MAINSTREAMING MICRO

The State of the Art of Microfinance and Microenterprise Development in the Philippines

Stakeholders Conference and Policy Recommendations

NINOY & CORY AQUINO FOUNDATION

Hanns Seidel Foundation

PINOY ME
FILIPINO MICROENTERPRISE
PEOPLE POWER AT WORK

{ OVERVIEW }

While microfinance and microenterprise development continue to evolve, the microenterprise sector is faced with growing opportunities and pressing issues that must be addressed in order to fulfill micro-entrepreneurship's promise in helping the poor move out of poverty.

To address these issues, PinoyME organized a group of policy experts and practitioners to come up with a research and policy agenda that can provide strategic direction for microentrepreneurship in the country.

Mainstreaming Micro is the result of research efforts and a series of policy discussions on the current state and future direction of microenterprise development in the country. It presents a menu of policy issues and recommendations derived from an extensive survey of around 280 studies on microfinance and microenterprise development in the Philippines in the last two decades. This compilation and study of microfinance literature was undertaken by Napoleon Micu in behalf of PinoyME with the support of Hanns Seidel Foundation/Germany (HSF) which is financed by the Federal Ministry of Economic Cooperation and Development (BMZ) under the joint project, Microfinance Capacity Building Program, in partnership with the Ninoy and Cory Aquino Foundation (NCAF).

The paper is divided into two parts:

The *Policy issues paper* is a document that was presented during the Philippine Microenterprise Stakeholders Conference held last April 15, 2010 in Manila. It was intended to create a common knowledge base in the sector and build consensus on the ways forward in microenterprise development among different stakeholders.

The *Conference results paper* is a summary of conference agreements. The conference was attended by more than 100 representatives of government agencies, NGOs, MFIs, development practitioners, donor agencies, and academic institutions. It enumerates action steps that demand greater collaboration in scaling up microfinance and microenterprise development as a means to alleviating poverty in the Philippines.

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{ THE MICROFINANCE NARRATIVE }

Microfinance helps alleviate poverty

Microfinance was conceived as a sustainable tool for poverty alleviation. Since becoming popular in Bangladesh in the 1970s, it now reaches more than 100 million poor people all over the world through a combined portfolio of $15 billion. Microfinance helps dampen poverty by raising incomes and human capital stock. It also reduces the vulnerability of the poor to internal and external shocks. Livelihoods financed through microfinance boost income, which, in turn, is spent to increase food consumption, attain better education, maintain good health, improve housing conditions, and acquire durable goods and assets. The biggest impact of microfinance has been in helping the poor smooth their consumption. In the Philippines, government figures indicate that microfinance now reaches 7 million individuals through the services of 500 microfinance institutions (MFIs) with a combined portfolio of P12 billion. The microfinance industry also employs directly about 35,000 people and an additional 1,400,000 indirectly through the microenterprises financed by the industry. A supportive regulatory and policy environment, including the phase-out of government directed credit programs, helped spur the growth of microfinance in the country.

The commercialization of microfinance has created new opportunities for the sector but it has ushered in new challenges as well.

Because of its effectiveness and profitability, microfinance has assumed a commercial character, which provides strong incentives for private funds to invest in it. Microfinance has penetrated the financial system as a viable investment vehicle. Its profitability is drawing investors from capital markets. This has enabled its proponents to increase rapidly their outreach toward the poor. These investments also facilitate the MFIs drive for scale, thereby enhancing competition, which then stimulates operational efficiency among competitors. Competition spurs an MFI to cut costs, provide products that are more responsive to the needs of its clients, and generate higher returns in the process. At the same time, the demand for higher return on investment is pushing MFIs to focus more on profitability, with poverty reduction taking a secondary role. There are also preliminary indications that the increasing competition among MFIs encourages multiple borrowing among microfinance clients, possibly leading to problems of over-indebtedness; this recent phenomenon, however, requires further research scrutiny.

Microfinance is a sustainable tool for poverty reduction.

The unique character of microfinance is that it is not dependent on direct subsidy. It also facilitates the participation of the private sector in efforts to reduce poverty. A number of private companies are already implementing models of CSR-driven ventures with microentrepreneurs, in turn, can serve as strategic investment. The cost subsidy may eventually recede and the profitability of these ventures with micro entrepreneurs may rise as the business achieves economies of scale. Private sector participation in poverty reduction, in turn, leaves the government with more resources to address the basic needs of the extreme poor, who have proven to be difficult to reach using the existing financial tools and capacity of the microfinance industry.

Although microfinance has played an important role in poverty reduction, many of the rural poor, particularly those in agriculture, are yet to be reached by microfinance.

Recent studies indicate that most microfinance clients are not poor, by official definition. The majority of microfinance funds have gone to urban areas in the richest part of the country, while comparatively little has gone to the poorest provinces. Thus, microfinance has so far been an urban phenomenon that finances largely retail or trading microenterprises. Because 70 percent of the poor in the Philippines are in rural areas, the challenge to microfinance is how to reach the rural, agriculture-based poor population. In addition, there is evidence that the chronic poor tend to borrow primarily for consumption smoothing rather than for income-generating activities. However, new lending products that are tailored to the multiple needs of the poor¯and thus priced and structured appropriately¯are yet to be designed. More generally, the financial needs of the poor must be understood more thoroughly.

