**Building Specialized Institutions from Scratch**

Apart from the institutional approaches of downgrading, upgrading, and financial linkage-building, the approach of introducing new types of institutions from scratch or hybrids of more traditional types of organizations like commercial banks, such as the newly-established microfinance or microenterprise banks, certainly presents the opportunity to look at how these new institutions differ from their counterparts in the general banking sector. Whether these new institutions are able to effectively overcome the constraints in dealing with the lower-income market segment while at the same time provide financial services to the target clientele on a sustainable basis is an area of study that will be of interest to many researchers. In the Philippines, the introduction of such specialized institutions is evidenced by the launching of the Micro-Enterprise Bank (MEB) in Mindanao (the southern part of the Philippines) in late 2001. MEB is a joint venture among international investors and a local counterpart, the Planter’s Development Bank group. Recently, other similar developments have also taken place in Batangas (south of Manila) with the creation of Bangko ng Masa (Bank of the Poor), a private local undertaking.

**Concluding Remarks**

The characteristics of the different players in the Philippine financial sector outlined in this paper underscore the available opportunities and the constraints that may be dealt with in designing approaches to help address the credit needs of microenterprises. It should not, however, escape the reader that given the oligopolistic nature of the Philippine financial system, the expectation that current bank restructuring will result in improved access of smaller enterprises to bank credit is very much clouded with skepticism (Vos & Yap, 1996).
In the Philippines, the commercialization of microfinance activities has led to the emergence of new types of institutions and has helped define some approaches markedly different from those which were used when microfinance was dominantly viewed as a purely social activity. This is a continuing process which requires changes in perception among the different players in the financial market. New methods and approaches need to be continuously introduced in the provision of services and in mobilizing resources. As has been shown, the appropriate strategies needed in widening and deepening the credit reach of the various players in the financial sector are those which recognize the market specialization of each group of lenders and at the same time provide incentives for institutions to be able to effectively transform and develop into institutions more capable of addressing the credit needs of the small-borrower market segment.

Notes


3. RA 8289 serves as an amendment to RA 6977, which was enacted in 1991, mandating all financial institutions to set aside certain portions of their loan portfolio for small enterprises. The portion mandated for allocation to SMEs based on RA 6977 was at least 5% by the end of 1991, raised to 10% by the end of 1992 until 1995, and 5% by the end of 1996. In 1997, RA 6977 was amended through RA 8289, which extended the mandatory allocation feature of the law for another ten years, from 1997 to 2007. Allocation requirements were adjusted to 6% and 2% for small and medium enterprises, respectively. (Philippine Department of Trade & Industry, 1997.)
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4. Further information on this case can be found at http://gdrc.org/icm/inspire/inspire.html.

5. This term was used by Floro & Yotopolous (1991).

6. These include the Cooperative Rural Bank of Aklan, the Davao Cooperative Bank, and other cooperative banks in Mindanao (southern part of the Philippines).

7. In the early 1980s, the rural banks, along with the Philippine National Bank (PNB), a state-owned bank, were pushed to implement Masagana '99 and various subsidized lending programs primarily to farmer groups. The funds were provided by the Central Bank, but liability resided with the rural banks. These programs resulted in poor loan performance partly brought about by the fact that borrowers immediately perceived the funds as government aid. Hence, credit discipline in the repayment of loans was not maintained. Also, as a supply-driven approach, the lending programs failed to consider the benefits of the savings-mobilization component among the targeted groups. When what seemed to be a steady inflow of cheap money dried up in the early 1980s, many rural banks failed. While the government bailed PNB out, it was not able to do the same for participating rural banks. About 450 from a total of 1,250 rural banks collapsed during this crisis (GTZ, 1997, pp. 4–5).

8. The Microenterprise Access to Banking Services Program (MABS), an initiative co-sponsored by USAID Philippines and the Rural Bankers Association of the Philippines (RBAP), shows that as of April 2001, the number of rural bank branches involved in the program reached a total of 57, more than the targeted goal of 48. This number had further gone up to 66 by the end of July 2001. No capitalization assistance is given and loans are funded from the deposit base of the participating rural banks.

9. For more in-depth discussion on the transformation process of CARD Rural Bank, see Seibel and Torres (1999). As of 2003, there were three transformed MFIs operating as banks with microfinance functions in the Philippines, namely, (1) CARD Rural Bank in Laguna (rural bank), (2) Opportunity Microfinance Bank in Rizal Province (thrift bank), and (3) Vision Bank in Catanduanes (rural bank).

References


In 1992 Grameen Bank started its experimental leasing program by leasing power looms to weavers in Ariahazar, near Dhaka, the capital city of Bangladesh. Many of the borrowers in this area were weavers who produced fabrics using handlooms. The borrowers noticed that many of their competitors were using power looms and wanted to know if the bank would help them to gain access to power looms. Initially, the bank bought the power loom and rented it out to the borrowers. However, the bank manager realized that the borrowers would be better served through an arrangement where the machines could be leased to the borrowers, who could then pay off the cost of the machines by using the earnings from them. Based on this experience, in 1993 Grameen Bank