Are Grameen Replications Sustainable, and Do They Reach the Poor?

The Case of CARD Rural Bank in the Philippines

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Abstract: The Grameen Bank in Bangladesh is known worldwide for its success in providing credit to the poor. However, subsequent replications of its methodology in other parts of the world have been less successful. Is there really an infallible solution that works everywhere, and is outreach to the poor compatible with sustainability? A Grameen replicator in the Philippines, the Center for Agriculture and Rural Development (CARD), has recently set itself firmly on the path to sustainability by becoming a formal sector, rural bank—the first credit NGO in the country to do so. During the period, from 1993 to June 1999, CARD's all-female outreach soared from 1,711 to 26,369. Its operational self-sufficiency ratio increased from 0.46 to 1.09. At the end of June 1999, CARD's loan portfolio stood at US$2.7 million, its repayment rate was 99.9%, and its financial self-sufficiency ratio was 0.85. The principal lesson to be learned from the CARD's success is that Grameen-type microfinance institutions (MFIs) can be sustainable and can substantially increase their outreach. CARD's social capital comprises (a) a core of good Grameen practices, such as high moral

commitment on the part of the leaders, based on values instilled through training; peer control, to preclude adverse selection and moral hazard; and a strict credit discipline; (b) innovative adaptations to suit the Philippine context, such as the adoption of rural bank status under central bank supervision; vigorous mobilization of voluntary savings; the provision of differentiated, profit-making loan and insurance products; and a broadening of the clientele to include poor and nonpoor depositors, while adhering to its mission of lending to poor women only.

Grameen Replicators in the Philippines

The Grameen Bank in Bangladesh, formally established in 1979, is widely considered one of the world's most successful financial institutions banking with the poor. In an effort to alleviate poverty, donors have supported replication programs in numerous countries, including the United States. The International Fund for Agricultural Development (IFAD) of the United Nations was the first major supporter of the Grameen Bank and has subsequently assisted capacity-building in many replication programs. Assuming that the only institutions capable in the long-run of reaching large numbers of poor people are those that mobilize their own resources and cover the costs from their income, donors are becoming increasingly concerned about the viability and sustainability of the Grameen replicators.[1]

The Philippines was one of the first countries to replicate Grameen banking on a large scale. When the government program's executing agency—the Agricultural Credit Policy Council (ACPC)—examined

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its experience with 27 replicators, 23 of which were still in existence in June 1993, there were mixed conclusions. The repayment performance was impressive, averaging a rate of 96.8%, but the overall picture was dismal. The replication program was found to be donor-driven. Internal resource mobilization appeared to be minimal. Interest rates were inadequate and administrative costs exorbitant, amounting to 47% of every peso lent and 170% of every peso saved.' The operational self-sufficiency ratio averaged 0.24. Noting that “excessive brokering of low-cost funds may discourage savings mobilization,” ACPC (1995) warned that “any attempt . . . to replicate or expand . . . should be carried out with great caution.” The replicators were not sustainable, nor did they reach a significant number of poor people, in a country with over 800 rural banks and 3,000 credit cooperatives (Seibel 1998).

In 1996, the Asian and Pacific Development Centre (APDC)—an intergovernmental body of Asian-Pacific countries, based in Kuala Lumpur—carried out an assessment of microfinance institutions (MFIs) in 11 of these countries, with the support of UNDP. Included in the study were seven MFIs from the Philippines, six of which used the Grameen technique. By the end of 1995, the situation of the sample replicators had improved generally, but the gap between good and poor performers had widened. Transaction costs per peso lent ranged from 0.19% to 1.30%, the operational self-sufficiency ratio from 0.08% to 1.34%, and the full financial self-sufficiency ratio (adjusted for subsidies received and for inflation) from 0.07% to 1.18% (Getubig, Remenyi, & Quiñones, 1997; Seibel et al., 1998). The only fully viable and sustainable institution among the seven was a rural cooperative bank. The two best performers among the credit NGOs quickly learned their lesson and decided to vie for sustainability and outreach. In order to mobilize savings legally, they applied for rural banking licenses, which would also bring them under the supervision of the central bank and its prudent standards. When the central bank raised the level of minimum capital requirements, one of the two applicants was forced to withdraw. The remaining applicant, the Centre for Agriculture and Rural Development (CARD), then received the required license to establish the rural bank. How did this event impact CARD's outreach and viability, and what were the innovations introduced by CARD in order to meet the required standards of a rural bank? Behind these questions lies a broader question: Is sustainability compatible with outreach to the poor?