Because microfinance is one of many interventions for lifting people out of poverty, a growing number of MFIs have latched on to the trend of providing more service than just microcredit.

Recognizing the limits of the traditional mode of microfinance, many MFIs have recently diversified their services to include microinsurance, micro-housing, and business development services (BDS). This trend reflects growing sensitivity to client needs as MFIs experience success in repayment rates. MFIs are also moving into the delivery of business development services or "microfinance plus", to promote the sustainability of clients' businesses. Thus, microfinance is evolving into microenterprise development, which combines financial and non-financial services in helping the poor integrate more fully into the formal economy. However, the question of whether MFIs should be moving away from their key areas of comparative advantage micro-credit and savings¯remains a subject of debate.

Complementary structural reforms will be necessary to achieve sustainable poverty reduction.

Studies have shown that lack of access to markets and lack of access to capital are two of the major causes of poverty in the world and, in response, microfinance and microenterprise development have emerged as powerful interventions that address these root causes of poverty. Participation in the economy through microenterprise development, however, is not the panacea to eliminating poverty. Poverty is multi-faceted and any poverty-reduction program must be based on a broader framework for poverty reduction. To enable microfinance to achieve its potential in helping reducing poverty, the government must promote its sustainability as a vehicle for financial intermediation, while enacting a complementary reform agenda that addresses broader structural causes of poverty.

Key policy principles

For microfinance to contribute more toward poverty reduction in the Philippines, the key challenges are to: (a) increase outreach to more poor people, particularly those in the rural, agricultural communities; (b) promote the integration of microentrepreneurs into the mainstream market; (c) ensure that MFIs are profitable as they help reduce poverty among their clients; and (d) increase the access of the poor to formal financial services. Consistent with these four challenges, the figure in Annex A illustrates a four-pillar research and policy framework for scaling up microfinance and microenterprise development. Toward this end, a strategic research initiative needs to be carried out to monitor indicators of how these four pillars of the microenterprise equation are effectively serving as pathways out of poverty. The pillars also highlight the key policy inputs for utilizing microenterprise development as a driver for poverty reduction, though further studies need to be undertaken to develop evidence-based and actionable policy recommendations. Two key principles should serve as the basis for these policy recommendations:

First, the government must play a diminishing role in lending to the poor to promote further a market-driven environment, prevent the distortion of prices, and allow more private sector-led initiatives. Second, the government must create an environment conducive to microfinance and microenterprise development, by creating a level playing field and promoting fair competition among financial institutions, by providing timely and relevant information to the market, by delivering services to poor households that will not be served by the market, and by enforcing client protection, among other measures. The policy options enumerated below will require coordinated and complimentary efforts from the government, the business sector, the academe, and MFIs themselves.

Key Policy Challenge #1:

Increasing the outreach of microfinance

Increasing the outreach of microfinance to the poor is a two-fold challenge. On one hand, there is a need to retain existing clients and expand the financial services that are being offered to them. On the other hand, there is also a need to take microfinance into frontier areas where poorer households do not have access to such services. Microfinance should be understood not simply as the provision of microcredit but also as the provision of the full range of financial services to the poor, including savings, microinsurance, and remittance services.

The challenge in taking microfinance to the rural, agriculture sector is complex. Current microfinance products are designed mainly for cash flow financing and are not suitable for rural financing, taking into account all the risks associated with agricultural economic activities. For the rural poor, meanwhile, there are essentially three pathways out of poverty: higher agricultural income (including from fishing and farming activities), higher non-agricultural income, and emigration.

Policy Recommendation #1:

Review the effectiveness of mandatory allocation of financial resources, determine demand for this type of funding, and provide other incentives to encourage private investments in financial services for the poor.

The "agri-agra" law and other government policies requiring the mandatory allocation of financial resources have not been effective in promoting private investments in rural areas. Rather than expose their monies to inherent risks in the agricultural sector, some banks have instead resorted to either investing in government securities as an alternative compliance mechanism or by simply paying the penalties for non-compliance. To channel these scarce resources toward more productive uses, the executive department should expand the types of projects currently deemed eligible under the law to include loans granted by banks for basic infrastructure (such as roads, bridges, communication facilities, markets) and services (such as marketing, transportation, bulk storages) in predominantly rural and agricultural areas. This serves to encourage investments in physical infrastructure in rural areas and, as a result, enhances the creditworthiness of farm workers and boosts the profitability and long-term viability of farm-based production activities.

In partnership with the academe, government and donor agencies must conduct suitable studies to identify alternative forms of support for micro-small-and-medium enterprises (MSMEs). Such support may include incentives and guarantee schemes such as weather and crop insurance that will minimize the risks in lending to the agriculture sector. Although it is a much bigger issue beyond microfinance, the government needs to address the festering obstacles to agricultural productivity and efficiency if it wants to reduce poverty in rural areas. We cannot expect private investments in agriculture and rural areas while agriculture continues to be a losing proposition for small farmers, fishers and other agriculture-dependent sectors.

In addition, legislation is required to prevent the reversal of the National Strategy for Microfinance. The Philippines' structural environment for microfinance is recognized as the most advanced policy edifice among other developing countries, in large part because the provisions of the National Strategy for Microfinance (1997), complementary Executive Orders, and BSP policies, have encouraged the private sector and MFIs to provide financial services to the poor. These measures have also created an environment conducive to market

forces and resources. To sustain this environment, the executive department must certify as urgent a bill to institutionalize the National Strategy for Microfinance.

