State of the Art of Microfinance: A Narrative

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NAPOLEON P. MICU

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Abstract

This paper provides a comprehensive review of the state of microfinance in the Philippines and in other countries based on existing literature, focusing on "four corners" of microfinance: outreach, progress, impact and access. It captures the different perspectives on developments, challenges and future directions of microfinance-- some specific to a certain country or region and others across jurisdictions. In essence, this paper provides policymakers, regulators, microfinance institutions, donor community, academe, microfinance researchers, analysts and other stakeholders with the necessary information on available best microfinance policies and practices and thus should assist them identify potential gaps in microfinance literature, which can be the subject of future research agenda and policy advocacy.

The paper has three major parts: (1) the narrative of the State of Microfinance in the Philippines and in other countries in terms of practices, as well as policies and regulations, (2) the discussion of the "four corners" of Microfinance, namely, outreach, progress, impact and access and (3) the discussion of the evolution (i.e., directed credit programs to market-oriented regime) of microfinance policies in the Philippines.

The State of Microfinance in the Philippines

This section focuses on how far has microfinance contributed to poverty reduction in the Philippines, discussing lessons learned thus far, as well as practices and policies that have worked and failed.

Microfinance helps alleviate poverty but only with appropriate policy environment

Microfinance[1] has proven to be a potent tool for poverty reduction by helping the poor increase their income, smooth consumption, build assets, and reduce their vulnerabilities in times of contingencies and economic shocks. It now reaches more than 100 million poor people all over the world through a combined portfolio of US$15 billion. The experience of Bangladesh (where Grameen banking originated), Indonesia, Sri Lanka and many Latin American countries has been a testament to the critical role of microfinance in improving overall welfare of poor individuals. In the Philippines, microfinance has reached 5.7 million individuals as of end-December 2009 through the services of over 500 microfinance institutions, while jobs generated by microfinance activities since 2004 have reached 2.8 million.[2] Total loan portfolio released (July 2004 to end 2009) has reached P160.5 billion.

Studies show that a supportive policy and regulatory environment is necessary to a sustainable delivery of microfinance services that expands outreach and at the same time improve access by the poor to financial services.[3] Market-based approaches, for instance, have enabled private financial institutions to enter the market and grow fast.

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. However, new lending products that are tailored to the

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[1] Under Republic Act 8425 (Social Reform and Poverty Alleviation Act), "microfinance" is defined as a credit and savings mobilization program exclusively for the poor to improve the asset base of households and expand the access to savings of the poor. It involves the use of viable alternative credit schemes and savings programs including the extension of small loans, simplified loan application procedures, group character loans, collateral-free arrangements, alternative loan repayments, minimum requirements for savings, and small denominated savers' instruments.

[2] Microfinance Program Committee (composed of PCFC,LBP,DBP,NLDC, SB Corp and QUEDANCOR)

[3] See Fukui and Llanto (2003) and Llanto (2003)

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.

Commercialization has increased outreach and expanded services dramatically, but challenges to promote it further remain

The microfinance institutions (MFIs) that have achieved the largest outreach to date have increasingly applied commercialization principles in their operations and are generally self-sufficient (Charitonenko, Campion and Fernando, 2004, p.1). The Rural Asia Study by the Asian Development Bank (ADB) (ADB 2001) cited that commercialization is essential for microfinance development and for outreach to be expanded and microfinance services to be sustainable. In the Philippines, there is yet a need to explore existing or remaining challenges (such as threat of policy reversal or potential for backsliding) and implications for various types of stakeholders, including government, MFIs and clients, while preserving the traditional social objective of microfinance institutions of expanding access by the poor to financial services.

Appropriate government intervention as well as donor support is necessary to mainstream microfinance into the financial sector

Empirical evidence indicates that microfinance services thrive in areas with relatively better infrastructure[4]. Conversely, there is a severe lack of microfinance services in areas with poor physical infrastructure since this means unacceptably high risks and transaction costs (Charitonenko, 2003). Aside from infrastructure, governments need to strengthen the capacities of concerned public institutions to regulate and supervise, including equipping them with the necessary information infrastructure to carry out their mandate more effectively. In the Philippines, the Regulatory Framework for Microfinance clearly defined the respective roles of government entities involved in microfinance with the end in view of fostering more efficient and effective microfinance market.

At the macro level, donor support is critical in providing assistance to ensuring government's adhere to policy and regulatory environment conducive to the growth of microfinance. At the micro level, donor assistance should consider capacity-building for MFIs to promote their viability and sustainability. These should include improving financial and administrative governance as well as development of innovative and appropriate products and services. It is worth noting that the Microfinance Development Program[5] (MDP) (2007-2008) for the Philippines which was funded by the ADB addressed these macro and micro concerns. Less direct government intervention in credit delivery enhances competition, lowers interest rates and promotes greater access of the poor to microfinance services. Government's business in the microfinance industry should be to provide policy directions so that it will attract more private sector participation in microfinance. More entry means greater competition and greater access by the poor to not only credit but other financial services.

[4] Charitonenko, Campion and Fernando (2004)
[5] MDP was a program loan to improve microfinance policy and regulatory environment in the Philippines

Capacity building, setting standards builds and develops strong, viable and sustainable MFIs

Training of MFIs' human resources and setting standards builds and develops strong, viable and sustainable MFIs. A number of standards and capacity building schemes have been developed for the Philippine microfinance industry in recent years.[6] These were designed to address potential problems that may arise from the ever growing microfinance industry. For instance, problems of sustainability and outreach will always arise. The industry will always be confronted with problems like inefficient MFIs, delinquency, loan defaults, etc. There is no better way of confronting these challenges than providing appropriate performance standards and benchmarks. These will challenge MFIs to re-assess, rethink, and restructure their operations towards better systems, processes and practices if only to become more viable and sustainable.

Greater access to market promote progress of growth-oriented microenterprises

The great majority of microenterprises are into retail/trading that have low value-added and are vulnerable to shocks. They lack the skills and capacity to enhance their entrepreneurial abilities. Hence, the provision of business development services (BDS) -- especially in the area of providing business information and market development and access -- as well as non-financial services. are crucial to improving market opportunities for these entrepreneurs. Government should take the lead and strengthen its resolve to supply BDS to microenterprises. BDS improves microentrepreneurs, generate additional employment, promotes economic growth and contribute to poverty reduction.

A supportive policy environment has enabled microfinance to flourish in the country.

Microfinance is the central strategy for poverty reduction in the Philippines under Republic Act 8425 (Social Reform and Poverty Alleviation Act) and is an important part of the Medium-Term Philippine Development Plan (MTDP) 2004-2010.

The Philippine microfinance industry has been one of the more advance vis-à-vis other developing economies in Asia and Latin America in terms of policy and regulatory environment. Reforms that were pursued in the last 12 years have provided the backbone for its growth.

Foremost is the National Strategy for Microfinance (NSM) (1997) which fueled the rapid growth of the industry. The shift to market-based principles as espoused by the NSM attracted greater participation of the private sector in the provision of microfinance services. Likewise, the mainstreaming of microfinance in the banking sector through amendments of the General Banking Law to consider the peculiar characteristics of microfinance facilitated the significant entry of rural banks as retailers and lately of universal and commercial banks as wholesalers of loan funds to retailer MFIs.

[6] Performance standards like COOP-PESOS for the credit cooperatives and Business Development services (BDS) for Microenterprises: A Guide for MFIs developed by NCC in collaboration with NAPC

It is no wonder that the Philippines is recognized worldwide as one of the leaders in the development of the microfinance industry. It is the first in Asia-Pacific to adopt microfinance in its central banking system. The industry was declared by the Consultative Group to Assist the Poor (CGAP) as the best in implementing microfinance programs to reduce poverty during the International Year of Microcredit 2005 held in New York City.

Latest figures show that after ten (10) years, the number of MFIs has reached over 1400. Including branches, this has swelled to over 2,000. From a few hundreds of thousands in 1997, outreach has reached 5.7 million as of end December 2009

Latest figures on the mainstream banking sector also showed the growing microfinance exposure of microfinance-oriented banks. As of end September 2009, there were 214 banks serving almost 900,000 borrowers with a total loan portfolio of P6.4 billion

Table 1
Microfinance in the Banking Sector
As of 30 September 2009 (preliminary)
(in millions)

	No. of Banks	**Amount (in millions)**	**No. of borrowers**
Microfinance-oriented rural banks	5	958.12	174,874
Microfinance-oriented thrift banks	3	218.36	55,580
Sub-total	8	1176.48	230,454
Microfinance engaged rural banks	162	3,957.97	567,099
Banks	25	769.38	79,750
Microfinance engaged thrift banks	19	516.88	17,552
Sub-total	206	5,244.24	664,401
Grand total	**214**	**6420.71**	**894,855**

Source: BSP

More reforms were seen recently with passage of the Credit Information and Systems Act (CISA Law) which has provided the industry players with the necessary and critical information to identify creditworthy borrowers which should lead to lower lending rates and reduction of credit pollution. On the other hand, the enactment into law of the Amendment to the New Cooperative Code of the Philippines is designed to strengthen the regulatory capacity of the Cooperative Development Authority to govern cooperatives, especially credit and financial cooperatives which accept deposits from and mobilize funds of their members. Cooperatives are critical because of their large number especially in rural areas where they can function as intermediary between savers and borrowers. With stronger cooperatives, untapped savings can be pooled for mobilization to those who need them for productive purposes.

As more individuals have been reached by microcredit and evidence of increased income of borrowers noted[7], increased demand for other financial services such as housing and consumption loans, payment transfers and insurance have emerged. This has fostered greater competition among players. The Philippine setting saw the offering of microinsurance products as a large potential for more fierce competition among players within the next few years, given the fact that only around 3.0 million of the adult population are insured. This means there is a large room for growth for this kind of financial service for the poor.

[7] Microfinance Program Committee

The Four Corners of Microfinance

This section highlights several literatures that discuss the various parameters in measuring the success of microfinance.

It is acknowledged that poverty is multi-faceted and that any poverty reduction agenda must take into account the broader poverty framework. One realizes that participation in the economy through microenterprise development, with microfinance as an important element, although already proven to be effective in alleviating poverty, is not the panacea to eliminating poverty. The government needs to provide basic needs and social protection of citizens, particularly the poor and the marginalized which are dependent on public resources for their subsistence. Government also has the responsibility to put in place the public policies and infrastructure that ensure that no one is excluded from economic and political processes. Finally, the poor need to have a voice in governance so that they are not just beneficiaries of public policy but also participants in crafting it.

At the same time, the United Nations Development Programme, through its Human Development Reports of 1992 has determined that lack of access to markets has been one of the major causes of poverty in the world. The report also shows the tight link between credit and access to capital to market penetration. The Department for International Development of the United Kingdom has also established that financial capital is the most flexible type of capital but it also the least available to the poor. The combination of these two obstacles –the lack of access to market and lack of access to capital- constitutes the biggest root causes of poverty.

Thus, the key challenges for microfinance to achieving a sustainable path to poverty reduction in the Philippines are in its ability to: (a) increase its outreach to more poor people, particularly those in rural, agricultural communities; (b) promote the integration of microentrepreneurs to the mainstream market; (c) ensure that MFIs are profitable and at the same time create impact in reducing poverty among their clients; and (d) increase access of the poor to the formal financial system.

OUTREACH: Going to unserved and underserved areas

In the Philippines, poverty remains a rural phenomenon. Even the reach of microfinance remains limited, but a number of factors explain this phenomenon. The country’s archipelagic character, poor infrastructure and transportation system make microfinance a high risk , not to mention the transactions costs involved. There are also cultural and social barriers that prevent microfinance institutions from entering the microfinance market. Rural folks lack education. They do not practice bookkeeping as basis of cashflow and credit evaluation by formal institutions like bank. In many developing countries, social, cultural, and language barriers do not allow for an easy relationship with a modern banking institution (Charitonenko, Campion and Fernando, p. 74), although this belief has been debunked by recent developments that more banks, even commercial banks through acquisition of rural banks, have entered the microfinance market, believing that the poor is bankable after all[8].

The People's Credit and Finance Corporation identified 42 areas[9] spread across the three major islands as being unserved by any microfinance institution. These are :

Luzon

1. Abra (Lacub, Lagayan,Licuan-baay,Malibcong, San Isidro, Tineg)
2. Ilocos Sur (Suyo)
3. Camarines Sur (Siruma)
4. Palawan (Kalayaan)

Visayas

1. Easter Samar (Maslog)
2. Western Samar (Mataguinao)

Mindanao

1. Lanao del Norte (Matungao, Munai, Pantao Ragat, Poona Piagapo, Tangcal)
2. Sultan Kudarat (Palimbang, Sen. Aquino)
3. Maguindanao (Datu Unsay, Pagalat)
4. Sulu (Old Panamao)
5. Tawi-Tawi (Turtle Island)
6. Lanao del Sur (Bacolod-Kawali, Binidayan,Bumbaran, Butig, Lumbatan,Lumbayangue, Madalum, Masiu, Mulondo, Pagayawan,Piagopo, Poona Bayabao, Pualas, Sultan Dumalondo, Sultan Gumander, Tagaloan, Tamparan, Taraka, Tubaran, Tugaya)

The Philippine Deposit Insurance Corporation's (PDIC) regional profile of deposits revealed that the Autonomous Region in Muslim Mindanao (ARMM) and Region 8 (Eastern Visayas) have bank to depositor ratio of 1:199,759 and 1:31,419, respectively, indicating that the areas are likely underserved by banking institutions. This is in contrast to Metro Manila with 1:4,000 ratio.

Global experience in expanding outreach

It is estimated that 60% of Asian households do not have access yet to microfinance[10]

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[8] This is true in the case of the Philippines where a greater number of MFIs have entered the microfinance market for the last ten years
[9] Based on 2008 data of PCFC.
[10] Summary of Proceedings on the ADBI-sponsored forum on Promoting Financial Inclusion through Innovative Policies

Mc Guire and Conroy (2001) noted that about 90 percent of the 180 million poor households in the Asia-Pacific region still have little access to institutional financial services. There is also a large number of low income households in the region that may be above the poverty line, but which nevertheless have an effective demand for financial services which is substantially unmet. Of the countries which they studied, only in Bangladesh and, to a lesser extent, Indonesia has microfinance reached a significant proportion of poor households.

Across Asia, microfinance outreach is significant in Bangladesh and Indonesia, with about 12 million outstanding loans in each country at the end of 2001. Indonesia is the world's leader in terms of the microcredit supplied on a commercial basis, estimated to be more than 80% of the industry total. Savings mobilization there by predominantly formal MFIs has fueled broad microcredit outreach. Most remarkable about the Indonesian experience, especially that of Bank Rakyat Indonesia, is that commercialization has allowed the sustainable expansion of microsavings on an unprecedented scale in addition to expanding access to microcredit. For example, at the end of 2001, savings mobilized by the BRI Units in *Simpedes* savings product alone (Rp 15.9 trillion, or US $1.5 billion) equaled 1.61 times the amount of their total outstanding loan portfolio. (Charitonenko, Campion and Fernando, p. 37-39, 2007).

Table 2. Commercial Microfinance –Outreach Nexus

Commercial Attribute	Results	Impact on Outreach
Commitment to financial self-sufficiency and profitability	Charge at least cost- recovery lending interest rate	More sustainable outreach (improved continuity of services)
Improved efficiency	Continually reduce operating and other costs; lower prices for clients	Increase depth of outreach
Focus on client needs and preferences	Design of more demand-driven, flexible financial products	Improved scope, breadth, and depth of outreach
More formal institution with transparent operations	Access to a wider menu of commercial sources of funds	Increased breadth of outreach
Commercialization breeds increasing competition	MFIs vie to retain and continue to attract new clients by going up-market, down-market, or tapping into new geographical locations or client types (sectors)	Increased breadth and/or depth of outreach

Source: Charitonenko, Campion and Fernando (2007)

Charitonenko, Campion and Fernando (2007) define outreach as the provision of services to a target market. Broadly, they view outreach as having four common attributes: (1) breadth or the number of clients served, (2) depth or the extent to which the poor are served, (3) scope or the range of products offered, and (4) sustainability of services or permanence of service provision.