CARD: Unsustainable Beginnings as a Credit NGO

CARD was established in 1986 as one of many new NGOs inspired by the onset of a new era in the Philippines after the downfall of the Marcos regime. In January 1988, with the support of two small grants, CARD began organizing the poor into mixed groups of 15 to

Table1. CARD Performance Data, 1988-June 1999

Year	No. of Borrowers	Repayment rate	Loans outstanding (in million P)	No. of deposit accounts	Operational self-sufficiency ratio	Financial self-sufficiency ratio
1988	150	68.0				
1989	89	100	.089	89		
1990	307	98	.59	307		
1991	468	96	.66	468	0.31	
1992	949	98.2	1.76	949	0.25	
1993	1,711		2.63	1,711	0.46	
1994	3,547	98.0	7.30	3,547	0.77	
1995	4,240	98.8	11.41	4,240	0.46	0.42
1996	6,844	99.2	22.35	6,844	0.77	0.68
1997	10,868	100	34.21	10,954	1.22	0.73
1998	20,617	99.9	82.79	20,882	1.00	0.73
June 1999	25,130	99.9	109.2	26,369	109.3	0.85

Source: Torres 1998; Annual Statement, 12/1998

Note: As an NGO, CARD accepted voluntary withdrawable deposits from the members since 1990. In September 1997, when CARD Rural Bank opened, it began accepting deposits from the public, including poor and nonpoor. The drop in operational self-sufficiency after 1997 was due to the opening of 11 new CARD NGO branches—two in 1997, three in 1998, and six in 1999—which necessitated the hiring of additional staff.

45 members, then registered them as associations and channeled standardized short-term microloans to each member, offering negotiable repayment schedules. This turned out to be a false start. After eight months of operation, the only groups that had repaid their loans were the two that had opted for monthly installments. The remaining five, committed to lump sum repayment upon maturity, defaulted. The overall repayment rate during the year was 68%. Under pressure from international donors, CARD had to either revamp its operations or close.

In late 1988, the president of CARD visited the Grameen Bank in Bangladesh. Deeply impressed by the ability of the poor to engage in income-generating activities and repay their loans on time, he decided to adopt the Grameen approach for CARD and reorganized the members of the various associations into groups of 5 and centers of 30 members each. However, this change met with considerable opposition. The complex Grameen discipline—which included weekly meetings and the payment of weekly installments—was greatly disliked, particularly by the men, and four of the associations left the project. However, 89 poor women agreed to participate in a pilot venture from January to December 1989. The results were very positive. The credit discipline, which is one of the most outstanding achievements of the Grameen approach, has produced repayment rates of between 98% and 100% since 1994. This impressed the central bank so much that it consented to fully noncollateralized lending when CARD established itself as a rural bank

Because the rigid criteria enabled only the poor to gain access, growth in active membership was slow initially, increasing from 89 members in 1989 to 1,711 in 1993. The years 1990-96 represented a period of experimentation to modify the Grameen technology. CARD developed its own training system and operations manual.

Basically, it substituted six-month first-loans with one-year loans, requested a minimum self-financing ratio of 25% from repeat borrowers, introduced a mutual life and accident insurance fund, replaced group funds by center funds, offered multipurpose loans for prime borrowers, added voluntary withdrawable savings (ignoring the law which prevents NGOs from collecting deposits), and finally, provided a staff-incentive scheme. Active membership grew from 1,711 in 1993 to 6,844 in 1996. By 1996, nonwithdrawable compulsory savings stood at PHP12m, and voluntary savings at PHP1m. The ratio of operational self-sufficiency, or viability, which had declined from 0.31 in 1991 to 0.25 in 1992, increased to 0.46 in 1993 and rose to 0.77 in 1996.