MFIs should explore providing complementary financial services in areas where the government has provided subsidies such as conditional cash transfers (CCTs) and where it has financed community-driven development projects. Some of the government's delivery mechanisms may also help ensure that sufficient infrastructure exists to ease the entry of MFIs into geographic areas that are otherwise hard to reach. More important, as the effect of government-provided subsidies take hold on beneficiary households, the need for such financial services as savings, microinsurance and microcredit will rise. Microfinance can therefore aid in moving communities into productive mode as they graduate from subsidies.

Government should refocus some of its resources for microfinance to subsidies in capacity building for MFIs to enable them to become more effective in serving the financial needs of poor and in reaching areas that are currently unserved or underserved by microfinance. Particular attention should be given to enabling MFIs to use information and communications technology to increase the efficiency of their management information systems.

A government-led census of the microfinance industry—showing more accurately the current size and reach of the industry, including the volume of lending, the geographic distribution, and the number of people employed to date (and by extension the potential for more employment generation)—can help establish critical information about the industry. Clarifying the key facts regarding the industry's state and its potential can encourage more private resources to support financial services for the poor.

Key Policy Challenge #2:

Increasing the poor's access to formal financial services.

Despite the rapid outreach of microfinance, a large majority of the poor are still unable to access services from the formal financial system. Consistent with the new concept of "financial inclusiveness", developing countries should have a policy and regulatory environment that promotes a continuum of financial institutions that offer appropriate products and services to all segments of the population. "Inclusive finance" is defined as safe savings, appropriately designed loans for poor and low-income households and for micro, small, and medium-sized enterprises, and appropriate insurance and payment services.

An inclusive financial system is important to the poor because access to these financial services facilitates payment, strengthens their protection against shocks, lowers their business cost, helps them to build up their assets over time, and generally allows them to participate more full in the formal economy.

Policy Recommendation #2:

Create an inclusive financial system by facilitating the provision of a broad range of financial services that cater to the needs of the poor.

These services, which may or may not be credit-related, and enabled by information and communications technology, should be tapped to promote better access to financial services among the poor. Several studies show the poor's demand for non-credit financial services, such as savings, insurance, and remittance services is largely unmet. First among these is the need for risk protection and providing suitable services can encourage greater financial discipline among the poor. Moreover, the provision of microinsurance to the poor¯with MFIs serving as delivery channels¯can help reduce their vulnerability to external shocks, such as natural calamities and disasters. Toward this end, the executive department should continue to implement policies espoused in the recently adopted National Strategy and Regulatory Framework for micro-insurance, according to which all stakeholders (both government and public sector) are enjoined to provide appropriate risk protection measures for the poor. For example, private insurance providers are instructed to develop and make available simple and affordable microinsurance products that respond to needs of the poor. Support institutions, meanwhile, can provide technical assistance and training programs necessary to launch and distribute these microinsurance products to low-income households. They can also run a much-needed education campaign to raise public awareness of microinsurance.

Cooperatives should be promoted as another avenue for providing financial services to the poor. However, there is a need to improve the regulation of cooperatives. There are more than 70,000 cooperatives registered with the Cooperative Development Authority (CDA) nationwide. Current records indicate, however, that more than 50,000 cooperatives are no longer operating or no longer in existence. Only about 20,000 remain operational of which about 3,000 may be considered marginally viable and sustainable. A small fraction has attained the status of rural banks in terms of assets and operations. The current state of the cooperative sector can be traced primarily to a poor regulatory environment and the lack of effectiveness of the CDA as a regulator. For almost two decades, CDA has focused mainly on its developmental functions rather than on its regulatory functions, in part because the CDA Charter is ambiguous and does not grant the CDA the necessary authority to regulate cooperatives. Considering the potential of cooperatives as vehicles for promoting social and economic empowerment in the rural areas, the thrusts of the CDA need to be refocused and its policy and regulatory functions need to be enhanced so that it can help strengthen cooperatives in the areas of governance, management and operations, among others. An amendment to the CDA Charter, the restructuring of its organization, and the professionalization of its staff (following the BSP as a possible model) will create a strong cooperatives sector that can help deliver microfinance services in the rural areas.

Meanwhile, the academe should conduct systematic studies on the effectiveness of microinsurance. The results of such research can help develop this service further. The potential for broader use of information and communications technology to promote access to financial services among the poor also needs to be explored further, in recognition of the popularity of mobile telephony among them.

Key Policy Challenge #3:

Promoting the progress of microentrepreneurs.

The majority of microfinance clients (70 to 80 percent, based on anecdotal information) are in retail/trading microenterprises (e.g. sari-sari stores) that typically have low value-added and are vulnerable to external shocks. Only 1 to 2 percent of these microenterprises graduate into small-enterprise level. While BDS is becoming a popular intervention in microenterprise development, the provision of non-financial services needs to be scaled up to help the poor enter the formal market economy.

Policy Recommendation #3:

Facilitate access of microentrepreneurs to business development services and facilitate their registration to enable them to enter the formal economy.

