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A Microfinance Promise: To Provide the Poor Access to Finance Services

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*"... I am getting curiouser
and curiouser..."*

Alice in Wonderland

In the 1970s and mid-1980s, the government's credit financing approach was characterized as supply-led whose hallmarks were mandatory credit allocation, loan targeting, below-market interest rates and credit subsidies to target sectors. The government provided funding sourced from budgetary appropriations and foreign loans for the subsidized credit programs. The intention was to provide loans to small farmers, small fisherfolk and generally small-scale borrowers because of their inability to borrow from banks.

Government intervention in the credit markets was thought to be justified because banks did not consider this type of borrowers attractive.

Unfortunately, the results were far from expectations. Various studies (Esguerra 1981; Neri and Llanto 1985; among others) showed that the intended beneficiaries did not get the credit subsidies; many rural banks that participated in the government's subsidized credit programs collapsed; and the government was burdened by unpaid loans and huge arrears.

In view of these, the government, with much prodding from multilateral lending institutions, adopted the stance of financial liberalization and deregulation of interest rates in the 1980s. Market-oriented financial and credit policy started to replace the financial repression policies of the earlier decades. However, despite attempts of the Department of Agriculture (DA) and the Agricultural Credit Policy Council (ACPC) to rationalize the agricultural credit programs at this time, directed credit programs still continued to proliferate. It was not until in recent years that this approach was abandoned by the government for a more nontraditional and liberal approach: microfinance.

This *Notes* briefly traces this eventual shift and cites the advantages of the new approach.

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Goodbye directed credit programs...

As recently as 1997, there were still as many as 86 directed (*read: subsidized*) credit programs being implemented by 42 nonfinancial government agencies and government financial institutions.¹ With as much as P40 billion (or 1.8% of GNP in 1996) in government funds and monies calculated to have been borrowed from external donors and channeled to these directed credit programs,² it is unfortunate that these programs proved to be money-losing undertakings with loan repayment estimated at an average of 82.6 percent. But what is even more unfortunate is the fact that only a few of the intended beneficiaries—small farmers, fisherfolk, and microentrepreneurs—got to enjoy the credit subsidies.

Thus, because the directed credit programs became a costly and wasteful government intervention, policy-makers eventually decided to do away with this approach. In 1997, Congress made the bold move to phase out all agricultural credit subsidies and install a market-oriented credit policy framework for all agricultural lending through the enactment of Republic Act (RA) 8435 or the Agriculture and Fisheries Modernization Act (AFMA).

The AFMA terminated the directed credit programs and consolidated them into the Agricultural Modernization Credit and Financing Program (AMCFP) which shall then serve the credit demand of the agriculture sector through the use of market-based interest rates and will be implemented through government and private financial institutions.

To complement the AFMA, the government issued Executive Order (EO) No. 138 which, aside from phasing out all directed credit programs (DCPs) in other sectors, also terminated the participation of nonfinancial government agencies in the implementation of such credit programs.

¹G.M. Llanto, M.P Geron and C. Tang. 1997. Directed credit programs in the Philippines.

²Data on initial fund allocation for 63 DCPs that reported to the survey conducted by the Credit Policy Improvement Program (CPIP) of the National Credit Council, Department of Finance.

The underlying philosophy of both the AFMA and EO 138 was that market-based policies and mechanisms in the financial markets will provide the poor households, the small farmers and microentrepreneurs better access to finance services. At the same time, however, ...the withdrawal of the DCPs would create a vacuum in the credit markets at the expense of the target beneficiaries.

EO 138 also mandated the adoption of market-based financial and credit policies and required the use of government financial institutions as wholesale credit institutions to the private financial institutions that will take care of on-lending at the retail level.

The underlying philosophy of both the AFMA and EO 138 was that market-based policies and mechanisms in the financial markets will provide the poor households, the small farmers and microentrepreneurs better access to finance services. At the same time, however, some interest groups pointed out then that the withdrawal of the DCPs would create a vacuum in the credit markets at the expense of the target beneficiaries.

Was this fear justified? What has happened since then?

Hello, microfinance...

Because of the failure of the traditional formal banking system and the government's DCPs to provide small-scale clients access to loans and other finance services, credit-granting nongovernment organizations (NGOs) were motivated to take the lead in developing and evolving various microfinancing techniques that could effectively reach the poor on a sustained basis.