The breadth of outreach, which is the most common understanding of outreach, has always been measured by the number of clients served with microfinance products and services. The experience of many countries show that expanding outreach is determined by the existence of appropriate policy and regulatory environment that supports expansion of outreach on a sustainable basis. Directed and subsidized programs, which were used as strategies in the early days of microfinance, proved to be a disaster.

In the case of MFIs, there is a need to have an appropriate regulatory and supervisory framework. Llanto (2000) prescribed risk-based supervision of banks engaged in microfinance. [11]

Corpuz and Paguia (2008) documented how the country's regional peers reformed their policy environment towards expanding outreach and making this sustainable:

- *In June 1983, the Indonesian government announced a major restructuring of its financial sector. Interest rates on loan and deposits were deregulated as a preparatory move to the transformation of Bank Rakyat Indonesia's (BRI) local banking system Following the reforms, the government decided that the subsidized unit banks would be transformed into a sustainable system of commercial banking at the local level, and that a program of general rural credit at commercial interest rates would be implemented through the unit banking system.*
- *Thailand started to deregulate its financial sector in 1992. The Bank of Thailand allowed financial institutions to charge interest rates based on market conditions. However, the government continued to regulate its interest rates on loans to the poor including small farmers and fishermen. The primary reason for such a policy is to give the poor more opportunities to engage in income-generating activities through cheaper credit. There is a general ceiling of 15 percent on interest rates on loans. This ceiling is spelled out in the Civil and Commercial Code, and applies to all bodies and transactions unless they are specifically excluded. Non-bank microfinance institutions like credit cooperatives are also allowed an interest rate ceiling of 19%.*
- *In Vietnam, about 75 percent of the population and 90 percent of the poor reside in the rural areas. Hence, in spite of the country's vigorous industrial growth and economic structural transformation throughout the 1990s, the rural economy is still dominant in Vietnam. Since its establishment in 1988, the Vietnam Bank for Agriculture and Rural Development (VBARD) has been the major source of credit and savings in rural Vietnam. Now the biggest commercial bank, it has a very extensive network (nearly 2,000 branches) and serves more than 5 million households. The Vietnamese government also established the Vietnam Bank for the Poor (VBP) in 1995 to serve poor households that could not be reached by VBARD.*

- *In India, financial sector reforms were put into place in the early nineties to improve the soundness, efficiency and productivity of all credit institutions, including 'ailing' rural credit institutions. The reforms sought to enhance the areas of commercial freedom, increase their outreach to the poor and stimulate additional flows to the sector. The*

[11] See also Corpuz and Maldia (2007)

reform program also included liberalizing interest rates for cooperatives and regional rural banks (RRBs). The deregulation of interest rates in India is a result of their past experience that limiting interest rates did not allow banks, particularly cooperative banks to recover their costs and gain sufficient margins in their lending operations. However, the government has sought exemption from this policy particularly for its poverty alleviation programs where loans for the poor are still given at subsidized interest rates.

The authors further noted that despite differences in the extent of and liberalization and the policy environment in which financial institutions are operating, the Philippines, Thailand, Indonesia, Vietnam and India were able to develop successful lending programs for the poor and marginalized farmers. This success can be explained by (1) linkage between government banks and grassroots through the development of an effective delivery mechanism; (2) wide network/extensive[12] outreach of credit retailers which provides more opportunity for supervised lending (close, frequent monitoring and supervision) and lessens transaction costs; (3) joint-liability group lending scheme; (4) Cash flow-based repayment which takes into account the seasonal nature of agriculture and therefore provides a more flexible repayment schedule based on the farmer household's cash flow (e.g. payment upon harvest); (5) integrated approach to microfinance which incorporates components that complement the provision of credit and ensure its sustainability, namely: (i) savings/deposit mobilization, (ii) capacity-building (education, business development training) and (iii) micro-insurance; and (6) interlinked transactions such as contract growing effectively lower transaction and monitoring costs on the part of both lender and borrower. It also provides a number of benefits to small farmers which include technology transfer, credit assistance, access to markets and lower price risks.

[12] In the Philippines,the Land Bank of the Philippines remains the largest single source of credit to small farmers with 356 field units (285 branches, 38 extension offices and 33 lending centers) in 79 provinces of the country. Thailand's BAAC currently has 588 branches and sub-branches nationwide. Since the expansion of branch networks in 1988, the number of borrowers has doubled. In 2002, 5.2 million farm households registered as BAAC direct and indirect clients representing about 92 percent of the total farm households in Thailand. The transformation of Indonesia's BRI unit desa system in 1983-84 produced spectacular results in outreach and financial performance (Corpuz and Paguia,2008)

Key lending program components to ensure outreach

"(i) ***Savings/deposit mobilization.*** *This component has been widely recognized by most as the most instrumental in the success of these programs since it fosters less dependence on subsidy to sustain operations… Indonesia's KUPEDES operates on the philosophy that developing a savings instrument for the poor is at least as important as providing them with loans. By mobilizing rural savings, the program provided the banks with a stable source of funds and kept financial savings in rural areas, spurring further development in the countryside. Thailand's BAAC has recently received a great deal of international attention because of its impressive performance in savings mobilization, among other factors, with almost 9.6 million savings accounts of borrowers. The active rural savings mobilization program of BAAC enabled the bank to become financially self-reliant and was able to significantly reduce its dependence and loans from domestic and foreign sources… Under India's SHG-Bank Linkage Program, savings is the fulcrum of the lending scheme. Groups have an incentive to save more because banks provide loans at a certain proportion of the group's accumulated savings. Moreover, since savings form part of loans extended to individual members, peer pressure is expected to ensure timely repayment of loans.*

(ii) Capacity-building activities/training*. This is another equally important component of lending programs, apart from savings. Grant assistance for the conduct of capacity-building activities are provided to farmers to strengthen their capacity to access and manage credit funds. The Philippines' AMCFP-IRF Program underscores the importance of institution-building (IB) coupled with the delivery of credit services. The goal of the program is to upgrade the maturity levels of farmers/fisherfolk cooperatives to be effective financial intermediaries and business organizations. In Indonesia, continuous staff training has also been largely responsible for transforming village banks into self-sustaining full-service financial units (under the KUPEDES Program) and for the success of BRI-Unit Desas, which have since developed into effective channels for banking services to the rural poor. Likewise capacity-building activities are also provided for joint-liability groups (JLGs) and self-help groups (SHGs) assisted by BAAC in Thailand, VBSP in Vietnam, and NABARD in India.*

(iii) Micro-insurance*. Micro-insurance is characterized by low premium and low caps or low coverage limits, sold as part of a typical risk-pooling and marketing arrangements, and designed to service low-income people and businesses not served by typical social or commercial insurance schemes. This component is an integral part of several microlending schemes in the Philippines (e.g. CARD).*

Source: Corpuz and Paguia (2008)

Llanto et al (1996) stressed that the key issue is building sustainable institutions by having (a) the appropriate organizational form, (b) strong equity and financial base and (c) suitable systems and procedures.

According to Chua and Llanto (1996), one of the keys to success in micro-lending is to keep overheads very low. This is certainly something that non-profit organizations that are into micro-finance should look at. Cost efficiency is sometimes obscured by other development undertakings that do not lend themselves well to cost and output quantification. Additional important findings of their study were: (a) additional capital is necessary for lending investors and pawnshop to further broaden their operations; (b), savings mobilization, coupled with a lending window, allows money to circulate within a group or community and increase the options for investment; (c) There is a need and a demand for a capability-building program for credit NGOs/POs/cooperatives that makes use of existing networks and structures to lower start up costs and ensure sustainability. The capability-building program should not only consist of training but should include direct consultancy and technical assistance to the implementors so that specific problems are addressed in the context of the organization. In this regard, it may be good to invest in and develop so-called micro-finance experts capable of improving the performance of micro-finance providers.

Innovations

Innovation plays an important role in increasing outreach. Any policy distortions arising from an existing policy environment makes it difficult for MFIs to innovate or have sustainable operations[13] (Llanto and Lavina 2000). A competitive environment is a requisite to fueling innovation in the financial market [Llanto quoting Buchenau (2003)]. Financial institutions are most likely to develop and provide innovations if they have to compete. Competition promotes greater quality and more competitive pricing of their services to protect or increase their market shares. Otherwise, they could not cope with the competition[14].

Llanto and Fukui (2003), quoting Lariviere and Martin (1998) identify five categories of innovations in the area of rural microfinance:

The CARD-MBA Story

A number of MFIs now offer microinsurance products as one of the means of expanding outreach to the basic sector. Notable is that of the Center for Agriculture and Rural Development (CARD) NGO in Laguna, Philippines which established a simple mutual fund called the Members Mutual Fund (MMF) to address the problem faced by the institution upon the passing away of a member-borrower.

The primary purpose of the mutual fund is loan redemption in case of death of member-borrowers. The strong support provided by the members who benefited from the loan redemption scheme led to rapid growth of assets and membership. Thus, the MMF was later on used to cover death, disability and pension benefits. On October 29, 1999, the MMF was registered with the Securities and Exchange Commission as CARD Mutual Benefit Association (MBA), and on May 29, 2001, the Insurance Commission granted CARD MBA a license to operate as an MBA for client members. The unique feature of CARD MBA is that client-members own and manage it. Management was turned over to members in 1999. The Board of Trustees is elected from the membership of the association. As of May 31, 2002, CARD MBA has a total membership base of 94,854 households from 49,887 as of end-2001. CARD MBA had total assets of P27.1 million (US$525,292) on December 31, 2001; the assets stood at P94 million (US$1.8 million) as of May 31, 2003.

The basic infrastructure of CARD's Mutual Benefit Association is the prevalent practice of *damayan*, a local custom in the Philippine rural areas where the members of the community, relatives contribute cash to the family of an individual who passed away. The practice is "mutual" since everybody expects to be treated the same when a death occurs in the family. Ingrained in this custom is the feeling of oneness and solidarity with the bereaved. CARD used locally available information and the advantage of informal monitoring and enforcement system to build a solid mass of client-members united in the vision that they would someday be co-owners of an insurance company. Thus, CARD introduced the MBA to address a particular market niche that is not served by traditional insurance companies. Ninety eight percent of CARD clients are poor women, a large number of which are landless coconut workers (Llanto and Fukui, 2003).

Strategic innovations refer to strategies followed by MFIs to develop their clientele. Examples are risk information systems among MFIs, strategic planning for market development.

Institutional arrangement innovations refer to changing legal status and the institutional arrangements to improve MFI performance. Examples are NGO transformation into a formal financial institution, downscaling strategy of commercial banks, developing new financial legislation adapted to the circumstances of MFIs like NGOs and credit unions.

Donor incentive innovations refer to those mechanisms that are available to donors to improve the performance of MFIs. Examples are design features to improve the MFIs' outreach and viability.

The development of microinsurance products has been one of the most significant innovations in microfinance in recent years. This came about as a result of the reluctance of traditional insurance companies to offer insurance products to the poor because, among other information asymmetry, problems they were perceived to be non-bankable and not creditworthy.

Another noteworthy innovation was the Unit Desa system at Bank Rakyat Indonesia which was transformed to a commercial and financial intermediary from a loss-making channeling agent in 1984. At the heart of the reforms was Unit Desas' resolute saving mobilization campaign and the creation of a simplified but effective unit desa structure. BRI is a state-owned bank with 23 divisions. The Business Unit Desa (BUD) Division was one of those divisions. Only this division and its managing director were directly responsible for the unit desa system.

Robinson 2002, in her monumental work, "Microfinance Revolution", stressed that the Unit Desa system has enabled millions of poor Indonesians gain access to a savings facility that provides liquidity and return. The poor put a high value on savings services as indicated by the response of millions of poor depositors with the Unit Desas. Depositors outnumber borrowers, expanding BRI Unit Desa's client base. Security of deposits and relatively high returns serve to attract those depositors.

Llanto and Lavina (2006) also cited the village banking technology which has been widely documented to improve outreach of financial institutions, supporting the study made by Robinson (2002) on BRI'S unit desa. They also cited Mali's CVECA's system which operates using the same village banking technology. Satellite offices are set up and transactions are made in an office in the village which is open one day a week for 4-10 hours depending on the season, effectively reaching clients in remote areas as well as reducing fixed operational costs.

On the other hand, the same study highlighted Bangladesh's ASA's hybrid mandatory-voluntary product, which provides voluntary liquid savings service which takes the form of a mandatory-voluntary product that is delivered during weekly meetings by a credit officer that visits the neighborhood. A remarkable practice worth mentioning is that ASA practices extreme attention to minimizing its costs, such as hiring staff members that are not highly educated (at most 12 years of schooling). However, this is possible because of the simplicity of its system, which allows the institution to operate smoothly. In effect, ASA proved that it is possible to offer voluntary savings services to small depositors on a viable basis without also mobilizing large deposits from the public.

Local outreach strategies

The Philippines is not without its successful outreach strategies. In fact, government and donor participation can also develop financially sound institutions that can readily broaden outreach. The Credit Union Empowerment and Strengthening (CUES) Project of the World Council of Credit Unions (WOCCU) initially in Southern Mindanao and has now expanded to other areas promotes *model credit union building and branding* (called Finance Organizations Achieving Certified Credit Union Standards or FOCCUS) in order to strengthen the capacities of credit cooperatives to deliver services to their members. The program includes strengthening of participating credit cooperatives' internal organization. Government and donor participation can also develop financially sound institutions involved in rural finance. The credit union is also equipped with PEARLS[15] monitoring system to ensure that cooperatives are operating on a sound basis. Product diversity and savings mobilization are emphasized.

The MABS (Microfinance Access to Banking Services) Approach for rural banks also proved to be successful. Funded by USAID, the MABS, which started in 1998, assists rural banks in the Philippines to develop the capability to profitably provide financial services to microenterprises. A systematic method for transferring microfinance best practices knowledge and product development is provided, which includes intensive one-on-one technical assistance, workshops, seminars, in-bank coaching, and exposure and training visits to participant banks. Each bank is assigned a technical advisor who makes sure that the training and technical assistance are delivered properly and efficiently. MABS participating banks had disbursed approximately US$ 37 million to more than 70,000 microentrepreneurs as of December 2002.[16]

The Agricultural Credit Policy Council (ACPC) has always advocated for innovative financing schemes for agriculture owing to its peculiar characteristics, and high-risk nature. Credit alone is not effective. The extension of credit should be supported by improved technology, infrastructures, inputs, and extension services and markets.

Some policy implications

Relative to cooperatives or rural banks, NGOs encounter bigger problems in terms of expanding outreach on their operations and offering innovative financial products. First, they lack the legal personality and authority to act as real financial intermediaries, limiting their capacity to develop. They are not allowed to mobilize deposits beyond compensating balance. The second

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[15] PEARLS stands for **P-** Protection, **E-** Effective financial structure, **A –**Asset quality, **R-** Rates of return and costs, **L –** Liquidity**, S –** Signs of growth. PEARLS is a financial performance monitoring system designed to offer management guidance for credit unions and other savings institutions**.** PEARLS is also a supervisory tool for regulators. PEARLS can be used to compare and rank institutions; it can provide comparisons among peer institutions in one country or across countries.