The key to promoting progress is in finding sustainable, commercial relationships that will support fledgling microentrepreneurs' integration into the mainstream market. Much of this effort will involve business development services, including documenting case studies of established businesses that can serve as templates for microentrepreneurs. These market opportunities need to be identified and made explicit to microfinance players to enable them to grow their businesses and integrate into the mainstream. The government should allocate more resources for business development services of such agencies as the Department of Trade and Industry, the Department of Agriculture, and the Department of Science and Technology and direct these agencies to extend their services to microenterprises, particularly those in rural areas. The policy environment for micro and small enterprises also needs to be improved in order to make the market work for the poor. In addition, government should make it easy for microenterprises to register as formal businesses so they can participate more fully in the formal market. The executive department must enact measures to encourage LGUs to facilitate the registration of MSMEs. The academe should also conduct case studies of registration systems and use the results of such studies to design suitable registration systems for microentrepreneurs.

Key Policy Challenge #4:

Increasing the impact of MFIs on poverty.

As previously mentioned, there is growing concern that commercialization may be diverting MFIs away from their mission of reducing poverty. There is a strong relationship between MFIs' financial sustainability and social impact.

More financially sustainable MFIs that can afford to lower their interest charges are in a better position to reach the chronic poor while less sustainable MFIs tend to target the entrepreneurial poor whom they can afford to charge higher interest rates. The chronic poor tend to borrow primarily for consumption rather than for income generating activities. The entrepreneurial poor generate more revenues from microfinance loans because they use such loans for business rather than for consumption. As such, the financial success of MFIs and that of their clients are very closely linked. MFIs that are able to provide effectively for the needs of their clients will be able to retain these clients, become more profitable, and increase their share of the market. Thus, it is important to determine if MFIs are increasingly measuring their success in alleviating the vulnerability and poverty of their clients while also becoming more profitable.

Policy Recommendation #4:

Monitor indicators of social performance management (SPM) among MFIs and promote the use of SPM tools.

One of the key accomplishments of the Philippine microfinance industry is the development of tools to measure poverty impact of MFIs_the social performance management (SPM) indicators. However, SPM is not yet widely practiced among MFIs. MFIs should be encouraged to incorporate SPM indicators into their management information systems (MIS). At the same time, financial incentives that can help promote the broader use of SPMs should be identified.

The government must establish the Credit Information Systems Corporation (CISC) immediately. Studies worldwide have shown that a comprehensive credit information system enhances financial discipline, lowers lending costs, mitigates credit risks, and promotes financial inclusion. In November 2008, the Government passed the Credit Information Systems Act. The Implementing Rules and Regulations (IRR) as required under the law were finalized by the Securities Exchange Commission in the first half of 2009. However, the CISC has not yet been established. The next government should immediately exert efforts to provide the necessary financial and human resources, and encourage potential investors to put up the Corporation immediately.

This paper is a product of the collaborative effort of several individuals and institutions convened by PinoyME through its strategic research initiative. The following participated in the preparation of this paper: Dr. Cayetano Paderanga, Dr. Gilbert Llanto, Prof. Ronald Chua, Dr. Ma. Piedad Geron, Dr. Erwin Tiongson, Dr. Fernando Aldaba, Prof. Salvador Sibayan (UP Institute of Small Scale Industries), Ms. Pinky Abellada (Pulse Asia), Dir. Joselito Almario,(National Credit Council), Danilo Songco and Angelica Espinosa (PinoyME), Ms. Jocelyn Badiola (Agricultural Credit and Policy Council), Mr. Jerry Pacturan (Philippine Development Assistance Program), Ms. Gemma Marin (John J. Carol Institute of Church and Social Issues),Ms. Lalaine Joyas (Microfinance Council of the Phils)., and Mr. Reuel Virtucio (PUNLA Foundation).

CONFERENCE HIGHLIGHTS

INTRODUCTION

PinoyME and its partner organizations convened Mainstreaming Micro: The Philippine Microenterprise Stakeholders Conference wherein Mainstreaming Micro, a policy issues paper on microfinance and microenterprise development, was presented to create a common knowledge in the sector and build consensus among the different stakeholders. (See Mainstreaming Micro: A policy issues paper on microfinance and microenterprise development for details.) Close to 120 individuals attended the conference representing microfinance institutions (MFIs), commercial and rural banks, business organizations, entrepreneurs, academics, government agencies, service providers and donor agencies.

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IDEA

Based on the paper, discussion groups with representatives from MFIs converged to confer about key policy challenges in microfinance which are:

1} Increasing the outreach of microfinance institutions
2} Widening the poor's access to formal financial services
3} Promoting the progress of microenterprises
4} Strengthening the impact of microfinance

The following is a summary of the discussions in the conference workshops and plenary:

EXECUTIVE SUMMARY

Increasing the outreach of microfinance institutions

For the cooperative sector, the test is to reach out to poorer segments of the society. As the sector realize the need to provide services to unserved and underserved areas, they also recognize the need for capacity building programs for them to understand new markets, learn the intricacies of microfinance, and put in place appropriate information technology.

For the banking sector, the limitations in regulations hinder services to microfinance clients. Given the marginalized segment that rural banks are mandated to serve, it can be readily discerned that the client-borrowers of rural banks, who are the Agri-Agra beneficiaries, small farmers, fisher folk, and micro and small entrepreneurs, are by nature perceived as higher-risk than the typical borrowers who go to the larger commercial banks.