Microfinance institutions (MFIs) such as credit-granting NGOs provide micro or small loans without collateral at

market rates of interest to small-scale clientele, mostly nonfarm enterprises and microenterprises. Typically, the MFI's familiarity with the borrower and the local economy enables it to extend loans based on the borrower's cash flow and to tailor fit the loan repayment in accordance with that cash flow. It follows the simplest documentation, lending, loan collection and monitoring procedures and uses proven lending mechanisms such as peer pressure and joint liability groups to ensure borrower discipline, incentives to motivate good behavior of clients and loan officers, and threats of cancelation of future loans for defaulting borrowers, among others.

Through the years since the phase-out of DCPs, MFIs began to take their roots in the country's credit finance system.

For its part, the government, through the National Credit Council of the Department of Finance, issued a National Strategy for Microfinance, a policy and strategy document that maps out the respective roles of government, government financial institutions, regulatory authorities and private microfinance institutions such as credit-granting NGOs, rural banks, and donors in the development of microfinance in the country.

The document was instrumental in making government assume a different role in the credit markets. From a direct provider of subsidized loans, the government has taken, as its task, a hand-holding role in the creation of a policy and regulatory environment that will support the development of market-oriented financial programs for the poor.

At the same time, Congress introduced innovative provisions on microfinance in the revised General Banking Law of 2000 (RA 8791). To implement said provisions, the Bangko Sentral ng Pilipinas (BSP) issued several circulars and other guidelines supporting microfinance development such as the issuance of clear guidelines on the treatment of microfinance-oriented banks; provision of a rediscounting facility for banks engaged in microfinance; and formulation of a supervision format that is appropriate for microfinance operations of banks.

Meanwhile, what became the lead government institution for raising financial resources for microfinance services was the People's Credit and Finance Corporation (PCFC) which was organized and registered by the Land Bank of the Philippines as a microfinance company. With ODA assistance provided through the ADB-IFAD Rural Microfinance Project and the Microfinance Loan Fund, a component of the Countryside Loan Fund project of the World Bank with the Land Bank of the Philippines, the PCFC was able to provide wholesale loans to accredited MFIs which in turn lent to microfinance clients.

Market-based credit policies have proven effective...

Given the above developments, what have been the results so far?

Data from the Microfinance Council of the Philippines, as shown in Tables 1 and 2, seem to indicate that the twin objectives of serving a greater number of poor clients (outreach) while at the same time, ensuring the sustainability of the financial institutions serving them are being met. The implication is that the government has found in microfinance a very good substitute to DCPs. On the one hand, the poor are having access to sustainable finance services without creating a fiscal and insti-

Table 1. Performance of microfinance institutions, 2001- 2002

	Aggregate data of 15 MFIs as of Dec. 31, 2002	Aggregate data of 12 MFIs as of Dec 31, 2001
Number of branches	172	121
Number of staff	2,324	1,475
Number of field staff	1,881	1,177
Number of borrowers and savers	382,672	251,211
Value of loans outstanding (pesos)	1,566,435,367	1,050,458,155
Value of clients' savings deposit (pesos)	638,511,066	402,633,016

Source: Microfinance Council of the Philippines

tutional burden on the part of government. On the other hand, private MFIs are having a good business with microfinance.

Table 1 suggests a rapid expansion of outreach in terms of borrowers and savers.³ In 2002, the Microfinance Council of the Philippines reported that there was a general trend on the part of leading MFIs to expand to relatively poorer provinces. For instance, the Taytay sa Kauswagan, Inc. (TSKI) has established branches in Leyte, Southern Leyte, Samar and Siquijor while the Negros for Women Tomorrow Foundation (NWTF) opened a new branch in Palawan, thereby expanding to areas outside of Negros Island and Cebu. Community Economic Ventures, Inc. (CEVI), with its head office in Bohol, has branches in Palawan, Agusan del Sur and South Cotabato. Tulay sa Pag-unlad, Inc. (TSPI) opened new branches in Camarines Norte while the Center for Agriculture and Rural Development (CARD) chose to open new branches in the poorer municipalities of Camarines Sur. There is a relatively high concentration of MFIs operating in Bulacan,

³In 2002, 15 MFI members of the 22-member organization called the Microfinance Council of the Philippines reported the field data. In 2001, only 12 members reported. While the two observations are not strictly comparable because there were fewer members reporting in 2001, the data reported in Tables 1 and 2 are indicative of the progress being made by MFIs in reaching the poor on a sustainable basis.