[16] See Campion and Owens (2003)

problem is the lack of an extensive and viable financial delivery system that has substantial focus on the poor. While rural banks and the credit cooperatives have a nationwide delivery system through branches and unit entities, many of them have yet to consider microfinance as profitable opportunities. Only few microfinance NGOs have achieved scale or become financially viable. The problems inherent in NGOs would probably make them less capacitated relative to rural banks and cooperatives to contribute to a substantial increase in microfinance outreach over the long-run. Thus, Llanto, Garcia and Callanta (1996) suggested the following: (a) transform credit NGOs into full-pledged formal financial institutions, (e.g., private bank, finance company, non-stock savings and loan association or credit cooperative); and (b) alternatively, credit NGOs may organize or invest in formal financial institutions

An essential component of government policy to promote greater outreach came from Daley and Sautet (2005) who prescribed that removing corruption (in the Philippines) promotes an environment in which entrepreneurial endeavors and investment are encouraged. Further, they added that reducing the number of laws and the scope of government activity while improving the strength and transparency of essential government services is the key to reducing the ability of government employees to use their authority to obtain graft and bribes.

The same study raised the importance of securing property rights which is expected to attract more traditional banks to seek out lending opportunities. Quoting De Soto, the authors cited that the current value of dead capital[17] in the Philippines is roughly US$ 132 billion, more than 600 times the amount the government intends to inject into microfinance. Real property must be titled to be used as collateral, and it must also be transferable to the creditors in case of foreclosure. Titling, in conjunction with reform of the existing mortgage and foreclosure laws, will not only help the land markets function more efficiently; it will also encourage and stimulate the flow of funds into the poorer communities. Daley and Sautet also suggested the removal of discriminatory laws, which have disenfranchised and continue to disenfranchise generations of people (i.e. grant domestic non-citizens the same rights as citizens to own property and businesses; liberalize and remove restriction to foreign ownership).

An interesting study that has implications for policy and implementation was that of Lamberte and Manlangit (2003). Their analysis of households with access to community-oriented financial intermediaries (COFI)[18] system and non-access to the COFI system showed that poverty incidence is clearly higher among non-clients than clients of the COFI system. They surmised that those who were able to access the COFI system might already be economically better off than those who had no access in the first place. If such is the case, then access to the COFI system could have worsened and can worsen the income disparity between those with access and those without to the system. If the COFI system itself will not be able to expand its coverage to include those who are currently excluded from its services, then poverty alleviation programs of the government will need to focus on those who currently do not have access to the COFI system. For the COFI system to be able to expand its services to those who are currently excluded, the proper policy environment allowing COFIs to increase their reach must be put in

[17] Per De Soto, the poor are unable to access the value of the capital because untitled or informal ownership is not recognized by financial institutions in the same way as formally titled property.
[18] COFI is a category of MFIs, but the study looked only into the credit cooperative system.

place. At the very least, poverty alleviation programs should target households who currently do not have access to the COFI system so that they can eventually participate in said system.

Lamberte and Manlangit (2003) further noted that planners of poverty alleviation programs should take note of the survey results showing that there is virtually no difference in the extent of poverty between male- and female-headed households. As such, they should reconsider their present thrust of mainly targeting poverty alleviation programs for female-headed households. They should instead explore other indicators to improve the effectiveness of poverty alleviation programs. Finally, the COFIs can contribute more to the effort to reduce poverty and income disparities within their respective communities by changing their internal policies so that they can provide more and better financial services to their poorer clients.

Partnering with strong microfinance organizations is important in expanding depth of outreach. Ani (2002), sharing his experience as microfinance practitioner, pointed out that developing and implementing good selection criteria for partnership are very important. The criteria should be designed so that all the weak organizations and those without good and dynamic management or leadership are eliminated. Preference should be given to those which have established their credibility and integrity, those who have at least two years of good track record, and those with credible and honest Board and management. He further mentioned that one should always examine closely the stated and articulated vision of the organization, its clarity, its realism, and its consistency with what they are doing.

Ani noted that, generally speaking, NGOs that do a lot of different types of projects are not good partners for microfinance. The reason is their lack of focus. They generally do not develop the rights skills, systems, corporate climate and environment for sustainable microfinance. In general, most NGOs, especially the multi-program ones, do not have the focus, mentality and determination to become profitable viable MFIs.

Just like banks, MFIs must make money through profits. Many NGO leaders are social welfare minded and do not have the right kind of business skills. The author found out that cooperatives are good partners because their cost structure is lower, they focus on profitability, and their business skills good. Cooperatives attain financial self-sufficiency quickly (sometimes within 12 months). Cooperative leaders have good management and HR skills, and they aim for profit from the very start. NGOs on the other hand carry a lot of baggage. They are concerned with many social issues that take away their attention from the essential business of financial intermediation. These NGOs generally offer interest rates that are so low that it is impossible to break even or make a profit. They mistakenly believe that offering low-cost subsidized credit to poor people is a good policy. In reality it is a wrong policy, as subsidies are not sustainable in the long term.

ACCESS: The need for sound policy and regulatory environment.

The United Nations (though its UN Captial Development Fund or UNCDF) has identified microfinance as an effective means of contributing to poverty reduction on a sustainable basis and the achievement of the Commitments of the Brussels Programme of Action for Least

Developed Countries and the Millennium Development Goals. No less than former UN Secretary General Kofi Annan recognized the lack of access to financial services by the poor:

"The stark reality is that most poor people in the world still lack access to sustainable financial services, whether it is savings, credit or insurance. The great challenge before us is to address the constraints that exclude people from full participation in the financial sector... Together, we can and must build inclusive financial sectors that help people improve their lives."[19]

Thus, the UN made a strategic shift in its microfinance programs in December 2002 by building on inclusive financial sectors or the integration of microfinance in the formal financial system. One of the strategies is by deepening the financial system – identifying the constraints and opportunities that need to be addressed -- in a given country to ensure sustainable access to financial services by poor and low-income people.

Since early 2003, financial sector assessments have been carried out by UNCDF in Burkina Faso, Central African Republic (CAR), Democratic Republic of Congo, Guinea Bissau, Liberia, Madagascar, Mozambique, Nepal, PIC LDCs, Senegal, Sierra Leone, Somalia, and Timor Leste. UNCDF is already in the process of facilitating the development of a national (financial) strategy and action plans in Madagascar, Senegal and Togo.

In the Philippines, solid policy groundwork for microfinance[20], specifically providing the poor better access to financial services, has been undertaken since 1998, starting with the issuance of the National Strategy for Microfinance which called for a paradigm shift from directed credit and subsidized policies to a market-based orientation. Several enabling laws were passed subsequently to support and complement the implementation of the National Strategy, detailed discussions of which are provided under Microfinance Policies of this narrative.

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[19] Statement of UN Secretary-General Kofi Annan, 29 December 2003, following adoption of 2005 as the International Year of Microcredit

[20] In 2004, ADB extended technical assistance to enhancing Access for the Poor to Microfinance Services in Frontier Areas. The purpose of the TA is to support the development of a sound and viable financial system that can provide efficient and sustainable microfinance services for the poor, enabling them to pursue economic opportunities and income-generating activities. The TA supported education for the poor on microfinance. Likewise, in 2005, ADB provided technical assistance titled Microfinance Development Program (MDP to enhance the enabling policy and regulatory environment and remove regulatory impediments and policy distortions to promote market efficiencies and increased outreach of services at competitive prices to the poor. The MDP sought the following reforms: build viable microfinance institutions (MFIs) that can provide efficient and cost-effective retail delivery of services to the poor; strengthen regulatory and supervisory capacities and oversight for a sound microfinance sector; and increase financial literacy and consumer protection for the poor and users of microfinance services.

Regulation and policy reform for improved access

The end goal of microfinance regulation is to ensure that MFIs maintain sound and prudent practices in their operations that invariably employ innovative and nontraditional lending methodologies (Lamberte 2001).

According to the National Credit Council (NCC), "microfinance regulation refers to the issuance of the necessary rules and regulation, including cancellation, suspension, [and] sanctions, governing the intermediation of microfinancial services. The current regulatory environment has also defined the roles of institutions involved in the delivery of microfinancial services such as thrift banks, rural banks, credit cooperatives, and microfinance NGOs. The BSP supervises thrift banks, rural banks and cooperative banks while the Cooperative Development Authority (CDA) supervises the credit cooperatives and other cooperatives engaged in savings and credit. Microfinance NGOs are not currently regulated, but they are required to register with the Securities and Exchange Commission (SEC).

The NCC implemented the ADB-funded S150 million program loan called the Microfinance Development Program (MDP) in 2005 to enable Government to address the systemic weaknesses in the sector and achieve the Millennium Development Goals including eradication of extreme poverty and hunger, and the promotion of gender equality and empowerment of women. The MDP aimed to promote access to sound, sustainable, competitively-priced financial services for the poor and their microenterprises. The overall objective of the MDP was to improve household incomes, reduce poverty, and reduce vulnerability of the poor. Part of the government's commitments are key strategic reforms to enhance the enabling policy and regulatory environment and remove regulatory impediments and policy distortions to promote market efficiencies and increased outreach of services at competitive prices to the poor. These include the following:

(1) Issuance of BSP Circular 505 allowing microfinance-oriented banks to set up branches anywhere in the country, subject to meeting the criteria and standards set by BSP to ensure a loan portfolio quality. It has provided greater flexibility in bank branching for financially sound and well-managed microfinance operating banks. BSP has also promoted electronic banking to facilitate electronic payment transactions and value transfers, including remittances to MFIs, by issuing information technology (IT) risk policies, providing baseline IT risk standards, and aligning policies with international best practices;

(2) Issuance of Circular No. 542, entitled Consumer Protection for Electronic Banking, prescribing the rules and regulations for consumer protection. The expansion of e-banking, including the application of cellular phone technology to financial transactions, has lowered the cost of transfers and payments, and promoted savings mobilization for MFIs. Savings mobilized in rural and thrift banks have increased to P2 billion in 2009 from P15 (1.5?) billion in 2006;

(3) Issuance of SEC Memorandum Circular No. 2 on 18 January 2006, which requires NGOs providing microfinance and related services to disclose this information to SEC. Within 30 days

of its issuance, NGOs were required to file a revised general information sheet (GIS) and, if necessary, amend articles of incorporation. GISs and annual financial statements of microfinance operating NGOs are downloadable from the SEC data system. These actions taken by the SEC have increased the transparency and disclosure of MFIs and facilitated public access to the information on microfinance operating NGOs; and

(4) In response to the unified taxation to different types of MFIs called for by the MDP, Revenue Regulation No. 14-97 titled Tax on Non-government Organizations (NGOs) and Cooperatives Engaged in Microfinance activities was issued on 11 December 2007. It clarified the BIR interpretation of the current Tax Code in relation to the taxation treatment to microfinance operating NGOs and cooperatives by stating that they are subject to corporate income tax.[21]

To build viable MFIs that can provide efficient and cost-effective retail delivery of services to the poor, the NCC, through the MDP, pursued the following: (a) development of performance standards for MFIs; (b) strengthening governance of MFIs by prescribing minimum qualifications and fit and proper standards for board directors and key management for savings and credit cooperatives, including installation of an effective internal management systems (mandatory committees for audit, credit, elections, education/training, ethics and mediation and conciliation); (c) in cooperation with NAPC and DTI, formulated guidelines and model BDS Manuals; and (d) in collaboration with NAPC, issued Industry Advisories on 22 October 2007 to promote adoption of sound, sustainable microfinance schemes, including microinsurance and savings, to support the development and expansion of viable MFIs with products and services in compliance with existing laws.

The government's Privatization Management Office (PMO) has likewise formulated a privatization plan and options for the Philippine Postal Savings Bank (PPSB), with assistance from its financial advisor. PMO submitted the privatization options and action plans for PPSB, including the financial assessment and valuation, to the PPSB board of directors. The PPSB board discussed them on 9 October 2007 at the board meeting with a view to bringing in strategic investment for an accelerated outreach of savings and remittance services in rural and remote areas. Mobilization of savings through postal savings networks can be an effective way to expand outreach and provide essential services to the rural poor in remote areas.

At the macro level, Lamberte (2001) notes that the absence of a stable macroeconomic environment that is conducive to the expansion of financial services to micro, small and medium enterprises can lead to the collapse of banks, especially small ones whose clients are the poor who are most vulnerable to any downturn in the economy., This can ultimately undermine the public's confidence in the banking system. From 1998 to 2000 alone, at the height of the Asian financial crisis, 12 thrift banks and 83 rural banks were closed by the Philippine Deposit Insurance Corporation (PDIC).

[21] RR 14-97 has been amended with the passage of New Cooperative Code of 2008

The role of central banks

The role of central bank in microfinance cannot be underemphasized. The liberalization and deregulation of the financial sector in the 1990s paved the way for the rapid growth of the microfinance industry.

The passage of the General Banking Law in 2000 and the issuance of circulars demonstrate government's policy towards microfinance. [22] BSP Circular No. 272 which was issued on 30 January 2001, defines microfinance as "small loans granted to the basic sectors, as defined in the Social Poverty and Reform Act (RA 8425) of 1997, and other loans granted to the poor and low-income households for their microenterprises and small businesses so as to enable them to raise their income levels and improve their living standards." . It also provides that "microfinance loans may be amortized on a daily, weekly, bi-monthly or monthly basis, depending on the cash flow conditions of the borrowers." This is intended to give small borrowers flexibility in choosing their amortization schedule that would reflect the timing of their cash flow.

The Circular likewise states that "interest rate shall not be lower than the prevailing market rates to enable the lending institution to recover the financial and operational costs incidental to this type of microfinance lending." Further, the Circular provides for a guideline that does away with requirements that are not appropriate for or raise the cost of microfinance loans which states that "a bank may not require from its credit applicants a statement of assets and liabilities and of their income and expenditures and such information as may be prescribed by law or by rules and regulations of the Monetary Board…." Small borrowers have no formal booking or accounting system; thus, they cannot present to a bank audited financial statements which are required of big borrowers. Finally, the Circular also encourages banks to lend to small borrowers not on the basis of a collateral but on the basis of borrowers' cash flows. This is to address the problem requiring small borrowers to produce hard collateral.

Llanto (2000) outlines the important roles for Central Banks in fostering microfinance:

- It should continue to promote the National Strategy for Microfinance and market-driven interest rate and credit policies
- It should continue to review regulation and supervision of licensed banks especially pertaining to microfinance.
- In most countries, central banks should undertake promotional activities to support microfinance, such as pilot projects, research, data collection and publication, advocacy, and training.
- Central banks should regulate nonbank MFIs that accept voluntary savings from members, when the volume of savings exceeds a certain threshold.

[22] Section 40 of the General Banking Act of 2000 recognizes the peculiar characteristics of microfinance and directs the Monetary Board of the BSP to issue appropriate measures for the regulation and supervision of such banks).

Improving Access: MFI level

Lamberte (1998) noted that credit unions can be important agents in broadening access to financial services by the poor as in the case of Development Assistance Program for Cooperatives and People's Organization(DAPCOPO) and the Tulong sa Tao Self Employment Loan Assistance Program (TST-SELA). Established in May 1990, DAPCOPO, is a special credit program for the agricultural sector which addresses the credit needs of non-bankable farmers' groups and their members, provides capacity bulding for farmers' groups and encourages savings mobilization among farmers.