Transformation into a Rural Bank

In May 1996, CARD submitted its application to establish a rural bank, and received approval in December of that year. Consequently, CARD Rural Bank now falls under the regulations and supervision of the central bank, which mobilizes an entirely new quality of social capital.

CARD Rural Bank deposited PHP5m as paid-up capital with Landbank, and formally opened on September 1, 1997. There are now two separate institutions: CARD Rural Bank (five branches) for full-fledged financial intermediation, and CARD NGO for group formation and guidance, including financial intermediation in areas not covered by CARD Rural Bank. CARD NGO has 16 branches, covering the island provinces of Masbate, Marinduque, and Mindoro. An application for branching out has been submitted to the central bank in order to bring all financial activities under the umbrella of CARD Rural Bank (RB). Due to legal restrictions, CARD NGO owns only 25% of CARD RB; the rest is owned by five board members and staff, who have entered into a trust agreement with the NGO.

CARD's transformation into a bank appears to have greatly facilitated its growth in outreach, which soared to 10,868 in 1997 and to 26,369 in June 1999. CARD RB has ambitious goals: 50,000 active members by 2000 and 150,000 by 2002.

CARD Rural Bank offers passbook savings at 5% and fixed deposits that range from a minimum of PHP10,000 for one month at 7% interest, to PHP500,000 for 12 months at 15%—all of which is above the usual rates of commercial banks. As of July 1998, the savings deposit balance was PHP14m. There are five loan products, all with weekly installments: regular loans, increasing from a first loan of PHP2,000 to a fourth loan of PHP10,000; asset acquisition loans up to PHP50,000; housing loans up to PHP20,000; short-term, multi-purpose loans up to PHP5,000; and prime-borrower loans up to PHP100,000. Maturity ranges from 12 to 75 weeks, but most are 50 weeks. Interest rates are a flat 20% plus an upfront service fee of 4%. Effective annual interest rates are approximately 45.6% to 53.8%.

In July 1998, CARD Rural Bank's loan portfolio amounted to PHP32m, and that of CARD NGO to PHP38m. By December 1998, the portfolios had increased to PHP39m (6,530 borrowers) and PHP44.3m (14,087 borrowers), respectively, a combined total of PHP83.3m (20,617 borrow-ers). In June 1999, the total portfolio of loans outstanding amounted to PHP2.7m. Deposits in December 1998 amounted to PHP14.8m (38.0% of loans outstanding) in CARD Rural Bank and PHP10.9m (24.7% of loans outstanding) in CARD NGO, totaling PHP25.8m (30.9% loans out-standing). Equity and deposits together accounted for 37.0% of loans outstanding. In 1998, both entities obtained a loan of PHP15m from the People's Credit and Finance Corporation (PCFC), which is funded by the Asian Development Bank (AsDB) and IFAD, with a 12% interest per annum and a 1% annual service fee on the outstanding balance. Other donors include CGAP and Grameen Trust.

CARD's transformation into a rural bank, which included a preparatory phase in 1996-97, provided the legal foundation for vigorous voluntary savings mobilization and put it quickly on the road toward its desired goal of self-reliance and sustainability. The cost efficiency ratio (cost per peso lent) improved from 0.69 in 1995 to 0.33 in 1997. The operational self-sufficiency ratio went from 0.46 in 1995 to 0.77 in 1996, 1.22 in 1997, 1.00 in 1998 (a decline due to the addition of new branches), and 1.09 in June 1999. The financial self-sufficiency ratio (adjusted for subsidies and inflation) grew from 0.38 in 1995 to 0.52 in 1996, 0.70 in 1997, and 0.85 in June 1999. CARD's branch viability (operational self-sufficiency ratio of at least 1.0) increased rapidly, from 1 out of 8 branches in 1995 to 4 out of 10 in 1996 and 8 out of 13 in 1997.