Credit pollution is also a problem and can be a limiting factor in increasing outreach. Over-indebtedness is becoming an issue in many areas in the country. However, with a fully functioning credit bureau, expanding outreach can be better regulated. In relation, transparency and consumer protection need to be included in the government's microfinance policies.

Moreover, financial literacy is an important tool in increasing outreach. The local government units (LGUs) can be the ideal partners in financial literacy and capacity building. However, most frontier areas do not have the necessary infrastructure to spur economic activity. Thus, there is also a need to identify alternative forms of support where private sector can provide financing.

As such, it is crucially important for the providers to identify who their clients are. The poorest of the poor may not need microfinance. Welfare is different from credit; credit is not a social safety net.

Increasing the poor's access to formal financial services

The major recommendations to improve access to financial services are to: capitalize mobile technology platforms in increasing access to credit, fully implement the Credit Information Systems Act; review and amend the Anti Money-Laundering Act (AMLA); provide capability building activities for financial institutions manpower, amend and strengthen the charter of the Cooperative Development Authority (CDA); enjoin the government to actively participate in the provision of microinsurance; and promote linkage between banks and MFIs to improve channel of funds for lending.

One of the controversial recommendations floated which divided the subgroup access but nonetheless pushed vigorously by the members from the banking sector was the repeal of all mandatory laws on banking compliance.

Promoting the progress of microenterprises

To promote the progress of microentrepreneurs, the following are recommended: identification of business development services (BDS) providers in collaboration with MFIs; review of the devolution of the Department of Agriculture in relation to the Local Government Code; conduct of a forum specific to microfinance and the agriculture sector; study on the possibility of ID system for microfinance clients; analysis on the segmentation of microfinance clients, and cooperation with state colleges and universities (SCUs) for BDS training.

Increasing the impact of MFIs on poverty alleviation

MFIs, as agents of social change, have a dual nature of applying commercial principles to achieve social ends. Social Performance Management (SPM) is important. To measure impact, fundamental questions on who the clients are; what the changes in the lives of the clients need to happen; what changes are already happening; and what can be attributed to access to financial services, have to be answered. There is also a need for the development of industry and MFI-level process and results indicators.

Specifically, the government can provide resources for industry-level program evaluation and capacity building to support MFI's integration of SPM. To increase impact, funders, donors, and support institutions need to appreciate the importance for MFIs to manage SP. They can also provide project management grants for SPM Integration and development of day-to-day SP Management tools. The academe can assist in doing industry-wide program evaluation and develop key performance ratios using SP data.

In summary, for microfinance and microenterprise development to have stronger impact on the poor, financial literacy, broad range of financial products for different segments of the poor, and BDS should be promoted. It is imperative to continue building the capacities of MFIs and BDS providers; use technology in designing new product and improving outreach of current products; improve impact, access, progress and outreach through a responsive information system; improve the institutional capacity of MFIs; and promote a balance between profitability and social mission among MFIs through SPM practices. Amendments to selected national financial policies and strengthening the regulatory framework will be required to facilitate the provision of financial services needed by the poor and promote their access to capital.

Key principles for policy recommendation.

Two key principles serve as the basis for the policy recommendations summarized below:

First, the government must play a diminishing role in direct lending to the poor, prevent the distortion of prices, and allow more private sector-led initiatives to further promote a market-driven environment.

Second, the government must create an environment conducive to microfinance and microenterprise development by creating a level playing field and promoting fair competition among financial institutions, by providing timely and relevant information to the market, by delivering welfare and non-direct lending services to poor households that will not be served by the market, and by enforcing client protection, among other measures. These policy recommendations require coordinated and complimentary efforts from the government, the business sector, the academe, and MFIs themselves.

CONFERENCE RECOMMENDATIONS

IMPERATIVES

For microfinance and microenterprise development to have stronger impact on the poor, the following should be promoted:

Financial literacy.

Provide financial literacy training and promote awareness among the poor of the financial services available to them.

- Facilitate the poor's access to information regarding financial services available to them. This will enable them to choose the appropriate financial product suitable to their needs and budget. It will enable microentrepreneurs to reduce their business cost and allow them to participate in the market more effectively.
- Recognize other non-traditional providers of financial services such as NGOs and cooperatives.
- Tap on the pool of trainers and financial literacy centers, which the National Anti-Poverty Commission has established in partnership with the National Credit Council and in compliance with ADB-funded Microfinance Development Program, In November 2007, NAPC launched its regional trainers training as a part of its National Financial Literacy Program (FLP). The TOT aims to equip a pool of trainers from academic institutions, MFIs, and NGOs, which will help stakeholders in executing financial literacy training to the poor. The last phase of the FLP implementation also includes creation of financial literacy networks in different parts of the country.

Broad range of financial products for different segments of the poor.

The market should cater to the broad range of needs of the poor.

- Segment the market for financial services for the poor and design financial products suitable for each segment. For this purpose, it is important for financial services providers to determine which are the segments of the market that are still unserved (where there is no presence at all) and those that are underserved (already being served but services are inadequate, e.g. rural/agricultural communities). Financial products should be designed based on the needs of these segments.
- The menu of financial products should go beyond microcredit and include savings, insurance and remittance.
- Provide microinsurance and its support products. Microinsurance will enable microentrepreneurs to mitigate risks from external shocks such as natural calamities and economic crises. Such products should extend to the following: non-life insurance, credit insurance, life insurance, and even education and health insurance.
- The poorest of the poor (chronic poor) in unserved areas may need other types of intervention other than microfinance, such as pure subsidy. In this case, other institutions, not MFIs, may be in a better position to provide assistance. However, MFIs should be ready to provide financial services in areas where there are major subsidy programs such as conditional cash transfer and KALAHI-CIDSS when the poor are ready for such services.