On the other hand TST-SELA is a special credit program for the non-agricultural rural sector implemented by the Bureau of Small and Medium Business Development (BSMD) of the Department of Trade and Industry, with an initial funding from the government of P30 million. The program, which started in 1987, uses NGOs as conduits. NGOS could charge sub-borrowers the prevailing rate in the area (on average 18 percent), while the DTI charged a fixed 7 percent for its wholesale loans to NGOs, which give a reasonal spread to cover administrative costs and credit risks. The author came to the following conclusions:

(1) the repayment records of these programs (i.e., from the intermediaries to the refinancing agents) has been remarkable;

(2) Credit unions have been doing well in terms of mobilizing deposits and allocating credits to small borrowers rationed out by the banking system even during periods when the banking system encountered some difficulties. However, they often face some resource constraints which have prevented them from satisfying the credit demands of their members on time. Access to external sources of funds, such as those of special credit programs, could relax such constraint;

(3) access to external sources of funds such as the special credit programs of the government does not have significant differential impact on the performance of credit unions. More specifically, it has not undermined the savings mobilization efforts of credit unions. One of the reasons is that, unlike credit programs in the past, these special credit programs emphasize savings mobilization. Another reason is that credit unions have a built-in savings mobilization program in their lending activities. Access to external sources of funds has also no significant differential impact on the overall profitability of credit unions as measured by the rate of return on investment and on loan delinquency problem;

(4) credit unions do not discriminate poor and rich members when it comes to granting credit because every bona fide member is given an equal opportunity. Thus, it is argued that very small borrowers will not likely benefit from the loan programs if they are coursed through the credit unions.

Elser, Hannig and Wisniwski (1999) stressed that lack of savings facilities creates problems at three levels: (i) the level of the individual; (ii) the level of the financial institution; and (iii) the level of the national economy. At the level of the individual, the lack of appropriate institutional savings facilities forces the individual to rely upon in-kind savings such as savings in the form of gold, animals or raw materials, or upon informal financial intermediaries, such as Rotating Savings and Credit Associations (ROSCAs) or money-keepers. These informal savings options, however, do not offer a combination of security of funds, ready access or liquidity, positive real return and convenience in order to meet the various needs of the particular saver.

At the institutional level, MFIs lacking effective savings mobilization strategies are unable to increase their outreach to a significant number of clients. In addition, few MFIs that do not mobilize savings have attained full financial self-sufficiency, independently covering their expenses for operations, loan loss, cost of funds and inflation with their revenues. Throughout the world, MFIs have often experienced that exclusively offering credit services can lead to undue dependency on external sources of financing. This dependency can cause the MFIs to concentrate on the demands of the donors rather than on the demands of potential clients, especially potential savings clients.

At the level of the national economy, high levels of savings increase the amount of national resources and decrease the need to resort to foreign indebtedness in order to cover domestic investment and consumption demand. Numerous countries with low internal savings rates must borrow from abroad, which results in a debt service burden. This clearly underlines the importance of savings mobilization to sustain economic growth with national financial resources.[23]

Karlan and Zinman (2007) designed and conducted a field experiment in South Africa to determine the impact of consumer credit on marginal groups. The study highlighted the potential of credit scoring in improving microfinance operations. As credit scoring systems are enhanced for MFIs, scoring will lower costs by reducing both the number of defaults and the amount of time credit officers spend recovering loans. Credit scoring, therefore, promises to be a key ingredient in expanding financial access.

Use of Information Technology

The use of information technology can significantly improve the poor's access to formal financial services. Mobile phones, for instance, have proven to be an essential means to improve access. They can be used for micropayments (m-commerce), as electronic money (e-money), and

[23] Elser,Hannig and Wisniwski (1999) concluded that savings mobilization is an important step towards the commercial viability of microfinance institutions, as deposit taking provides further incentives to improve governance and cost efficiency. For microsavings to become a commercially viable business, product design must respond to the preferences of customers. Careful market research is necessary to assess those preferences and prudential testing of new products is required before they are launched in the market. As noted above, a broad range of deposit facilities, offering different levels of return and access, will be most attractive for microsavers. Clear and simple design of savings products alongside expressive trademarks and product names help customers choose a product and strengthen the corporate identity of the financial institution. Finally, marketing and service delivery strategies must help to create a close relationship between the depository and its potential depositors.

as a banking channel. CGAP (2006) outlined the following reasons why there is so much excitement about banking with the poor through mobile phones:

(a) *Many merchants and poor people have mobile phones, and the number is growing fast.* African mobile phone subscribers grew from 7.5 million to 76.8 million from 1999 to 2004 (International Telecommunications Union 2005), and this will further increase to 250 million in the next four years, according to the Progressive Policy Institute ;

(b) *Poor customers are already familiar with mobile phones.* Many poor people already use mobile phones for voice calls and text messages, thus increasing the likelihood that they will need only a limited amount of training to be able use it for banking. *Mobile phones are "always" on.* Because mobile phones generally are always connected to the network, banks can receive transaction details as soon as the transaction takes place, reducing its uncertainty. Clients can use their own phone anytime, to determine their account balance.

(c) *Mobile phone operators already know how to handle cash transactions for customers (airtime).* Operators already have a network of retail outlets with which they do business, albeit indirectly because they sell only wholesale airtime. Also, prepaid mobile phone subscribers, many of whom are poor, are accustomed to handing cash to these dealers in exchange for value in their airtime account.

While the use of mobile banking has eased access and financial transactions of the poor, CGAP (2006) provided some reasons to be cautious about its use:

(a) *Mobile banking applications are not yet interoperable.* In most countries, it is not yet possible to send money between any two mobile phones easily and at low cost. Until these restrictions are overcome, mobile phone banking may not achieve the "network effect" that has caused mobile phones to spread as quickly as they have.

(b) Mobile phone payments may not conform to international security standards. Because mobile banking is in its early stages, most banks and mobile phone operators have not agreed to a single standard for securely sharing customer account information and verifying customer identity.

(c) *For banks, a "mobile phone only" channel has not yet proved profitable.* So far, most mobile banking services offer only a limited range of products. Until customers pay for a range of financial services through their phone, the channel is unlikely to make money.

(d) *Mobile phone banking may not be able to reach the most remote and poor areas.* So far, most self-employed or informally employed poor people have not used mobile phone banking because providers don't have large networks where they can deposit and withdraw cash easily.

(e) *Mobile phone banking may not be easy to use for illiterate and older users.* Most mobile banking interfaces and processes require literacy. Further adaptation and training will be required for all customers, particularly illiterate and older customers, to adopt this system.

(f) *Regulation surrounding mobile phone banking is not yet clear.* Key issues include how to protect customers who deposit cash at retail outlets; how to regulate providers that are outside the banking domain, such as mobile operators that issue e-money; and how to apply stringent "know your customer" requirements to providers opening accounts for poor people.

Automated Teller Machines (ATMs) and internet banking services have likewise become convenient means for broadening access to financial services. However, most ATMs are concentrated in the urban areas, making it hard for those in the countryside to access them. The smaller banks like rural banks do not yet have the vast ATM networks as the bigger banks. As of September 2005, there are a total of 5,996 ATM units in the country where only 38 are rural bank ATMs. Similarly, internet banking requires an internet connection; such services are still beyond the reach of most of the poor or low-income clients.

In 2004, CARD Bank, the first rural bank that focused on microfinance, and Tulay sa Pag-unlad, Inc. (TSPI), one of the largest microfinance NGOs, partnered with the Bank of the Philippine Islands (BPI) to provide ATM cards to their clients. Considering that a large number of CARD and TSPI clients are in the National Capital Region and Region IV, ATMs are very accessible. Through this partnership, CARD and TSPI clients can use any of the ATMs in the express link (elink) system of BPI. The elink is one of the largest ATM networks in the country with several commercial banks as members. The cards can be used as either loan disbursement cards or even withdrawal cards from the clients' savings account, when applicable.

In the Philippines, the use of mobile phone banking is also gaining ground because of its lower cost and an existing wide network of mobile phone users. In 2003 Smart Communications and in 2004 Globe Telecom launched the electronic money concept in the Philippines called *Smart Money* and *G-Cash*, respectively. The *Smart Money* technology allows users to make purchases, pay and receive domestic payments and to receive remittances by loading or transferring money from a bank account into a mobile phone account or reloading a prepaid card electronically through the mobile phone. The cash can be withdrawn from the phone account at either an ATM or one of the many SMART encashment centers, which include retail stores and even Mc Donald's outlets. The *G-cash* is a similar technology, which provides the same services but does not use a debit card and instead just uses Cash In and Cash Out Center/ Outlets via the mobile phone (Jimenez and Roman, 20005).

Mobile Phone Banking: "Text A Payment"

With the availability of the electronic money technology, the Rural Bankers Association of the Philippines- Microenterprise Access to Business Services (RBAP-MABS) entered into a joint project with Globe Telecom through the Text A Payment Project (TAP). RBAP MABS is exploring various services using the *GCash* platform. TAP allows micro loan clients to pay their loan amortizations using the *G-Cash* platform through short messaging services (SMS). Shifting from the traditional client field collection to TAP will lower banks' transaction costs and increase the productivity of their account officers. It has been a revolutionary solution for low value payments. On the other hand, paying through TAP is more convenient and less costly for clients as *G-Cash* outlets, establishments where clients can make cash-in transactions, are now widely distributed, ensuring increased accessibility. The process is very straightforward. The client will register in the system through SMS inputting some key information such as name, address and phone number. The user will then receive a reference number and TAP identification number through Globe Telecom's SMS facility. Once registered, the ill client can go to any Globe Cash In Center/ Outlet to convert actual money to electronic money. The process adequately addresses security concerns, as the client will provide a valid ID card and fills in the necessary forms in the Globe Cash In Center/ Outlet. A minimal service fee is also paid during this phase. Once the verification and processing is completed, the electronic money amount is sent to the mobile phone with a reference number. Both the outlet's service unit and the client will receive the confirmation. The client can then use the loaded electronic money to pay the rural bank by simply sending a text message with the amount and the personal identification number (PIN) to satisfy security concerns. Again, both the sender and receiver will get a confirmation of the transaction. Aside from the benefits briefly mentioned above, this service and product is very much attuned to the needs of the microfinance market. First, the loan amortizations for microfinance loans are usually very small and frequent therefore can be easily made through the *G-Cash* platform. Second, the large network of conveniently located *G-Cash* merchants/ outlets also makes it easier for microfinance clients to access. It is also more economical as it saves time and money for microfinance clients who can then use the time for their businesses. Some studies have shown that payment by mobile phone can result in savings of 6-8 hours that could be used for productive work. As mentioned earlier, the technology is very user friendly and the receptiveness of the market to the SMS platform also contributes to the success of the product. On the part of the institution, there are significant savings since the bank will not have to field as much loan officers to make actual collections of payments. There is also less cash-on-hand risk for their loan officers. A research project conducted by a student of the Asian Institute of Management saw this cash-on-hand risk issue as a very significant one for microfinance operations. TAP is currently being used by some RBAP-MABS participating banks, while the National Confederation of Cooperatives (NATCCO), the largest confederation of cooperatives in the country has tapped a service provider to enhance its financial services. Although the receptiveness of the market is generally positive, there will still be some resistance to the use of technology for financial services. A survey conducted among 60 microfinance clients, revealed that asignificant number still did not fully understand the *G- Cash* despite the advertisements on television and billboards. Despite wide network of mobile phone users across income levels, there may still be limited awareness onf using the electronic money platforms. In addition, the infrastructure of Cash In and Cash Out Centers/ Outlets may still be limited especially in the rural areas. Although there are numerous retail outlets that are accredited, reach in the very rural areas still leaves some room for improvement. The involvement of rural banks may additionally be a step in the right direction.

Source: Jimenez and Roman (2005)

Ashraf, Karlan, Yin (2005) evaluated the impact of offering a deposit-collection service for micro-savers of a rural bank in the Philippines. In this service, a bank employee comes to the individual's home once per month to pick up a savings deposit. The individual is charged a nominal fee equal to the transport cost. Of 137 individuals offered the service in the treatment group, 38 agreed to sign-up. Those offered the service saved 188 pesos more (which equates to about a 25% increase in savings stock) and were slightly less likely to borrow from the bank. Many believe that the poor need financial services that allow for frequent small deposits and infrequent large withdrawals. If the withdrawal comes first, this is called a loan; if the deposits come first, this is called savings. Some argue that the order is not important, but rather merely the access to a safe and reliable vehicle for the inflows and outflows matters (Rutherford 2000). A deposit collection service is about helping individuals make little deposits (with perhaps a goal towards large withdrawals later). The authors found that offering the financial service of deposit collection had an economically and statistically significant impact on increasing savings and a small, but significant, impact on decreasing borrowing.

The issue of collaterals and other security arrangements

The usual method is the pledging of collateral in loan applications that would give sufficient signals to both borrower and lender and would eliminate enforcement problems and uncertainties. However, the scarcity of collateral in rural markets prevents rural households from accessing credit.

Based on ACPC's assessment, farmlands can only become acceptable to banks as collateral once distortions in the agricultural land market are removed. [24] This can primarily be done by (a) amending the relevant laws to remove constraints to the marketability of government-issued land instruments, i.e., make the ownership of Certificate of Land Ownership Awards (CLOAs) , Emancipation Patents (EPs) , and Certificates of Stewarship Contracts(CSCs) transferable and at a much earlier date rather than after ten years, and (b) fast-tracking the completion of the CARP's implementation so that government's inappropriate involvement in setting land values and the uncertainties in land ownership can finally end (ACPC2001).

The ingenious products developed by two Latin American microfinance institutions (Banco Solidario de Ecuador(BSE)and Cajas Municipales de Arequipa (CMA) were in direct response to the lack of traditional collateral in poor households. These are:

Pawn loans respond to liquidity crunches, mostly consumption needs, in a speedy and secure manner (through gold as collateral). Transactions are usually of small sizes and loans are approved based on value of gold, not on character of borrower eliminating the need for costly background checks. Pawn loan is based on an existing product that is already recognized in the market. BSE and CMA further streamlined this known practice and launched a product that offers credit access to low-income people within 15-20 minutes with less paperwork required. Loans are backed by the value of gold. This product also allowed BSE and CMA to enter into the low-income bracket of the population.

[24] Distortions take place when foreclosed agricultural lands automatically fall under the jurisdiction of the Comprehensive Agrarian Reform Law (CARL) or RA 6657. That is, the bank, as the landowner, has to abide by the land ownership limits established by the law. However, the bank can dispose the land only to the government, which is likewise the one who determines the value. Moreover, government’s payment on the land depends on the availability of funding.

The ***preferential client loans***, on the other hand, are meant for business expansion or for business peak season needs. Clients with good track records are qualified for these loans, a way to reward them and to set out signals to other borrowers as well. BSE designed their product based on the value of the property, but eliminated the costly business of formal mortgaging by employing a third party, the fiduciary trust, that will take charge of liquidating the property in case of default and transfer the proceeds to BSE. CMA's product, on the other hand, is designed as a supplementary loan that will allow good clients to have multiple credits despite restrictive credit policies in order to eliminate tendency of clients to borrow from informal moneylenders during peak sales season

Contract farming and ***outgrower schemes*** are some examples of product-market credit. Contract farming is a type of product-market arrangement where a processor or buyer provides inputs on credit linked to a purchase agreement and repayment of initial input is deducted when the farmer sells the produce while the outgrower scheme is an integrated form of contract farming where the agribusiness has greater control over smallholder production while the smallholder producer basically offers land and labor in return for a package of inputs and extension services. Both schemes reduce the risk of side-selling by building formal contractual relationships with farmers. Some contract farming schemes also uses the techniques employed by microfinance institutions such as group liability, close monitoring and developing strong company-farmer trust. Another example of this scheme is ***trader credit*** where traders use personal contacts and existing trading relationships as a substitute for collateral and to reduce risk of side-selling.

Processors may also channel credit through traders rather than directly to farmers. Processors may use interlocking credit arrangements with traders to secure farmer produce. This type of product-market arrangement can be in the form of inputs provided to farmers, cash or in kind advances, based either on repayment at harvest or on agreed purchase. Product-market credit eliminates the need to demand collateral because the expected produce of the farmers secures the loan. This product-market credit also responds to other rural market constraints such as lack of client information, high operating costs and agriculture related risks.