CARD Rural Bank has proven that outreach to the poor and viability are not only compatible but are mutually reinforcing. This is also confirmed by Rojahn & Osner (1998), who observed that when Grameen replicators are low in operational viability, they are also low in outreach, while replicators high in viability are also high in outreach. With regard to financial self-reliance and full financial self-sufficiency, the Bank has made great progress in recent years. However, continuous access to "easy" donor money might hamper its vigorous efforts toward self-reliance and sustainability. This issue may require some careful monitoring over the next few years.

The Social Capital of a Successful Grameen Replicator

Is the Grameen approach a type of social capital that can be exported worldwide and meet with a success similar to that of the Grameen Bank in Bangladesh? Does the Grameen approach provide an optimal solution to the problem of how to provide financial services to the poor? Social capital is defined here, in the context of microfinance, as the shared normative system of a group or an organization that shapes people's capacity to work together and produce results according to the group's—or organization's—purpose. The specific norms of a group or an organization are, in turn, rooted in the more general norms and values of a society or a subsector. CARD Rural Bank, now part of the financial sector, falls under the regulations and supervision of the central bank as the norm enforcement agency. The consequent performance standards imposed on it will support its drive toward sustainability and economies of scale and scope, or wider outreach and product diversity. Such standards are missing among unregulated credit NGOs and are not always enforced by soft-hearted donors. This social capital perspective is being pursued further in a separate study (Quiñones, Seibel, & Llanto, 1999).

The outreach of some 30 Grameen replicators in the Philippines (Seibel, 1998) has been negligible compared to the totality of financial services provided by other microfinance institutions. The replications were found to be donor-driven, and donor dependency has undermined their viability. Only a few of the institutions were found to be operationally self-sufficient, covering the costs directly from their incomes. In some cases, even effective annual interest rates of around 50% (or real rates, adjusted for inflation, of around

40%) were not sufficient to cover the costs of the Grameen technology. However, all the institutions examined-the only ones that have survived-have made some progress in this respect.

Nonetheless, sustainability, as measured by the financial self-sufficiency ratio, is in sight for only one of the replicating institutions to date: CARD Rural Bank. The other replicators we looked at did not even remotely approach an adequate level of internal resource mobilization; nor had they earned sufficient revenue to cover the costs of all their operating, financial, and loan loss expenses, and the value of adjustments for subsidies and inflation. Paradoxically, the biggest obstacle in the development of the Grameen replicators has been donor support, a powerful incentive to substitute external resources for local savings.[5] Only savings and other domestic resources have a chance to grow dynamically: dole-outs do not. It seems speculative at this point to predict whether or not financial self-sufficiency might be reached by the other Grameen replicators. Those who adhere to the pure and unadjusted Grameen technology are, in the long-run, unlikely to withstand the growing competition from other MFIs.

Do the Grameen replicators reach the poor, and are they sustainable? According to the limited evidence available to date, the answer is that with the exception of one case, all the replicators are unsustainable and consequently are unable to reach a significant number of poor people. It appears that the Grameen approach has no magic formula and no best practice or unique and optimal solution that may be applied around the world in order to alleviate poverty. Perhaps no such optimal solution or best practice ever existed, or may ever be found. However, some good practices may work for a limited time under certain conditions and may compete with other good practices.

Several good practices contribute to the success of the one successful replicator: some are closely related to the basic Grameen approach, and some are innovative. It appears that three good practices in particular constitute the hard core social capital of the original Grameen approach:

- high moral commitment of leaders, based on values enforced through training
- peer selection and peer enforcement, precluding adverse selection and moral hazard
- credit discipline, including weekly installments, rigid insistence on timely repayment, and repeat loans of increasing amounts, contingent on repayment performance.

