

Is the promise being fulfilled?... **Microfinance in the Philippines: status, issues and challenges**

*Gilberto M. Llanto**

In a previous paper,¹ this author wrote about the concept of microfinance and its promise to provide and improve access to financing for small farmers, fisherfolks and microentrepreneurs. Said paper noted that microfinance is seen to be gradually replacing the government's previous directed credit programs (DCPs) as a major source of financing for the poor.

Has the picture remained the same or has it been altered at this point? This *Policy Notes* looks into this and discusses the status of microfinance in the Philippines and the outstanding issues and challenges that it faces. This *Notes* also provides recommendations to meet the challenges.

Impressive gains in the last three years

The most recent update of the performance of 21 reporting microfinance institutions (MFIs) provided by the Microfinance Council of the Philippines shows impres-

sive gains in the number of clients, gross loan portfolio, and amount of client savings over a three-year period from 2001 to 2003.

As shown in Table 1, there has been an increase in the number of active clients from 192,802 at the end of 2001 to 578,493 at the end of 2003. The growth rate in the number of clients over the two-year period is 200 percent. The gross loan portfolio (GLP) has also increased from P1.05 billion in 2001 to P2.3 billion in 2003, an equivalent 122 percent increase in the GLP over the two-year period. Correspondingly, client savings increased from P402.6 million in 2001 to P859.6 million in 2003, amounting to a 113 percent increase in savings over the same period.

More recent data provided by the People's Credit and Finance Corporation (PCFC) indicate that as of March 31, 2004, the 196 MFI borrowers (called conduits) of the PCFC have an aggregate outreach of 1,099,025 clients.

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¹ A microfinance promise: to provide the poor access to finance services. *PIDS Policy Notes No. 2003-06*. July 2003.

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Table 1. Aggregate data of member-MFIs, 2001-2003

Indicators	21 MFIs as of Dec. 31, 2003	15 MFIs as of Dec. 31, 2002	12 MFIs as of Dec. 31, 2001
Number of active borrowers	578,493	314,225	192,802
Gross loan portfolio	2,334,494,701	1,566,435,367	1,050,458,155
Value of client savings	859,613,843	638,511,066	402,633,016

Source: Microfinance Council of the Philippines

The Bangko Sentral ng Pilipinas (BSP) reports that as of December 31, 2003, the 121 banks engaged in microfinance have an outreach of 485,136 clients. It should be noted here that some of the 121 banks in the Bangko Sentral data are also borrowers of the PCFC. Thus, there is some overlap in the data. However, the Microfinance Council of the Philippines (MCP) estimates that minus the overlap, there could be as many as 1.3 to 1.5 million clients of all types of microfinance institutions combined.

The PCFC puts the aggregate loan portfolio for microfinance of 179 conduits² at P4.3 billion as of March 31, 2004. BSP data, on the other hand, place the aggregate loan portfolio of 121 banks at P2.96 billion as of December 31, 2003. Again, there is some overlap on these data; thus, the estimated aggregate loan portfolio for microfinance would be between P5 to P6 billion.

A few microfinance institutions, namely, the Center for Agriculture and Rural Development (CARD) Bank, CARD NGO, Negros Women for Tomorrow Foundation, Taytaysa Kauswagan, Inc., and Tulay sa Pag-Unlad, Inc., dominate the microfinance sector in terms of resources, gross loan portfolio, and outreach. However, recent entrants composed of medium- and small-sized MFIs also show significant gains in outreach and sustainability. Rural banks have also indicated a growing interest in microfinance because of the huge potential profitability and have thus joined the industry. The MCP points out

² Data was available for 179 conduits that submitted a report on their own portfolio.

that the new entrants are providing vibrant competition that is moving MFIs to be more client-focused. The sector continues to face the challenge of providing appropriate financial services to a greater number of poor households/microenterprises in a sustainable manner.

Issues facing microfinance development

Still, there are a number of issues that need to be addressed and monitored if microfinance development is to remain vibrant and responsive. Below are some of them.

► **Threat of policy reversal.** In the past months, there have been reports that the government would revoke Executive Order Number 138 which terminated the subsidized credit programs in the nonagricultural sector and would cap interest rates. While the Executive Order was not, however, revoked and interest rates continued to be market-determined, there is a continuing threat of policy reversal because of politicians' penchant for endorsing populist but unsustainable programs. The government should stay the course and continue the market orientation of financial and credit policies which have helped MFIs attain a high outreach and financial sustainability level. It should totally abandon any plan to revive subsidized credit programs and instead consider using well-targeted subsidies, e.g., output-based assistance, in cases where there would be a need to extend subsidies in fulfilling a particular goal or objective.