An example of linking credit to agricultural produce is ***warehouse receipt financing***. Microfinance institutions have a strong incentive to offer warehouse receipt financing because their risk is reduced given that the system has a built-in use of collateral that can retain a high commercial value and be liquidated quickly. Loans made against the receipts are extremely flexible. The following is a summary of the advantages and disadvantages of warehouse receipt financing for both the institution and the farmer.

Using the same principle of product-market credit, an emerging option for microfinance that would allow medium to long term financing for equipments and other fixed assets is leasing of the equipment with the equipment acting as the collateral for the loan. ***Leasing*** is not a new concept. It follows a basic premise that business profits arise from equipment use, not equipment ownership. With leasing, an institution can develop longer term financing mechanisms for its clients and increase their borrowing capacity. Because the lease is granted based on an enterprise's cash flow rather than on its credit history, assets or capital base leasing gives entrepreneurs with scarce financial resources the opportunity to start a business on a limited budget or increase an operation's productivity through new capital investments.

Llanto and Lavina (2006) stressed that financial institutions can play a major role in setting up ***transfer facilities*** from international sources to rural areas. With a conscious effort towards cost reduction, one option available to an institution is forming a strategic alliance between money transfer companies and banks, and among banks in other countries. Another strategy is to use software platforms designed for money transfers or transfers from credit union to credit union using international remittance network.

An efficient intermediating institution or facility for remittance transfer would reduce transaction costs and allow the institution to alternative source of fund for savings mobilization. Effects of migration through family remittances and other forms of migrant capital pose an important policy option linking financial opportunities in rural areas. Specifically, the demand for financial services by remittance receiving households represents the intersection between the role of microfinance institutions and the rural sector development. If adequately addressed, remittances can become a major form of foreign savings energizing the rural sector into a process of modernization. Remittances have a positive effect in the rural sector when they alleviate the restrictions that limit local production due to the creation of employment and its multiplier effects on the local economy [(Llanto quoting Taylor (in Orozco, 2003)].

The ***Income Generation for Vulnerable Groups Development*** (IGVGD) is a collaboration between the government of Bangladesh, the World Food Program and the Bangladesh Rural Advancement Committee (BRAC). IGVDG targets the destitute rural Bangladeshi women who have little or no income earning opportunities. The concept of IGVGD is built on a government safety net program that provides free food grain for an 18-month period to destitute, female-headed households that are at the highest risk of hunger. BRAC's conventional microfinance operations cannot include the poorest and it was looking for another "entry point" to involve the destitute in its development activities. In the IGVGD program, BRAC uses food grain relief assistance to attract the hardcore poor and cater to their immediate consumption needs but then adds skills training and savings and credit services to build their development capacity. After the free food grain ends, participants are able to engage in income generating activities and become clients of regular microfinance programs. Training options available are poultry and livestock raising, vegetable growing, sericulture among others. Trainings are done within 6 months at which time, participants are required to save a minimum of US$0.50 per meeting.

The IGVGD program was able to reach the poorest of the poor and has given them the opportunity to become active economic agents in society through livelihood training. The beneficiaries of the program are also taught the importance of savings and the proper use of loans. In a way, the program functions as a complementary market to microfinance institutions. The program educates the beneficiaries and has provided them with the proper tools to make them credit-worthy.

PROGRESS: Promoting successful 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. Of those that aspire to grow beyond trading businesses, only 1 to 2 percent will graduate into small-enterprise level. While the provision of business development services (BDS) is becoming a popular intervention among microfinance clients, the provision of these non-financial services needs to be scaled up to help the poor enter the formal market economy. Microfinance needs to evolve into microenterprise development.

The policy and regulatory environment has improved for the past ten years, although much remains to be improved to promote the progress of microentrepreneurs. The passage of the Barangay Micro Business Enterprises Act in 2002 provides for tax (e.g. income tax exemptions from enterprise operations), as well as other forms of incentives (e.g. one-stop business registration centers, special credit windows) to BMBEs, such as simplified registration with the local government units.

Despite this law, very few businesses have registered as BMBE. One possible reason is that they are required to register with the Bureau of Internal Revenue (BIR) as a taxpayer before they can avail of incentives. This could be a disincentive considering that many micro and small businesses are neither registered with the BIR nor paying taxes. Since most are operating underground, to come out in the open would put them into the mainstream of taxation. There may be a need to review the effectiveness of this law. Another reason is the too stringent documentation requirements for the registration of BMBEs and availment of tax incentives, although the Department of Finance (DOF) has previously simplified registration requirements for BMBEs with assets of P300,000 or less.

In a recent study on the impact of the implementation of the BMBE Law, UP-ISSI noted that, of the 1,610 LGUs in the country, only around 20% or 316 LGUs have reported to DOF-Bureau of Local Government Finance (BLGF) on the status of BMBE implementation. Of the 316 that reported, 53% or 175 LGUs implemented the law while 47% or 155 LGUs did not do so. The most frequent response on the non-implementation was that no BMBEs exist in their locality. According to UP-ISSI, this may not be plausible since microenterprises comprise 91% of all enterprises. Another common reason given was that administrative costs of registering BMBEs exceed P1,000, the maximum amount that can be collected by an LGU in registering microenterprise – therefore an incentive for LGUs. Other reasons given were the complex documentary preparations, the lack of information dissemination (i.e., microenterprises are unaware of the existence of the BMBE Law), absence of local ordinance, lack of LGU personnel to handle BMBEs and perceived inadequate benefits. The study concluded with the need to revisit the law by looking at the whole policy and institutional framework in the implementation of the BMBE Law to include registration procedure, incentives and benefits, information dissemination and the development of “champions” of microenterprises.

The recent passage of the Micro, Small and Medium Enterprise Law should expedite the development of microenterprises in the country given all the necessary incentives and support already provided and available to them under the law.

The NCC, in collaboration with NAPC, came up with a guide for MFIs on Business Development Services with the end goal of developing more client-centered approaches to enhance enterprise productivity and competitiveness, ensure sustainable business operations, and enhance incomes. The guide aims to help MFIs choose appropriate strategies to improve the access of their clients to BDS and at the same time ensure the provision of sustainable financial services. It also serves as a reference for MFIs and their clients on available BDS from existing service providers. Two important components of the guide are the training tools on entrepreneurship and business development and techniques in determining the BDS requirements for clients. It likewise has a directory of BDS providers to serve as link of existing entrepreneurs (on their expansion or diversification plans) and new entrepreneurs (on managing their business).

The delivery of BDS is usually carried out by way of direct services to microenterprises. This has been the case during the 1980s up to mid 1990s. However, according to Rodriguez (2010), the traditional model has its limitations: a) organizations can reach only a limited number of MSEs, b) BDS delivery can not be sustained beyond the life of projects through which they are funded and c) the cost to impact ratio of this model is quite high. As a result, other modes of BDS delivery have emerged since mid 1990s, which include the facilitation/market development model and systemic market development model . A number of institutions in the Philippines have also tried and adopted these two new models. The Table below summarizes the features and users of the different models.

Table 3. Summary of BDS Approaches

Approach	**Advantages**	**Disadvantages**	**Example Institution**
Direct Delivery	♉ Can tailor service to the needs of the client/beneficiary ♉ Can build up specific capacity to deliver	♉ Limited reach ♉ May require subsidies ♉ If subsidized, cost to impact ratio is high ♉ Limited impact given other needs/gaps	CCT, CARD, INSOL, TSPI, PDAP, ECHO Store, MUAD, PBSP, CORDNET (Other Examples: Notre Dame Business Center, Government agencies, universities, commercial providers)
BDS Market Development	♉ Long-term sustainability ♉ Wider reach ♉ Development of private-sector providers	♉ May take longer to deliver needed services, especially in weak markets ♉ Not all needed services will be available from commercial providers	TSPI, PDAP, MUAD, CORDNET (Other examples: Pinoy ME Foundation, Plantersbank, Peace and Equity Foundation

Systemic Market Development	♉ Sustainable cost recovery ♉ Effort to address all gaps (wholistic/ integrated solutions) ♉ Easily recognizable value ♉ Focused on market	♉ Requires greater management effort to build and maintain relationships ♉ Requires significant investments	TSPI, CARD, PDAP, MUAD, UMFI, ECHO Store (Other examples: Normin Veggies, PEF PCCI Village Store, SDC Asia)

Source: Rodriguez (2010)

The ten (10) institutions involved in the study confirmed that more systemic approaches (value chain development) should be adopted in the future because it is more sustainable and provides for greater impact and effectiveness in the long-run. Regardless though of the model one adopts, Rodriguez (2010) stressed that market assessment and organizational capability are critical in the successful implementation of BDS.

The government has also been active in promoting and implementing BDS. There are several programs that promote and facilitate the provision of BDS to microenterprises, many of which are either enshrined in laws that were passed in recent years or forms part of the mandate of government institutions providing BDS (see Annex 2).

One important capacity building fund that is government-implemented is the People's Development Trust Fund (PDTF) created under RA 8425 or the Social Reform Poverty and Poverty Alleviation Act. Said Fund is being administered by the PCFC. The PDTF though, since its creation, has been constrained by lack of funds so that very few have been benefited from this capacity-building program. PCFC and NAPC have, in the past, been pushing for additional budget to support wider coverage of the PDTF.

IMPACT: Balancing between profitability and social mission

Commercialization of microfinance has indeed hastened outreach as well as viability and sustainability of the industry. There is growing concern that commercialization has led to mission drift away from MFIs' goal of reducing poverty. Studies show however that commercialization has not diverted MFIs from their mission, at least in the case of Indonesia and Philippines. In fact, the experiences of several MFIs have shown that the commercialization level and depth of outreach have increased in tandem (Charitonenko, Campion and Fernando, 2007). In Indonesia, Perum Pegadaian (PP), a state-owned pawning company, and Bank Rakyat Indonesia (BRI) Units, the two main commercial providers of microcredit to poor borrowers, both experienced increase in microcredit client base. PP increased the number of customers it served from 9.8 million in 1998 to 15.7 million in 2001. BRI likewise saw its base reaching 2.9 million from 2.5 million over the same period. Average loan amounts in both institutions have remained relatively constant during this period, signifying that their target markets have remained essentially the same over time. The experience of USAID-funded CUES Project in the Philippines provides proof that an MFI's level of commercialization and depth of outreach can increase together. From December 1998 to December 2002, member-client outreach of the Project increased by 500 percent from 36,443 to 218,354. Three quarters of these member-clients were poor rural women and 107,744 of them had outstanding loans at the end of 2002, with an average outstanding balance of US$271, indicating a commitment to low-income disadvantaged borrowers (Charitonenko, Campion and Fernando, 2007).

Even as there is a positive correlation between financial sustainability of MFIs (through commercialization route) and outreach, the social impact – especially on poverty reduction -- of many lending programs have been mixed.

In 2007, the ADB conducted a special evaluation study to assess the impact of selected microfinance projects[25] in reducing poverty of rural poor households and in improving the socioeconomic status of women.

The impact study in the Philippines[26] revealed the following results:

- Positive impact on per capita income of the beneficiaries, with income of those that received microcredit loans increased by P5,222 per year compared with those that did not receive a loan;[27]
- Mildly positive impact on per capital total expenditures and per capita food expenditures;
- However, the impact on per capita income and expenditures was found to be regressive (i.e., the impact was negative on households with per capita incomes of less than P34,428, and become positive only for households with per capita incomes above P56,200). This result is similar to other studies on the provision of microcredit in Bangladesh, India, Indonesia, Sri Lanka, and northeastern Thailand. The finding suggests

[25]These include (i) the Rural Microenterprise Finance Project in the Philippines; (ii) Participatory Livestock Development Project in Bangladesh; (iii) Second Participatory Livestock Development Project in Bangladesh; (iv) Rural Livelihood Project in Bangladesh; and (v) the Small and Microfinance Development Project in Uzbekistan.

[26] The study used a quasi-experimental design that required treatment and comparison areas for each of the 28 microfinance institutions. These areas were geographically different from each other. Two types of household respondents were covered by the surveys: (i) households that received microcredit loans, and (ii) households that did not receive microcredit loans but qualified to join the program. Econometric estimation techniques were used to estimate the impact of microfinance on the beneficiaries. Controls were applied to address biases known to be associated with microfinance impact assessments.

[27] See also Kondo, Orbeta Jr., Dingcong, and Infantado (2008) and Manlangit (2004)

that targeting microfinance on the poorest households may not be the most appropriate way to help them escape poverty;

- The regressive impact found in the Philippine project which is also reported in other studies, raise the issue of whether ADB should continue to support microfinance projects designed to target the poorest of the poor or the ultra poor;
- Positive effects on the status of women[28], particularly in the household. The following changes were observed: (i) greater role in household generation of cash, (ii) greater involvement in making major expenditure decisions and generating cash savings, (iii) ability to generate more income on their own and greater role in business decision making, (iv) acquisition of more skills and expanding their network of friends and support system, and (v) increased acquisition of assets. These observations were supported by the results of the sample surveys in Philippines and Bangladesh of women that participated in microfinance programs. These surveys showed an increased role of women in accessing finance; managing their businesses; and improved relationships between husbands and wives, joint decision making, and sharing of household responsibilities.

Based on the above findings, the study recommended that ADB should bear in mind the need to:

- Adopt a more focused and deliberate approach in targeting.
- Use internationally accepted guidelines and principles for the design of microfinance projects.
- Build staff technical capacity in microfinance.
- Include plans for rigorous impact evaluations during the formulation of selected microfinance projects.

According to Karlan and Zinman (2007), the impact of credit may be particularly problematic to evaluate because of selection bias. It is likely that those who choose to borrow are more "driven" in some way than those who do not, yet there is no way to account for unobservables like "drive." Simply comparing borrowers to non-borrowers will yield a flawed estimate of the impact of credit. This issue seems particularly relevant in developing countries where microfinance organizations tout the entrepreneurial spirit of their borrowers as a critical component of success. Comparing these clients to non-clients would likely overstate the impact of credit. Conversely, programs that target the poor might appear less effective than they are in reality because their clients are poorer than non-clients. To determine the impact on household welfare of consumer credit on marginal groups[29] in a field experiment on a consumer credit program in South Africa, the authors used randomized controlled trial avoids bias problems. The expanded access to credit significantly improved average outcomes. Treated households were 5.8

[28] The Bangladesh and Uzbekistan cases showed positive results as in the case of the Philippines.

[29] The loan product was a four-month loan at 11.75% per month, charged on the original balance. Interest was charged up front, and the loan was then amortized into four equal monthly repayments. The median loan size made under the experiment was $127, or 40% of the median borrower's gross monthly income.

percentage points less likely to report hunger, and 3.7 percentage points more likely to report a food quality improvement. The median treatment household showed an estimated R3,500 (or 16%) increase in income and treated households were 7.4 percentage points more likely to fall above the poverty line, a 19% reduction in poverty.

The positive impact on poverty was also evident in the study on the impact of Ahon sa Hirap (ASHI) – the first serious replication of Grameen Bank in the Philippines -- made by Todd (2000). At entry, 76% of ASHI's clients were very poor; with ASHI, only 13% are in this category. Most clients had moved from a position of extreme poverty to moderate poverty, but only 22% had moved right out of the poverty group. It is possible that some clients who had moved out of poverty had fallen back because of the economic downturn.

There was a sharp contrast between clients and non-clients in poverty status, with half the non-clients still 'very poor'. The most dramatic shift is in Talim, which was the poorest of the three communities at entry, but is now the least poor. ASHI women clients were overwhelmingly self-employed, while almost half of the non-clients were either not earning, or doing menial, low-paid work for others. The movement of ASHI clients out of poverty was supported by ownership of productive assets – 54% owned productive assets, like machinery, vehicles or livestock of Ps5,000 to Ps.35,000 in value and 22% owned assets of above that value.