It further appears that some innovative features, which are modifications of the classical replication model, constitute additional core social capital dimensions:

- local rural bank status
- deposit mobilization from the poor and nonpoor through differentiated products with attractive interest rates
- demand-driven, differentiated loan and insurance products which cover all costs and risks
- client differentiation through different-size loan and deposit products.

We may hypothesize that Grameen-type MFIs in the Philippines are likely to be successful only to the extent that they implement criteria like those above—and unsuccessful to the extent they fail to do so. We tentatively consider the good practices listed above as being the essence of the social capital of Grameen-type institutions, at least in the Philippines. Whether or not this is the case worldwide remains to be seen. Depending on the policy environment, legal framework, microfinance infrastructure, and particular circumstances, most of these practices may be recommended for emulation, both by Grameen and non-Grameen MFIs, albeit not mechanically.

Conclusion

The principal lesson is that if a Grameen-type MFI registers as a bank, mobilizes its own re-sources through differentiated savings products, offers differentiated loan and insurance products which cover all costs and risks, and provides larger-size loan and deposit products to its poor and near-poor members, it has a good chance of becoming viable and financially self-sufficient. At the same time, it can continue to adhere to its mission and substantially increase its outreach to poor women. However, whether or not an MFI will do all of this depends on its management and board. According to CARD's experience, funding from donors can contribute to outreach and sustainability, but only if these donors refrain from interference and respect the institution's autonomy. To date, no regulatory authority supervises and enforces these good Grameen banking requirements in the Philippines. The lack of a definition of prudential norms and good practices for Grameen replicators in the Philippines, and of an effective delegated system of supervision under the ultimate authority of the central bank, is perhaps the greatest weakness of the Grameen replication program. The establishment of such a regulatory system might be a new field for donor support.

Notes

1 Viability is measured by the operational self-sufficiency ratio: Financial Income (Financial Costs + Operating Costs + Loan Loss Provision). Sustainability has two aspects: (a) measured by the financial self-sufficiency ratio, it refers to the extent to which an institution not only covers

its operational costs but also preserves the value of its resources by accounting for subsidies and the effects of inflation: Financial Income (Financial Costs + Operating Costs + Loan Loss Provision + Imputed Cost of Capital); (b) measured by the internal resources ratio, it refers to the extent to which an MFI mobilizes its own financial resources internally instead of depending on government, donor, or commercial funding: (Equity + Retained Earnings + Deposits)/Average Performing Assets. In donor-driven MFIs, the donations and grants ratio is more popular: (Donation + Grants)/Average Performing Assets (SEEP 1995).

2 Conversion of pesos into US dollar has been somewhat problematic since 1997. From 1991 to mid-1997, exchange rates were fairly steady, fluctuating between PHP25.7 and PHP27.5. Affected by the Asian financial crisis, the peso depreciated from a monthly average of PHP27.6 in July 1997 to PHP37.5 in December 1997, with an annual average of PHP28.6. During 1998, monthly averages fluctuated between PHP38.4 and a peak PHP43.6 in September, ending with PHP39.0 in December, and an annual average of PHP40.7.

3 CARD received support from IFAD through a training grant to CASHPOR in 1998 to establish a Grameen Bank Replica-tion Training Methodology within the Philippines. Recently CARD has gained access to PCFC, a national apex organization for the refinancing of MFIs, which is funded by AsDB and IFAD. Other donors include CGAP and Grameen Bank.

4 CARD (1998) is prepared to share its experience (card@msc.net.ph). Since 1996, it has trained 2,500 people in courses of one to two weeks' length. Training is conducted in English, at PHP500 (US$11.50) per day.

5 This conclusion is shared by the authors of a GTZ study of the financial sector in the Philippines, who "do not recommend promoting Grameen Bank replicators at the institutional level because the model is not currently implemented in a sustainable manner in the Philippines." This is seen in the context of "the need to revise the system of incentives created by national and international donors. These have accorded precedence to disbursing short-term credit to target groups over the institutional and financial sustainability of the programs and institutions" (Bieding et al. 1998:79).

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