> Make the poor more bankable to encourage more financial institutions to serve them. This can be achieved through capacity building, values formation, welfare services, and provision of other non-financial services in partnership with other institutions.

> Study models of MFIs that are trying to reach out to underserved and unserved areas and build on these success models.

Business development services.

Increase efforts to enable microentrepreneurs to access the market.

> Value Chain development. BDS providers should understand the value chain of the products being produced by their clients. They should link microentrepreneurs to the value chain, identify needs along the chain and respond to such needs through collaboration with different organizations. MEs should be provided a complete package of services (i.e. finance, marketing, production, human resource development) that will enable them to engage effectively in these value chains. The Department of Agriculture as well as other government agencies should make their extensions workers assist in providing BDS to microentrepreneurs.

> Disseminate information on recent trends and research. Undertake purposive research on characteristics and behavior of growth-oriented MF clients with growth potential, impact of MF interventions as a tool for poverty alleviation, among others. Popularize knowledge products on technology application, market trends and business opportunities. Provide MEs with tools to help them grow their business (e.g. business models, templates, checklist, mini business plan on certain types of livelihood).

> Business sector should continue to explore business partnerships with microentrepreneurs. Companies should replicate the experience of Jollibee Foods Corp. and San Miguel Corp. in procuring their raw materials directly from farmers. Cutting the middlemen increases the income of producers. The constant demand from the corporate sector establishes a constant market for microentrepreneurs that will enable them to plan for business growth. On the other hand, the investment of companies in building the capacity of its direct suppliers will pay off later in terms of lower cost of raw materials even as such initiatives creates impact on reducing poverty.

> Facilitate more efficient and less costly registration of MSMEs. Being part of the formal economy widens market opportunities for microenterprises. However, the current registration process and the amount of business fees become a disincentive for microentrepreneurs to register their enterprises. The executive department must enact measures to encourage LGUs to facilitate the registration of MSMEs. One source of incentive to make this happen is the use of Municipal Development Fund. LGUs can avail the MDF subsidy to make its registration system more efficient and reduce the business fees. The registration fee can be socialized in such a way that the amount depends on the scale of the enterprise. Having more enterprises integrated into the economy can spur economic activity which ideally lead to more tax revenues for the government.

SUPPORT SYSTEMS

In support of the goals described above, the microenterprise development sector should do the following:

Continue building the capacities of MFIs and business development services (BDS) providers

> Government and donors should continue to offer technical assistance to MFIs and microenterprises. This can include, among others, assisting MEs in meeting required documentation to access formal financial institutions as a means of graduating them from being clients of MFIs to becoming clients of formal financial institutions.

Use technology in designing new product and in improving outreach of current products.

> Capitalize on the popularity of mobile phones among the poor as a platform for rolling out these products.

Improve impact, access, progress and outreach through a responsive information system

> Promote transparency on client records following BSP's general consumer protection framework

> Establish a credit information bureau for microfinance in order to avoid credit pollution and over-borrowing among the poor.

Improve the institutional capacity of MFIs

> Instill risk management practices, especially for microfinance institutions venturing into riskier microenterprises.

> Inculcate proper financial management in MFIs to sustain, if not expand operations.

Promote a balance between profitability and social mission among MFIs through social performance management (SPM) practices.

> Promote greater awareness about the value of SPM among MFIs and fund providers. Funders should realize that emphasis on profitability as criteria for lending without the corresponding safeguards for social responsibility could lead to exploitation of the poor.

> Government and donors should provide incentives for MFIs to manage their social performance. Without such incentives, MFIs will have no interest in undertaking the costs of SPM.

> Provide technical assistance to encourage MFIs to integrate SPM in their organizational management and operations. Develop key performance ratios and tools to make it easier for them to practice SPM. Build and study models for social enterprises which other MFIs can emulate.

POLICY ENVIRONMENT

A number of policy measures will be required to facilitate the provision of financial services needed by the poor and promote their access to capital and to markets. These policy actions include:

Amendments to selected national financial policies

Amend or repeal existing policies that hamper the poor's access to financial service.awareness among the poor of the financial services available to them.

> Institutionalize the National Strategy for Microfinance 1997 (Executive Order 138) through legislation. There is a need to pass a law that institutionalizes this policy which, among others, relegates microlending to the private sector and instructs all government agencies from engaging in such programs. This will address any tendency for government to reverse this policy and use microlending for political purposes. It should also distinguish between government social safety nets (e.g. SEA-K) and loans. The role of local governments in microlending should also be clearly defined in light of this policy. LGUs should veer away from direct lending. Instead, the government should focus on capacity building, financial literacy, and business development services. Nonetheless, the law should also give leeway for LGUs to delineate their role. LGUs can also provide wholesale lending services wherein the source of funds can come from successful LGU bonds. In fact, there are LGUs which are able to raise funds to funds. This suggests that a similar strategy can be implemented for microcredit and other financial products and services.