In 2001, an opportunity to bring IA to a higher level of understanding came about through the *Imp-Act* programme. The programme's immediate objective is to help CARD build a social performance assessment system that clearly defines the IA process, including choice of impact indicators, and methods of data collection, analysis and reporting. The CARD Board eventually approved the use and tracking of indicators in the following core impact areas: *housing, productive assets, children's education and food security.* (Joyas and Alip, 2001). CARD, along with MCPI, have been promoting and supporting impact-monitoring and assessment among their respective network members.

A comprehensive study on measuring social performance of microfinance institutions was that of Hashemi and Foose (2007), emphasizing that, while growth is important, it is equally important that poor and very poor people are reached, that quality services are provided, and that microfinance improves client lives. In other words, both financial performance and social performance matter. This is especially true for some donors and social investors who explicitly aim for broader social objectives. Quoting the Social Performance Task Force, they defined social performance as "the effective translation of an institution's social goals into practice in line with accepted social values; these include sustainably serving increasing numbers of poor and excluded people, improving the quality and appropriateness of financial services, improving the economic and social conditions of clients, and ensuring social responsibility to clients, employees and the community they serve."

Llanto, Garcia and Callanta (1996) emphasized the importance of viability and sustainability of MFIs . Their paper showed that many MFIs' operations are far from attaining these goals. They recommended the following measures: (a) build up the equity base of MFIs by infusing more capital from existing owners and new investors; (b) diversify loans, savings and other financial products according to client demand; (c) maximize savings mobilization opportunities; (d) promote training in financial operations, resource mobilization, portfolio management, risk assessment and management, product packaging and pricing, management of loan arrears, strategic and business planning, among others; (e) improve systems and procedures such as automating systems and operating procedures, upgrading and institutionalization of performance standards, setting, up internal audit systems, conduct of periodic management audits, installation of updated and standardized accounting and reporting system. (f) professionalize management and staff of MFIs.

Microfinance Policies

This part discusses the evolution of microfinance policies from the 1950s to current times.

Directed credit programs

Poverty reduction has always been the overarching goal of the government. This goal, along with the strategies, are normally embodied in its medium-term blueprint. Poverty in the Philippines remains pervasive with roughly one-third of the almost 90 million Filipinos still wallowing in poverty.[30] Majority are concentrated in the countryside or rural areas, but urban poor is also increasing with the proliferation of slum areas in major urban areas and rapid urban migration and population growth.

Previous administrations attempted to address the problem of poverty with directed credit programs (DCPs), in combination with other strategies such as greater investments in physical and human capital. [31] DCPs were even used as a major tool to combat rural insurgency in the 1950s and 1960s and played a critical role in stimulating food production programs in the 1960s and 1970s.[32]

In the 1970s, up to the early 1990s , the government adopted DCPs as a major policy tool in alleviating poverty. Funds for these DCPs, which were mainly implemented in the agriculture sector, were earmarked for direct availment by targeted sectors at highly concessional rates. These credit subsidies were intended to bring down the cost of borrowing for the targeted sectors.

The loanable funds came from three sources: government budget or appropriations from the budget of agencies implementing DCPs, special funds, and external borrowings from bilateral and multilateral agencies. Loans were extended by channel institutions – rural banks,

[30] Thirty (30) out of 100 Filipinos in 2003 had income short of the minimum cost of satisfying the basic requirements, an improvement from 2000 in which 33 out of 100 Filipinos had income below the poverty threshold
[31] DCP refers to the channeling of financial resources to a select sector of the population for a specific purpose. Physical capital refers to basic infrastructure and services such as shelter, transport, energy, water and sanitation, and communication. Human capital refers to health, education and skills upgrading.
[32] The 1950s and 1960s were considered as the period of modernization so that development was synonymous with increased national production/GDP growth and the benefits of modernization would eventually trickle down to the poor. Trickle down effect hardly took place though.

government financial institutions, development banks – including government line agencies which do not have the capability and beyond its mandate to implement DCPs because their personnel are not trained to handle financial matters. Greater private sector participation in credit programs was constrained by the existence of so many highly subsidized credit programs.

DCPs, as a policy tool, became popular to politicians since they are relatively easy to implement and provide government high visibility, unlike infrastructure programs which take time to implement. DCPs are also perceived to have immediate effect on the target beneficiaries because the benefit, i.e., financial assistance, directly inures to them.

Feedback/studies show, however, that government DCPs were inefficient and ineffective.

- As of 1997, there were 86 on-going DCPs being implemented by 42 non-financial government agencies and government financial institutions, of which 46 were in the agriculture sector
- The 63 DCPs that had financial reports showed that their combined initial fund allocations amounted to P40.5 billion (or 1.8 percent of GNP in1996)
- There was limited outreach of DCPs especially those implemented by line agencies compared to those implemented by GFIs due to low turn around of loanable funds or slow average repayment rate. Out of the 30 DCPs evaluated (only those with complete data), 10 were found to be inefficient and have low outreach indices. The remaining 20 had high outreach indices but were inefficient.
- Some borrowers viewed the loans as dole-outs and do no bother to repay the loans, resulting in poor loan recovery DCPs implemented by GNFAs reached an average of 22,721 beneficiaries per program compared to 38,332 beneficiaries per program of GFIs
- The average repayment rate of DCPs implemented by GNFAs was only 73 percent as against the 92 percent repayment rate of DCPs implemented by GFIs.
- Loan funds mostly found their way in small and medium enterprises, not microenterprises or those considered non-bankable.
- 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.
- Large scale borrowers or those who are relatively well-off captured a larger proportion of the subsidy than those who are less well-off.

The inability to recycle funds due to low average repayment rate prompted many agencies to request for additional capital infusion to continue to run their program. Additional equity to poorly performing intermediaries, along with interest and default subsidies extended by government, created huge fiscal costs. For instance, the government coughed up P1.897 billion in interest and default subsidies for the 20 programs alone in 1996. Worse, the subsidy policy saw private financial institutions becoming dependent on cheap government funds, discouraging them from mobilizing deposits. Access to cheap rediscounting facilities made intermediaries more dependent on external funds for on-lending.

The performance of DCPs was increasingly criticized starting in the late eighties. In some countries, their government started eliminating subsidized credit programs because of their serious fiscal impact. Many experts from the private sector – economists, development specialists and microfinance practitioners -- also assailed credit subsidies because they were ineffective in alleviating poverty, and they weakened the ability of financial markets to intermediate between savers and borrowers. These findings prompted the donor community to re-assess their development programs. The World Bank, for instance, issued a major statement in the late 1980s recommending that donors and governments abandon interest rate ceilings and directed credit programs that involve subsidies to targeted borrowers.

In the Philippines, it was noted that directed credit was a failure in promoting effective and sustainable rural financial markets which led to question to question whether the government's scarce resources can be utilized more effectively and efficiently through other strategies or mechanisms for rural income expansion and poverty reduction (Badiola,2007)

The experience of Taiwan, South Korea, Hongkong and Singapore was worth noting, as these economies experienced unprecedented growth following the shift towards market-based policies such as interest rate liberalization. Such liberalization move allowed greater freedom of entry into the financial market which increased the number and competitiveness of banks and other types of financial institutions serving the basic sector such NGOs and cooperatives.

The Philippines followed suit. The disappointing result from the subsidized credit programs prompted government to shift to a market-oriented regime in financial market. Thus, major changes took place -- concessionary rediscount lines in the Central Bank were removed , interest rate policies were liberalized and termination of direct lending by some government agencies implementing credit programs in the agriculture.

Previously, the rediscount window was used by the Central Bank to direct the flow of credit through banks to priority sectors by giving these sectors preferential rediscount rates which could be as low as 1.0 percent and a rediscounting value which could be as high as 100 percent. This policy was changed in 1985 when the Central Bank started setting one rediscounting value equivalent to 80 percent of the value of the original loans and one rediscount rate for all eligible papers which was aligned with the market rate beginning in that year (Lamberte,1998). However, the same author noted that, while these reforms were introduced, there was increased proliferation of subsidized credit in the industry and manufacturing sector especially for small and medium scale industries. These contradictory policies merely reflected the attitude of the government to accommodate opposing views, which unwittingly led to the adoption of an incoherent financial sector development policy framework

The paradigm shift

Concerned about the basic (poor) sector not being able to access financial services and private financial institutions being averse to serve the financial needs of the poor, a broad alliance of government, non-government, and people's organizations established the Social Pact on Credit on October 8, 1993. The Pact called for rationalization of credit programs and policies to make them more accessible by the basic sector. This Pact became a component of the broader Social Reform Agenda which was the government's main blueprint to address poverty. Even if there were already reforms initiated in the past, there was no comprehensive policy framework on credit programs at the same time an institutional champion to take the driver's seat of the reform process and monitor implementation (Lamberte,2006). Thus, the NCC was created in 1993 to provide the government an instrument for leading and managing the credit policy reform process.

The NCC is a multi-sectoral policy body created in 1993 through Administrative Order No. 86 to meet the need to rationalize credit policy. It is chaired by the Department of Finance (DOF), with Landbank of the Philippines as Vice-Chair. Its membership is composed of the stakeholders in credit policy and delivery. The NCC has the following functions:

a. Rationalize and optimize, on a sound basis, the use and delivery of the various credit programs of all government institutions in order to harmonize, and where deemed necessary by the Council, consolidate activities through regular lending transactions, taking into consideration such parameters as clientele and local area characteristics, interest rate policy, delivery mechanism, mobilization proves, and fund sourcing;
b. Develop, through multi-sectoral consultations/linkages and policy dialogues, a national credit delivery system, incorporating the attendant capability upgrading and institutional strengthening mechanisms toward enhancing the credit beneficiary groups' productive capability and the financial intermediaries' efficiency and effectivity;
c. Encourage a higher level of private sector participation , with its extensive network of commercial banks whose combined resources are far greater than that of government, in the credit delivery of countryside small and medium enterprises and rural entrepreneurs to spur countryside development and the creation of wok places with small per capita investments as well as the setting up of rural infrastructure and other economic projects;
d. Define and rationalize the role of guarantee programs and guarantee agencies. Review the adequacy of guarantee funds and coverage with the goal of undertaking the necessary adjustments thereto.

Originally, the LBP acted as the Secretariat of the NCC. The Secretariat was later transferred to the DOF to avoid any conflict of interest that may arise from LBP's active involvement in delivery of credit programs.[33]

The National Strategy for Microfinance

In 1997, the NCC, in consultation with various stakeholders, drafted and issued the National Strategy for Microfinance which outlines the vision and strategies for developing the country's microfinance market. The vision is to have a viable and sustainable micro financial market in a market-oriented and liberalized economy.

The Strategy has four salient features:

1. Provision of an enabling policy environment through the appropriate policy and institutional framework to facilitate increased participation of the private sector;

[33] Administrative Order(AO) No. 250 6 February 1996)

2. Adoption of market-oriented financial and credit policies such as market-oriented interest rates on loans and deposits;
3. Non-participation of government line agencies in the implementation of credit and guarantee programs. Instead, these line agencies shall focus on providing infrastructure and capacity-building; and
4. Greater role of the private sector particularly private financial institutions in the delivery of financial services to the poor

The Strategy embodies new paradigm, veering away from directed or subsidized credit policy that was government-driven to a private-sector-driven market. It defines the government's role as the provider of appropriate and enabling policy and regulatory directions. On the other hand, donors can best optimize utilization of its assistance primarily by way of capacity building activities.

Enabling laws

The development of microfinance as a government policy called for either amendment of certain laws or creation of new ones. Putting policies within the spectrum of a law would put policies on a firmer foothold, something that can not just be reversed by whims and caprices of some sectors. One of the challenges faced by the government, particularly the NCC which has been in the forefront of microfinance policy reforms, has always been the pursuit of reforms and policies that require the enactment of laws that would be the basis for implementing the National Strategy.

Thus, policy advocacy became an important activity for the NCC to win support for its policy reforms. This involved activities ranging from talking to influential congressmen and senators, creation of inter-agency technical working groups, conduct of regional consultations, and the issuance of policy notes and technical papers that provided direction on credit policy. Clearly, these "inclusive" strategies employed where all stakeholders can claim ownership to the reforms initiated paid-off.

For instance, the market-based financial and credit policies advocated by NCC was adopted and incorporated into the credit provisions of the Social Reform and Poverty Alleviation Act and Agriculture and Fisheries Modernization Act passed in December 1997. These two landmark legislations adopted the principles of the National Strategy crafted by the NCC. Three important features of these two laws are the phase out of DCPs, the designation of GFIs as wholesaler of funds and the creation of the People's Credit and Finance Corporation as the forerunner of wholesale credit funds as well as the establishment of People's Development Trust Fund (PDTF) – a fund for capability building of MFIs and their clients.

The table below shows the major enabling laws/measures adopted to implement the National Strategy[34]:

[34] Draws largely from Lamberte (2006)

Table 4. Laws/Measures Adopted to Implement the National Strategy for Microfinance

Measures	Key Provisions
Enactment of the Social Reform and Poverty Alleviation Act (December 11, 1997)	▪ Market- based interest rate policy for microfinance ▪ Government funds used only for capacity building purposes ▪ Emphasis on savings mobilization ▪ Established the People's Credit and Finance Corporation, the forerunner of microfinance services through wholesale lending
Enactment of the Agriculture and Fisheries Modernization Act (AFMA) [December 22, 1997]	▪ Phase out of DCPs in the agriculture sector ▪ Adoption of market-based interest rates ▪ Non-provision of credit subsidies ▪ Government financial institutions (GFIs) acting as wholesalers of funds
Issuance of Executive Order 138 (August 10, 1999)	▪ directs government agencies implementing credit programs to adopt the NCC Credit Policy Guidelines. <u>**What are these guidelines?**</u> ➢ non-participation of government non-financial agencies in the implementation of credit programs ➢ government financial institutions to be the main vehicle in the implementation of government credit programs ➢ adoption of market-based financial and credit policies
Enactment of the General Banking Law (GBL) [May 23,2000]	▪ Recognition of peculiarities of microfinance e.g. allows cash-flow based lending and collateral-free/non-collateralized loans ▪ Makes banking rules and regulations more "microfinance-friendly" i.e., lifting of moratorium

Measures	Key Provisions
	on branching by microfinance banks ▪ Issuance of BSP Circular 272 on January 30, 2001 implementing the microfinance provisions of the GBL
Enactment of the Barangay Microbusiness Enterprise Act (BMBE)	▪ Requires market-based interest rates for loans to barangay or village-based microenterprises ▪ GFIs acting as wholesalers of funds ▪ Setting up of a special credit window, within a GFI, that will provide credit to barangay microenterprise business at market-based interest rates
Enactment of the Micro,Small and Medium Enterprise Law (May 2008)	▪ Facilitating access to sources of funds ▪ Complementing and supplementing financing programs and doing away with stringent and burdensome collateral requirements ▪ Encourage development of other modes of financing such as leasing and venture capital activities ▪ Provide effective credit guarantee systems ▪ Provision of concessional rates, lower financing fee
Enactment of the Credit Information Systems Act (October 31,2008)	▪ Establishes a comprehensive and centralized credit information system for the collection and dissemination of fair and accurate information relevant to, or arising from, credit and credit-related activities of all entities participating in the financial system ▪ Directly addresses the need for reliable credit information concerning the credit standing and track record of borrowers. An

Measures	Key Provisions
	efficient credit information system will also enable financial institutions to reduce their over-all credit risk, contributing to a healthier and more stable financial system.
Amendment of the Cooperative Code of the Philippines	▪ Start up capital from P2,000 to P15,000 ▪ CDA is authorized to increase the required capital after every five (5) years whenever necessary ▪ Credit cooperatives now include multi-purpose cooperatives that provide savings and credit to their members. ▪ Existing credit and multi-purpose cooperatives shall inform the CDA of its intention to continue performing its present functions. ▪ Should the said cooperatives decide to exercise enhanced functions, it shall notify the authority and satisfy the requirements for conversion to financial service cooperative ▪ Financial service cooperatives authorized to provide: (a) Savings and credit to their members; and (b)Other financial services subject to regulation by the BSP. ▪ Articles of cooperation and by-laws of any financial service cooperative, or any amendment thereto, shall be registered with the CDA only if accompanied by a certificate of authority issued by the BSP

The issuance of EO 138 in 1999 complemented the SRPAA and AFMA laws passed in 1997. This EO directs government entities involved in the implementation of credit programs to adopt the credit policy guidelines formulated by the NCC. These guidelines include the following:

- Instead of directly providing credit, GNFAs shall focus on the provision and facilitation of critical services such as rural infrastructure and capability building services;

- GFIs shall be the main vehicle for the delivery of credit services to clientele by providing wholesale funds to private financial institutions that includes rural banks, credit cooperatives, cooperative banks and microfinance NGOs; and
- The interest rates charged for government credit programs should not be less than the prevailing market rates.