⁴Microfinance Council of the Philippines. 2002. Update on the performance of the Council Members. July. Space limitations prevent a more detailed explanation of the recent performance of MFIs. The Update provides details.

Table 2. Sustainability indicators of 15 member MFIs (as of December 31, 2002 and in averages)

	Operational self-sufficiency (OSS) (in percent)	Financial self-sufficiency (FSS) (in percent)	Equity to asset ratio (in percent)	Current ratio	Savings to loan ratio (in percent)
<i>All MFIs (n=15)</i>	107.6	95.1	39.0	2.5	40.3
<i>By scale of operations</i>					
Large	122.9	103.9	29.3	2.0	39.3
Medium	100.7	95.9	52.6	2.2	39.2
Small	102.1	88.8	36.3	2.9	41.5
<i>By age of MF operations</i>					
New	94.6	79.4	60.7	3.2	31.2
Young	92.5	81.8	51.9	2.4	44.5
Mature	115.3	103.3	32.1	2.3	42.2
<i>By FSS levels</i>					
FSS MFIs	126.5	116.4	36.8	2.3	41.3
Non-FSS MFIs	97.2	83.3	40.2	2.6	39.8
Source of data: Microfinance Council of the Philippines					

Laguna, Nueva Ecija, Bohol and Cebu—areas where there is higher than average economic activity.⁴

Table 2, in the meantime, shows the sustainability indicators of the 15 reporting members of the Microfinance Council of the Philippines. Five out of the 15 MFIs report that they have achieved levels of financial self-sufficiency exceeding 100 percent, meaning they have the capacity to reach more poor people on a sustainable basis. Others are working hard to achieve operational and financial self-sufficiency.

The promise starts to be realized...

What really bodes well, though, for the small-scale clients are the reports from the field that indicate that not only the credit-granting NGOs are serving the microfinance market but also the mainstream banking sector. Table 3 shows BSP data on the growing microfinance exposure of microfinance-oriented banks.

Table 3. Microfinance Portfolio of Some Banks (as of September 2002)

	Amount (million pesos)	Number of borrowers
Microfinance-oriented banks		
Rural banks (2)	6.00	570
Thrift banks (2)	87.27	22,061
Traditional banks		
Rural banks (66)	1,258.50	232,855
Cooperative banks (25)	507.41	87,061
Total	1,859.18	342,547
Source: Bangko Sentral ng Pilipinas		

All these are welcome developments for the small-scale clients who have traditionally failed to access finance services in the formal financial markets.

But beware of policy reversals!

The countries that have shown remarkable progress in microfinance development are those that have stayed the market-based path. In a previous *Policy Notes*,⁵ this author pointed out the pitfalls that policymakers face in their desire to support microfinance. For example, there is the temptation to rush things and make microfinance accessible to as many poor people as possible without considering the possible implication on the sustainability of microfinance institutions and borrower discipline.

In this regard, there is a need to keep the market orientation of credit and financial policies and at the same time review the following:

- ▶ the threat to revoke EO 138; and
- ▶ the section of RA 9178 known as the “Barangay Micro Business Enterprises Act of 2002.”

⁵G.M. Llanto. 1999. Philippine credit policy and microfinance institutions: some lessons from the Latin American experience. PIDS Policy Notes No. 99-09. Makati City: Philippine Institute for Development Studies.

On the reported plan to revoke EO 138, what is being considered is the restoration of subsidized credit programs to benefit target beneficiaries. In effect, this will reverse the policy thrusts of the government that have achieved significant results in a relatively short period of time. With regard to Section 9 of RA 9178, known as the “Barangay Micro Business Enterprises Act of 2002,” meanwhile, which directs the Land Bank of the Philippines, Development Bank of the Philippines, Small Business Guarantee and Finance Corporation and the People’s Credit and Finance Corporation to create a special credit window that will service the financing needs of barangay microbusiness enterprises, it should be pointed out that the creation of these “special credit windows” is virtually like a revival of the failed subsidized credit programs. Policymakers should thus bear in mind the recent performance of local MFIs as well as those of successful MFIs around the world that offers a lasting testimony to the efficacy of market-based approaches in order to resist the temptation of resorting to populist credit programs.



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