> Amend the Anti-Money Laundering Act to ensure client protection and include monitoring of non-bank financial institutions. At the same time, remove provisions that impinge on the ability of the poor to access financial services such as the requirement of valid identification for all bank clients which discriminates against those who cannot read and write and those who do not have such identification cards.

> Implement fully the Agri-Agra Reform Credit Act of 2009 (RA 10000) which ensures that the mandated 25% of the total loanable funds of all banking institutions will directly benefit the agriculture and agrarian reform sectors. Allow lending for construction and upgrading of rural infrastructure and equity investment in rural banks as compliance with Agri-Agra Law. This will attract more private sector investments in rural development. It will thus enable government to redirect its resources normally devoted to this expenditure. Aside from this, RA 10000 institutionalizes the Agricultural Guarantee Fund Pool which is intended to guarantee unsecured loans of farmers from rural banks, credit cooperatives, NGOs, and other financial conduits. AGFP can also serve as a guarantee for micro-agri borrowers in order to mitigate the risks involved in production.

> Review the Agro-Industry Modernization Credit and Financing Program (AMCFP). Currently the Agri-Agra Law provides that charges for under compliance with will go to AMCFP. The Agriculture Credit Policy Council (ACPC) should study how the mandate of this fund can be preserved such that it will be used mainly for agricultural credit, government will not be able to use this fund for directed credit programs, and the private sector can be encouraged to access this fund.

Strengthening the regulatory framework.

This will protect the interest of the poor customers while leveling the playing field among funds and service providers.

> Establish a credit bureau. At the individual borrower level, it will help monitor and curb the risks of over-borrowing. At the MFI level, it can provide information that will assist wholesale lenders in allocating resources. At the macroeconomic level, this can help segment the microfinance market, improve targeting efficiency, and promote product development.

- > NGOs with microfinance operations should be recognized as a "submitting entity" as defined by Credit Information System Act (RA 95101). Otherwise, a separate credit bureau may be required, as MFI NGOs are not regulated well by the Securities and Exchange Commission (SEC).

- > Introduce a standardized ID system for clients. This facilitates the monitoring of credit information.

> Strengthen coordination among regulatory institutions BSP, SEC, and CDA. As MFIs evolve and transform from one legal entity to another, some are not able to meet the requirements of the other regulatory bodies. Better coordination can help ensure the consistency of treatment of MFIs.

> Organize a self-regulatory body for NGO MFIs. Because the SEC seems unable to monitor the microfinance operations of these types of NGOs, they will need to organize their own self-regulatory body. Toward this end, the microfinance sector has an existing regulatory framework that is underpinned by the consumer protection principle. Alternatively, the sector can use, and modify as needed, the regulatory framework of the Philippine Council for NGOs. Building on this framework, the sector can organize a certification and ratings system to monitor the performance of MFIs. Such certification can be used, for example, as a prerequisite for tax exemption.

> Strengthen the regulatory capacity of the Cooperative Development Authority (CDA) in order to maximize the potential of the cooperative sector as microfinance providers. Coops can be important providers of microfinance given their history and mandate. However, only 20,000 out of 70,000 CDA registered coops remain operational. If the CDA can exercise its regulatory function effectively, they can help strengthen the coop sector the way BPS has strengthened rural banks as MF providers. DOF, through the assistance of ADB's Microfinance Development Program, organized strategic planning workshops in 2007 for CDA management to facilitate the latter's transformation from a cooperative promoter to a cooperative regulator. In addition, ADB provided a grant assistance of $40,000 to help build CDA's MIS infrastructure. Despite these initial investments, CDA-sponsored regulatory policies, which enhance financial performance of cooperatives, are yet to be seen.

CONSORTIUM CONSULTATION

To further refine the preliminary conference results, PinoyME underwent a series of consultations with its consortium of development practitioners and members of the academe. After deliberating each policy issue and recommendation the consortium agreed to address the pressing concerns of microentrepreneurship. The consortium has collectively identified five priority areas for strategic policy agenda and advocacy.

Financing framework for economic investments for the poor.

> The framework can serve as a census of all economic investments for the poor. It can serve as a consolidation of financing programs and as a channel to gain macro-level strategies coupled with micro-level understandings of each program. The aspired output of this initiative will in turn be guide for resource mobilization of donor agencies, the government, and NGOs. A financing framework can also instill proper coordination among different stakeholders thereby maximizing the resources allocated for poverty reduction. The proposed framework will provided crucial foundation in determining the investment gaps which microfinance can address. This initiative can be lead by the National Credit Council (NCC) of the Department of Finance. The World Bank can provide technical assistance to NCC in pursuing this project as economic investments for the poor has also been one of its main thrusts.

Advocacy for legislating National Strategy for Microfinance

> The issuance of EO 138, which embodies National Strategy for Microfinance, follows the market-based principle in direct lending, which limits the role of government financial institutions (GFIs) in wholesale lending and technical assistance. This, in turn, leveled the playing field between private lending conduits and the government which resulted to a dynamic private sector participation in the microfinance market and contributed to the development of the country's financial sector. However, on August 2006, EO 138 was repealed and replaced by EO 558. EO 558 allows all government institutions to lend money whether or not such function is provided in their mandate. It endangers the financial sector's stability because the government may provide subsidized credit, which poses as a cut-throat competition against private lenders. The repeal of EO 138 can also compromise financial viability of borrowers in its lending operations thereby worsening the public's non-performing loans and widening the country's fiscal deficit. Therefore, it is critical to enact NSM into a law to prevent consequences of this policy reversal and protect the country's flourishing financial sector.