One important strategy adopted by the government was to encourage banks to go into microfinance. But this hinged on the need for a clear legal and regulatory framework that would promote and support the bank's microfinance activities. Hence, the General Banking Law of 2000 was passed to provide for clear policy framework for promoting microfinance activities of banks. This law recognizes the peculiar characteristics of microfinance (such as cash flow lending to the basic sectors that are not covered by traditional collateral) in formulating rules and regulations on the grant of loans or other credit accommodations. The GBL has brought microfinance into mainstream banking in the country.[35] The law also allows the adoption of more microfinance friendly banking rules and regulations to allow greater participation of microfinance-oriented banks. These include the lifting of the moratorium on the licensing of new thrift and rural banks to allow the entry of microfinance-oriented banks and the lifting of the moratorium on bank-branching for microfinance-oriented banks.

The GBL likewise has opened the door for banks to engage in microfinance operations. These have created opportunities for large commercial banks to be involved in microfinance by acting as wholesalers of funds to MFIs. The greater participation of big banks is expected to reduce pressure on the part of government to borrow funds from donor agencies to increase resources of GFIs for on-lending to MFIs. To date, around 10 BSP Circulars related to microfinance have been enunciated.

As a result of the law, the BSP underwent restructuring of its supervisory and examination sector and training of its personnel to acquire new capacities to effectively supervise and regulate banks engaged in microfinance operations.

Regulatory Framework for Microfinance

While the government's policy directions on microfinance have been clearly laid out with the passage of various measures, the NCC, in coordination with concerned stakeholders, issued a regulatory framework to clarify the regulatory agency responsible for supervising and regulating them.

Under the framework,

- Only institutions taking deposits from the general public and/or from its members are subject to prudential regulations and supervision;
- Banks will be regulated by the BSP;
- Credit cooperatives are under the regulatory authority of the CDA;
- Microfinance NGOs that collect savings beyond the compensating balance will be required to transform into a formal financial institution (either a credit coop or a bank)

[35] See Sections 40, 41, 43 and 44 of the General Banking Law of 2000 or Republic Act 8791.

- Microinsurance will be under the jurisdiction of the IC

As provided for in the framework, a common set of performance standards for all institutions engaged in microfinance was developed.[36] In October 2005, government and private sector organizations signed a memorandum of agreement to formally adopt and implement the PESO in the conduct of their respective mandates.

The standards were developed to allow greater transparency in the operations of MFIs. More particularly, the standards will provide the user the necessary basic tools that will facilitate the evaluation and assessment of the operations of the MFIs and compare their financial performances, regardless of whether it is a bank, cooperative or an NGO. The indicators and standards could be used in various ways. Donor agencies can use these standards in identifying the type of assistance to be extended to a MFI. MFI management can use these indicators and standards in identifying weak areas in their microfinance operations and determining the appropriate measures to improve operations. Domestic and international private sector investors can use these standards as barometer in deciding whether they will invest in a certain MFI or not. Wholesale financial institutions, whether private or government, can use these standards in assessing the creditworthiness of MFIs.

Legal and Regulatory Framework for Credit/Financial Cooperatives

Credit cooperatives play a critical role in mobilizing savings (from their members) and utilizing these savings in providing financial services for their members, especially in rural areas where a large number of cooperatives are operating. However, cooperatives were found to be poorly regulated and supervised, rendering their use as intermediary or conduit ineffective. The Cooperative Development Authority, which has oversight function over credit cooperatives, was not effectively performing regulatory and supervisory functions, as it was engaged primarily in registration and developmental activities.

Moreover, the CDA did not have the necessary information infrastructure to evaluate or gauge the performance of credit cooperatives (i.e., there was no standard chart of accounts and performance standards for credit cooperatives). Without these information, it would be extremely difficult to ascertain financial status and performance of credit cooperatives. Lamberte, who did a study of the performance standards of credit unions in the 1980s found it hard to apply a few set of performance indicators because the sample credit unions were using different charts of accounts with varying details. More than 60 percent of the consultant's time was used in sorting out financial statements and deciding on which ones to be included in the analysis.

Thus, the NCC developed a standard chart of accounts which was completed in 2000 and the performance standards called COOP-PESOS in 2003.[37] In 2003, CDA issued Memorandum

[36] PESO – P stands for portfolio quality, E efficiency, S sustainability and O outreach-- which was launched in November 2004

[37] COOP is a checklist of questions that gives information on the SCC's compliance with legal and administrative requirements. It has specific list of questions on the following:

• **C**ompliance

Circular 03-04 mandating cooperatives with savings and credit services to use the performance standards and COOP-PESOS as a management and supervisory and regulatory tool.

To strengthen and effectively supervise credit cooperatives, the NCC developed the Manual of Rules and Regulations (MORR) in 2007, which provides for provisions that promote safe and sound operations of credit cooperatives as well as sanctions. In addition, the CDA started automating its operations built on the Coop Information Infrastructure System, which will allow on-line registration and monitoring of operations of credit cooperatives. A Manual of Supervision and Examination was likewise developed to serve as a guideline for the supervision and examination work of CDA examiners. The Manual has been pilot-tested and applied to a select credit cooperatives.

Government initiatives for the cooperative sector:

- Standardized the Chart of Accounts for Savings and Credit Coops (SCCs)
- Formulated the Performance Standards for SCCs (COOP-PESOS)
- Developed the Manual of Rules and Regulations for SCCs
- Building the capacity of CDA to regulate and supervise SCCs
- Establishing the Coop Information Infrastructure System
- Drafting the Manual of Supervision and Examination for SCCs
- Passage of Amendments to the Cooperative Code

Microinsurance initiatives

The government recently launched the National Strategy and the Regulatory Framework for Microinsurance. The need for these initiatives was based on the following:

- *The need to provide for appropriate policy and regulatory environment that is conducive to the effective and efficient functioning of the private microinsurance market.* The National Strategy for Microfinance has provided the impetus for microfinance activities, including the provision of microinsurance to the basic sector by MFIs, to thrive. But while clients have grown from 500,000 clients to around 3.6 million at the end of 2007 (Llanto, et al 2008), penetration level of microinsurance remains low. Worse, many microinsurance or risk protection contracts are provided through informal schemes.[38]

- **O**rganization
- **O**perations and governance
- **P**lans and programs/performance

PESOS provides specific indicators and standards that determines the financial performance of the SCC. It stands for:
- **P**ortfolio quality
- **E**fficiency
- **S**tability
- **O**perations
- **S**tructure of Assets

The need to mainstream informal insurance. The in-house insurance schemes being offered by MFIs lack appropriate actuarial computations, unregulated and wanting of management and technical capacity. These expose the members and MFIs to great risks. There is therefore a need for safeguards to protect not only the interest of the members or clients but also the operations of the MFIs.

- *The need to institute financial literacy.* Since formal insurance penetration is estimated to be only 3 percent of adult population (Llanto, et. al, 2008), there is an urgent need to promote public awareness and education campaign on the importance of microinsurance. The poor should realize that; without adequate protection against risks such as illness or injury, death of a family member, man-made calamities, natural disasters, and other contingent or unforeseen events; it would adversely affect their overall welfare.

The Regulatory Framework clarifies the scope of activities to be covered by the framework, [39] defines the term "microinsurance" and "microinsurance product", [40] outlines the entities who can provide microinsurance products, enumerates the prudential as well as market conduct requirements, and provides for the establishment of performance standards and financial literacy programs.

Meanwhile, the National Strategy for Microinsurance cites as main vision the increased access of the poor to microinsurance products and services. This vision will be achieved through key policy strategies:

- Increased participation of the private sector in the provision of microinsurance services;
- Establishment of an appropriate policy and regulatory environment for the safe and sound provision of microinsurance by the private sector;
- Mainstreaming of informal insurance,insurance-like, and other similar schemes/activities; and
- Institutionalization of financial literacy (learning/education) that will highlight the importance of microinsurance, the applicable rules and regulations, the duties and responsibilities of the providers, and the rights of the insured.

The Strategy also identifies the key stakeholders in the microinsurance market, including their specific roles as well as the strategies to be pursued that include the provision of an appropriate

[38] Informal schemes refer to in-house insurance schemes developed and implemented by entities that do not have any license from the Insurance Commission or any other appropriate regulatory body.

[39] The framework does not cover social insurance schemes and risk protection programs administered and implemented by government such as those of Philhealth, GSIS and SSS.

[40] Microinsurance refers to the insurance, insurance-like and other similar business activity of providing specific products and services that meet the needs of the poor. Microinsurance product is a financial product or service that meets the risk protection needs of the poor where: the amount of premiums, contributions, fees or charges, computed on a daily basis, does not exceed five (5) percent of the current daily minimum wage rate for non-agricultural workers in Metro Manila; and the maximum sum of guaranteed benefits is not more than 500 times the daily minimum wage rate for non-agricultural workers in Metro Manila.

policy and regulatory environment, mainstreaming of informal insurance, and institutionalization of financial literacy.[41]

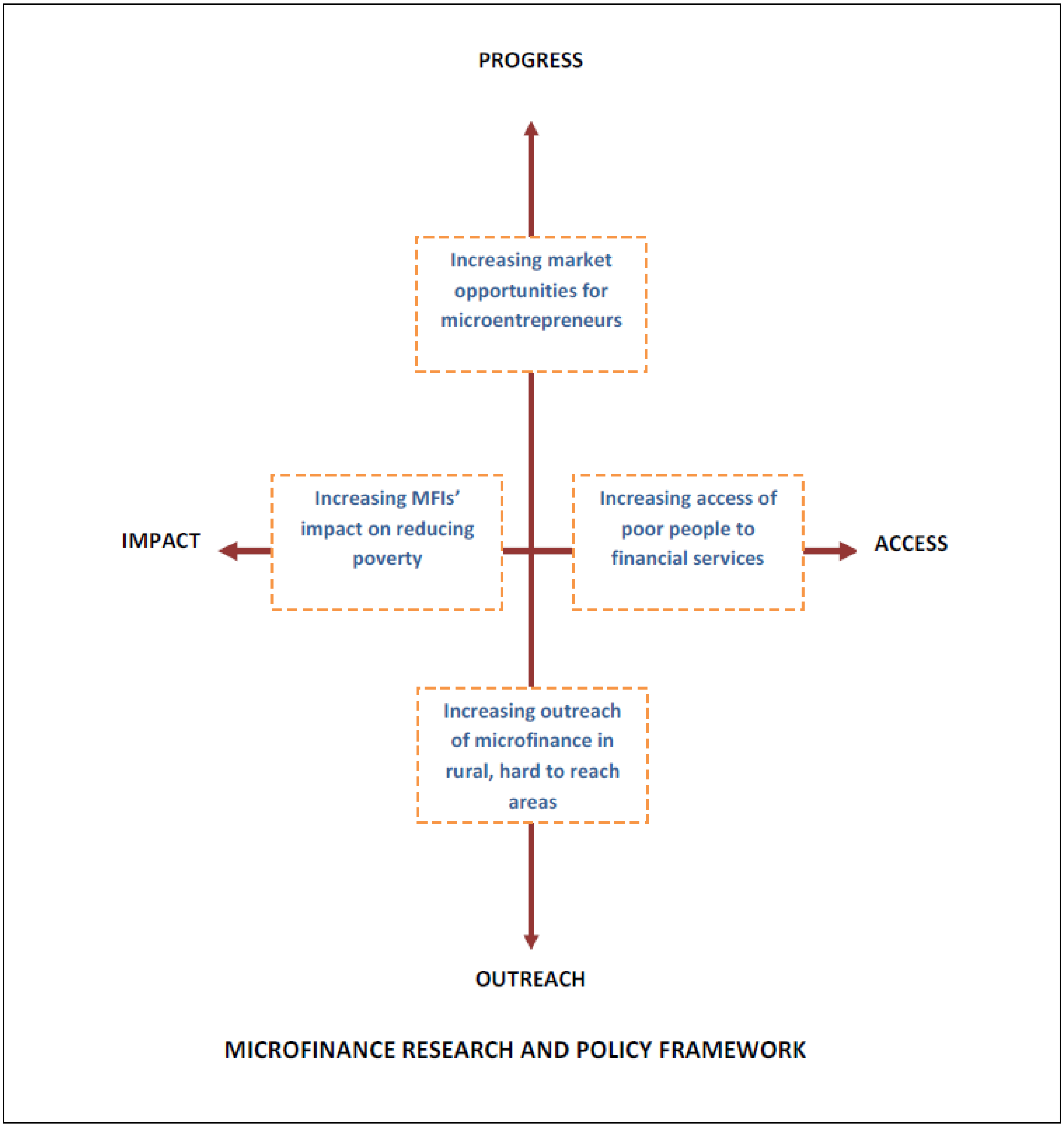
Some regulatory ambiguities existing in the market has been addressed with the passage of the Pre-Need Code which now considers pre-need plans as falling under the jurisdiction of the Insurance Commission. This law hopes to address the differing rules and regulations applied to these types of insurance products.

The issue on the eligibility of rural banks, thrift banks and cooperative banks to sell insurance products within their bank premises has been clarified with the issuance of BSP Circular No. 683. Many of these banks have been engaged in microfinance services and yet they are not allowed to offer microinsurance products. Only universal and commercial banks were allowed to sell financial products (including insurance) through their head office or any branch. As a result, rural banks option was to avail of group policy contracts with commercial insurers to cover credit life to protect their loans to bank clients. Under the new Circular, any rural, thrift or cooperative bank can present, market, and sell microinsurance products as defined under the Insurance Commission's Memorandum Circular (IMC) No. 1-2010 dated 29 January 2010, provided that the microinsurance product is duly approved by the Insurance Commission. In addition, these intermediaries can also service (i.e., collect premiums and pay claims) microinsurance products as collection and payment agents pursuant to Section 53.3 of the General Banking Law.

[41] The key stakeholders are government, policy and regulatory agencies, other national agencies and instrumentalities local government units, and social insurance providers, insurance and insurance-like providers,intermediaries, support institutions, and development partners.

Annex A

Policy Framework for Scaling Up Microfinance and Microenterprise Development



Annex B

Dimensions of Social Performance

The Social Performance Task Force[42] has rallied around a common definition of social performance -- "the effective translation of an institution's social goals into practice in line with accepted social values; these include sustainably serving increasing numbers of poor and excluded people, improving the quality and appropriateness of financial services, improving the economic and social conditions of clients, and ensuring social responsibility to clients, employees and the community they serve."

INTENT AND DESIGN
What is the mission of the FI?
Does it have clear social objectives, and are systems designed to achieve those objectives?

ACTIVITIES
What activities will the FI undertake to achieve the mission?

OUTPUT
Does the FI serve poor and very poor people?
Are the products designed to meet their needs?

OUTCOME / IMPACT
Have FI clients experienced social and economic improvement?