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► **Emerging credit pollution.** The stiff competition in some areas has emboldened some microfinance clients to overborrow and/or get loans from one microfinance institution to repay maturing loans in another. MFIs have encountered loan collection problems because of this phenomenon that had gone undetected for some time. The National Credit Council (NCC) of the Department of Finance and the BSP are taking steps to establish a credit information bureau in response to this problem. In this regard, the issues constraining the establishment of a credit bureau should immediately be resolved by these two institutions.

► **Need for appropriate regulation and supervision.** The traditional tools of regulation and supervision cannot adequately handle the prudential and safety requirements of microfinance where loans are provided on the basis of cash flow, trust and intimate knowledge of the borrowers; dispensed in small amounts without collateral to almost asset-less borrowers in the extreme; and collected on the basis of cash flow (weekly, monthly). The BSP has tried to issue Circulars that are intended to ensure the safety and soundness of microfinance institutions as well as taken steps to develop a risk-based supervision approach to microfinance in response to the demand for appropriate regulation and supervision.

Risk-based supervision is based on a more comprehensive understanding of risks faced by a microfinance bank.³ The microfinance market presents a different configuration of risks and no less than a deep understanding of this market and its risks is required for effective supervision. The BSP recognizes that it will take a long experience and systematic training to develop the capacity to effectively regulate and supervise microfinance banks.

³ Gilberto M. Llanto. 2001. Risk-based supervision of banks involved in microfinance. *PIDS Policy Notes No. 2001-01*. Makati City: Philippine Institute for Development Studies.

⁴ Gilberto M. Llanto. 2000. Protecting deposits in savings and credit cooperatives. *PIDS Policy Notes No. 2000-08*. Makati City: Philippine Institute for Development Studies.

The use of performance standards by MFIs will help them observe financial discipline and governance and establish their credibility in the financial markets. Access to commercial sources of capital will be facilitated if MFIs can show adherence to certain performance standards that provide an objective basis for judging their financial performance.

Donors may thus assist the BSP in developing the capacity on risk-based supervision and in making MFIs understand the requirements of this approach to supervision.

► **Effective regulation of credit cooperatives/credit unions.**⁴ Credit cooperatives/credit unions have shown their capacity to provide financial services to small-scale clients. Thousands of low-income people entrust their deposits to credit unions/cooperatives. Unfortunately, the regulation and supervision of these credit unions/cooperatives is neither effective nor efficient. There is therefore a need to develop the government authority's capacity to regulate and supervise these entities to ensure their safety and soundness. This will uphold the welfare of hundreds of thousands of small-scale borrowers and savers. The Cooperative Development Authority (CDA) should build its capacity for more effective regulation and supervision of credit unions/credit cooperatives.

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MFIs. The performance standards are currently undergoing field tests to check their applicability on the subject MFIs. Right after field tests, the NCC and BSP should decide at once on what performance standards to apply on MFIs.

► **Building the capacity of microfinance institutions.**

The favorable policy environment created by the government through the National Strategy for Microfinance (basic policy framework for microfinance), the General Banking Law of 2000 (legal basis for the various circulars on microfinance issued by the BSP), the Agriculture and Fisheries Modernization Act (market orientation of credit and financial policies and phase out of subsidized, directed credit programs in the agriculture sector) and Executive Order 138 (phase out of subsidized directed credit programs in the nonagriculture sector) laid the financial infrastructure for the growth of microfinance in the country. Donor assistance from the United States Agency for International Development (USAID), United Nations Development Programme (UNDP), Asian Development Bank (ADB) and International Fund for Agricultural Development (IFAD) has been instrumental in building the capacity of

MFIs. In response, MFIs have shown impressive gains in outreach and financial sustainability.

However, the emerging bottleneck for further microfinance development is the inadequate capacity of the MFIs to lend to more clients, either going down-market to poorer households or going up-market to bigger microenterprises/small enterprises. The government and donors should thus develop a systematic and sustained program of providing technical assistance to the MFIs in various areas, e.g., strategic planning, financial management, audit and control system, basic banking skills, simple accounting and financial analysis and MIS, loan delinquency management, asset and liability management, product development and packaging, risk management, appropriate pricing of financial products, information tools and appraisal systems, internal control, human resource development and client development.

Conclusion

The prospects of microfinance as a major source of financing for the small farmers, fisherfolk and entrepreneurs are bright. But they can be even brighter if the above issues are immediately addressed by all concerned. Only then will the promise of microfinance really be fulfilled. 📄

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