Market segmentation for microfinance clients

> Identifying the different profiles of the microfinance market can enable MFIs to design a broad range of products that cater to the needs of each segment. Moreover, identifying its current market allows the microfinance sector to target the unserved and underserved segments and formulate viable strategies to reach out to them. Market segmentation places a large influence in determining the direction of microfinance institutions for expansion and development.

Social performance management of MFIs

> Advocating SPM among MFIs is imperative in order to achieve microfinance's double-bottom line_financial stability and social impact. SPM must be institutionalized to prevent counterproductive effect of over-commercialization of microfinance, which can be observed in multiple borrowing and over-indebtedness of a number of end-borrowers.

Agricultural microfinance

> 70% of the poor come from the rural sector which microfinance has not yet reached. MFIs fail to expand to frontier areas in the rural sector because the present cash-flow design of microfinance does not match the financing needs of the rural poor due to many constraints. While there are a handful of MFIs that are already venturing into micro agri, there has yet been a comprehensive, macro-level approach in addressing the gaps and seizing opportunities in micro-agri. The sector needs to gain a common and comprehensive understanding about the current landscape of the country's agricultural microfinance. In this way, MFIs and government institutions can formulate strategies that would address the financing needs of the rural poor.

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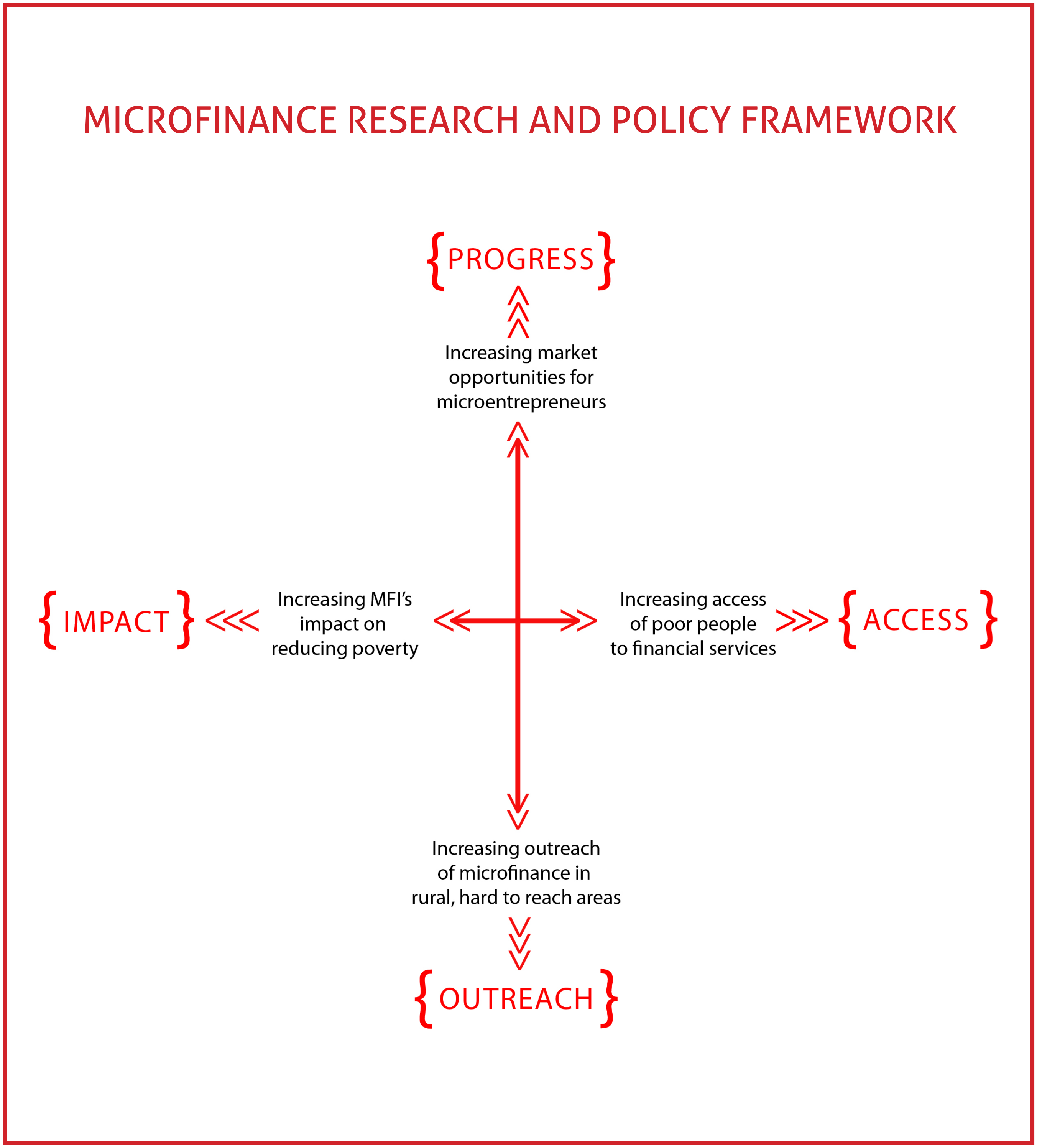
Policy Framework for Scaling Up Microfinance and Microenterprise Development



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