Social Performance Assessment Initiatives

<u>CERISE: Social Performance Indicators Initiative</u>

The CERISE tool is essentially a questionnaire and guide that helps an MFI evaluate its intentions, actions and corrective measures implemented, rather than transformations in clients. The underlying premise is that the analysis of internal systems and processes are adequate to

[42] According to Hashemi, Foose and Badawi, the Social Performance Task Force includes over a hundred leading microfinance networks, financial service providers, rating agencies, donors and social investors. These members are committed to regularly assessing, reporting on, and improving the social performance management of their organizations and the organizations they support.

determine whether an institution has the available means to attain its social objectives. The CERISE tool examines four dimensions of social performance: (1) outreach to the poor and excluded populations, (2) adaptation of products and services to target clients, (3) improving social and political capital, and (4) corporate social responsibility.

But rather than interviewing clients to determine depth of outreach, for example, the CERISE tool examines internal systems – the mission statement, whether targeting tools are used, loan size – to approximate whether poor clients are actually being served. Also rather than analyzing client empowerment at the household and community level, social and political capital of clients are determined through assessment of their involvement in MFI decision making and in the transparency of the financial transactions.

The appeal of the tool of course lies in its ease of use and the fact that it can be administered by the MFI. Long client level surveys are avoided. Instead available institutional information is mined to generate an assessment.

The Social Performance Assessment (SPA) Tool

The SPA tool combines a set of social performance indicators (a scorecard) at the level of the organization and a social audit to evaluate the social performance of MFIs. It is based on information on organizational processes rather than client outcomes and impacts. The rationale for this is explained in terms of cost considerations. It is far less expensive to focus on organizational process, especially on information that is already available, rather than create new formats for collecting new data. The organizational scorecard is based on the assumption that much of the financial information that financial institutions regularly collect can be used as proxies for their social performance. The scorecard includes a set of indicators under six dimensions of outreach—breadth, depth, length, scope.

The Accelerated Microenterprise Advancement Project (AMAP) for Financial Services Knowledge Generation developed the SPA tool for USAID. cost, and worth of outreach to clients and the community. The indictors are deliberately selected to reflect readily available information. For example, breadth of outreach reflects the number of borrowers, the percentage of clients with non-enterprise loans, and voluntary savers as a percentage of borrowers. Depth of outreach is determined through assessing average loan size, percentage of female clients, and percentage of rural clients. Scope of outreach includes number of distinct enterprise loan products, number of other financial services, the type of savings offered, and the percentage of clients with three or more products or services.

Indicators for assessing outreach to the community are the only ones that may not all be readily available, but they can still be collected from staff interviews. There are ten indictors for outreach to the community. They include: percentage of operating revenues reinvested back into the community, percentage of employees that have left, female-male employee ratio among professional level staff, benefits to employees, and transparency and management access for clients. The scorecard is supplemented by an independent "audit" that evaluates five key areas of an institution -- institutional mission, management and leadership; hiring and training;

monitoring systems; incentive systems; and strategic planning. The final social performance report includes both the scores from the organizational scorecard as well as the findings on internal processes from the audit. The tool does not attempt to measure social performance, per se, but rather determines the extent to which key performance indicators are consistent with social performance, and whether internal processes are designed and implemented in a way that aligns policies, behaviours, and outcomes with an MFI's stated social mission and whether it is likely to continue to do so in the future.

M-CRIL's Social Rating

M-CRIL has developed a social performance rating tool, administered externally by the rater, to assess "the likelihood of an MFI achieving its social mission in line with accepted social values." It covers both organizational level indicators and "results" indicators. It analyzes mission statements, institutional policies and internal systems of the organization to determine whether they effectively reflect its social mission and whether there are mechanisms in place for staff and client protection. The rating also assesses the efficacy of the services in meeting client needs. In addition short surveys are conducted to determine whether poor and excluded households are being served and whether clients are improving their social and economic conditions. The M-CRIL tool is much larger in scope than the others since it encompasses all different dimensions (intent, activities, output and outcome) of social performance.

ACCION's SOCIAL

ACCION has developed its own tool – the SOCIAL (social mission, outreach, client service, information transparency and consumer protection, association with the community, labor climate). It is a diagnostic tool to evaluate the success of an MFI in fulfilling its social mission and its contribution to broadly accepted social goals. It offers a comprehensive social assessment of MFIs to complement the financial assessment provided by the CAMEL.8 ACCION believes that its tool helps improve organizational performance by highlighting strengths and weaknesses in social performance, and providing information on how the MFI is perceived by clients, staff, and the community. It fulfills the information requirements of third parties, such as socially responsible investors or donors, who may require this information. It follows the example of many private sector businesses by providing share holders with a social performance report that demonstrates increased transparency and a broader framework for decision-making. It establishes a baseline of performance before entering a phase of change or evolution, as well as demonstrating to microfinance institutions how social performance can be measured practically on a regular basis. The SOCIAL is conducted through interviews with management, staff, board members, and clients. It includes reviews of strategic and business plans and minutes of board meetings. Data from MFI client databases are analyzed and validated through comparisons with external surveys, national data, MIX data, market studies and other secondary information. Branch visits are also made and maps of geographic coverage are constructed. To date, one pilot has been completed and others are in the pipeline.

The CGAP-Ford Social Indicators Initiative

While CGAP has welcomed the diversity of initiatives associated with assessing social performance, it strongly believes that what matters in the end is client level information. Internal structures and organizational level indicators are often weak predictors of performance. MFIs, for example, can have hierarchical structures and little staff or client participation in decision making, but yet be hugely successful in creating opportunities for clients that allow them to improve their social and economic conditions. So while internal process indicators may be relevant, CGAP feels, ultimately what is critical is indicators that demonstrate economic levels of clients and changes in client conditions. This led CGAP to partner with the Ford Foundation in 2005 to launch the Social Indicators Initiative. The CGAP-Ford initiative intended to track the social performance of MFIs by monitoring the levels and changes in the socio-economic conditions of clients without attempting to attribute causality. More specifically the project sought to develop indicators that could inform on:

- whether MFIs are reaching the very poor
- whether clients are increasing incomes and building assets
- whether client social conditions are improving

The challenge has been to select indicators that are simple and low-cost, yet at the same time rigorous enough and globally applicable. For example, the Cashpor Housing Index (which scores building material of walls and roof and number of rooms) is an excellent predictor of poverty and wealth in rural South Asia but not applicable in urban areas and in many countries. Data on incomes or nutritional intake, on the other hand, are universally understood but too costly and complicated for MFIs to collect. Early on, the project decided to measure poverty using national poverty lines and the international benchmarks of $1 (or $2) per person per day as global indicators of client economic levels and to link simple proxy indicators to these broad measures of poverty. The logic was simple: if most people living below the poverty line in rural areas of a country were landless, then landownership is a simple indicator of poverty that would be straightforward for MFIs in that country to collect. The percentage of landless clients could then be converted to a percentage of clients living below the national poverty line. If in another country quality of housing correlated well with poverty lines (e.g. a thatched roof implies living below the poverty line), then MFIs in that country could be collecting simple information on housing. This information could then be converted to percentage of clients living below the poverty line in that country. This would then allow global comparisons of client economic levels of MFIs in different countries. The challenge of course was to demonstrate, in an extremely rigorous fashion, that simple proxy indicators are indeed linked with poverty lines.

Mark Schreiner of CGAP and Grameen Foundation USA developed a method a tool called “Progress out of Poverty Index (PPI)” that provides poverty levels as well as changes in economic levels of clients.[43] The PPI is simple as it measures poverty by way of simple questions. In 2006, the CGAP came up with a PPI for the Philippines This index uses five indicators – housing material, type of toilet, presence of gas stove, children’s schooling, and ownership of TVs. Points for each response are pre-determined through econometric analysis of

[43] For a technical understanding of how the scorecards are constructed, read Mark Schreiner, “Seven Extremely Simple Poverty Scorecards”, prepared for CGAP, November 2006

national level data for each country. An MFI uses the PPI by visiting the client's home and getting answers to the five questions. Actual scores for each response are written down. For example a household with no gas stoves get a zero and one with water sealed toilets get a seven. Scores can range from zero (the poorest) to 100 (affluent). Of course the indicators for each country vary as do the scores for each.

Progress out of Poverty Index for the Philippines

Indicator	Points	Actual Score
1. What are the house's outer walls made of?		
Light materials (cogon, bamboo, sawali, nipa)	0	
Strong materials (aluminum, brick, wood, asbestos)	10	
2. What kind of toilet does the household have?		
Not water sealed	0	
Water sealed	7	
3. Does the household own a gas stove?		
No	0	
Yes	21	
4. Do all children ages 6-17 go to school?		
No	0	
Yes	9	
No children	26	
5. How many TVs do the household own?		
None	0	

Indicator	Points	Actual Score
One	17	
Two or more	36	

Source: Mark Schreiner "Seven Extremely Simple Poverty Scorecards", prepared for CGAP, November 2006.

Once scores are added up they are converted to a poverty likelihood using a pre-constructed table (Scores Table). For example, if one-third of Filipino clients have scores of 10, another third of 20, and the final third of 30, their poverty likelihoods (from annex 1) would be 77.8 percent, 76.6 percent, and 51.1 percent. The poverty rate for the group is estimated as the average, or (77.8 15 + 76.6 + 51.1) / 3 = 68.5 percent. In other words the group would have a 68.5% likelihood of being below the poverty line.

Philippines Scores and Poverty Likelihoods

If an individual's score is …	then the poverty likelihood is …
0-4	85.2
5-9	78.1
10-14	77.8
15-19	75.4
20-24	76.6
25-29	58.9
30-34	51.1
35=39	38.8
40-44	34.6
45-49	35.7
50-54	26.4
55-59	15.9
60-64	13.2
65-69	13.1
70-74	3.8
75-79	6.7
80-84	3.4
85-89	16.6
90-94	12.6
95-100	0.5

Poverty likelihoods are percentages
Source: Schreiner (2006)

Annex C

Available BDS Services Provided by Government

BDS Program	Government BDS Provider
A. Business/Entrepreneurial Skills Development Business information and promotion; establishment of one-stop centers and one stop shops; conduct of SME caravans	DTI-BSMED;DTI or LGU Business Centers, TESDA, DOLE-BRW
Information related to domestic trade that facilitate commodity flow and support market development services including those on trade associations, suppliers of indigenous raw materials and finished products, and large and institutional buyers, among others	DTI-BDT
Provision of technology and livelihood information information and instructional materials including Gabay or Business Guide	TRC/TLDCs
Promotion of innovative schemes and projects under the Promotion of Rural Employment through Self Employment and Entrepreneurship Development Program (PRESEED) including entrepreneurial trainings, community-based infrastructure support, credit tie up (i.e., PCFC, LBP,NLSF)	DOLE-BRW
Provision of small business primers, management guides, credit manuals and case books	UP-ISSI
Business counseling/advisory to clients	DTI or LGU SME Centers
Business counseling/advisory to clients and conduct of strategic planning seminars	TRC/TLDCs
Information on livelihood programs particularly in the rural areas through the conduct of livelihood and self-employment bazaars	BOLE-BLE;PESO
B. Market Development and Access	
-Conduct of trade fairs such as the International Food Exhibition, Manila F.A.M.E. International, Bio-Search, and Industry Search; selling missions, incoming trade missions, and other export promotion aspects, e.g., in-store promotions, food festivals, specialized exhibitions and special product displays abroad -assistance in matching buyers and exporters	DTI-CITEM

BDS Program	Government BDS Provider
and in merchandise development	
Linkaging and networking for raw materials sourcing and marketing	DOST
-Linkaging indigenous raw material suppliers, local manufacturers and trades and promotion of business alliances to expand SME markets -Provision of market matching services -Identification of new uses of raw materials and semi-processed products -Dissemination of suppliers/buyers' directories, raw material and product catalogues, and other promotional materials; - Conduct of marketing events (except trade fairs) such as in-store displays, showcases and domestic buying and selling missions -Conduct of commodity flow studies and other studies such as mapping of local marketing and distribution channels and improvements in the local distribution systems -Assistance to buyers/sellers in determining the most efficient distribution channels	DTI-BDT
conduct of regional and provincial matching seminar for farmers/fisherfolks and end-users (processors, exporters, distributors, consumers) to effect direct purchasers	DA-AMAS
market linkaging/networking	TRC/TLDCs
Establishment of one-stop centers and display centers to promote one-town-one-product (OTOP) strategy	DTI or LGU SME Centers
C. Technological Services **-**Packaging and labeling assistance - Equipment design and fabrication	 DOST
-Design, development or improvement of products and packages; new design/redesign (graphic design) of labels of food and non-food products based on requirements of target market -Hands-on learning and application of skills such as finishing, knotting, bleaching, and dyeing techniques related to product development	DTI-PDDCP
- Technical testing of materials and products, as well as evaluation of product quality to meet	DTI-BPS

BDS Program	Government BDS Provider
the standards of international markets; product certification	
- Inspection and licensing of establishments dealing with the importation, exportation, manufacture, repacking, distribution, and sale of food, drugs and devices, cosmetics, in vitro diagnostic reagents and household hazardous substances; monitoring of compliance with Good Manufacturing Practices (GMP); evaluation, testing, and registration of products and monitoring of the quality of products in the market; and approval of labels before they are marketed	BFAD
-Biological production and quality control	DA-BAI
Establishment of one-stop-shops for business development concerns including assistance in business registration	DTI or LGU SME Centers
Accreditation of livestock and poultry farms	DA-BAI
D. Training and Technical Services -Provision of technology (technology needs assessment and sourcing; manpower training and consultancy; and technical advisory services) in food and non-food areas including but not limited to: a) food processing; b)furniture; c) gifts, housewares, decors; d) marine and aquatic resources; e) horticulture (cut flowers, fruits and high value crops); and f) metals and engineering -Establishment of product standards and testing	DOST
Technology transfer on livestock production; animal breeding services	DAI-BAI
Technology transfer on fruit and vegetable utilization and preservation	DAI-BPI
Aquaculture and marine technology	DA-BFAR
Hands-on preparation of products; conduct of field trip/plant visit/on-site training especially for agri-business, chemical business (candle making) and crafts and others	TRC/TLDCs
Competency building (skills training), technical consultancy, materials manipulation/utilization, product sample making/prototyping, tooling and equipment, common facility servicing and other production related BDS for the country's furniture, gifts and housewares, wearables (fine and costume	DTI-CITC

BDS Program	Government BDS Provider
jewelry and footwear and leathergoods), food and other resource-based commodities sectors aiming to transform cooperative associations and other self-help groups into a full-blown sustainable community-based enterprise	
-Design and implementation of training programs on export marketing and management, entrepreneurial management, quality management and productivity, and trade exhibition management and participation particularly for the food, garments and furniture sectors -Training/short courses on how to sell or market products and services	DTI-PTTC
Community-based training and entrepreneurship development services and center-based training services	TESDA
Modular/short-term technology and entrepreneurship training (start your own business, appreciation seminar/training on entrepreneurship development and franchising)	TRC/TLDCs
Enterprise-based programs including: a) TESDA-KASOSYO Project, b) Community-Based Training and Enterprise Development (CBTED), c) Apprenticeship/Learnership Program, and d) Dual Training Scheme (DTS)	TESDA
Training courses in management development, productivity improvement, and entrepreneurship career development	UP-ISSI
E. Finance and Accounting Facilitating access and lending of funds to MFIs which have the organizational capability to provide sustainable credit access to borrowers in the livelihood sector	SBC,PCFC,NLSF
Training courses in financial management	UP-ISSI
Personality development including attitude towards basics of entrepreneurships; health and wellness; value formation/good manners and right conduct	DTI-PDDCP
Training courses on how to deal or handle customers	DTI-PDDCP
Business operation/management	TRC/TLDCs

Source: Business Development Services (BDS) for Microenterprises: A Guide for MFIs

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