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Assessing the efficiency and outreach of micro-finance schemes

Ronald T. Chua
Gilberto M. Llanto

International Labour Office Geneva

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Foreword

This paper by Ron Chua and Gilberto Llanto assesses the performance of different types of financial service suppliers frequently encountered in the informal sector of Metro Manila: lending-investors, pawnshops, cooperatives and support NGOs. The assessment focused in particular on two aspects: the institutional capacity to reach a large number of low-income clients with very limited resources and secondly, the capacity to manage these resources efficiently, reflected, for example, in positive real interest rates, high repayment rates and local refinancing arrangements.

The findings of this survey have been discussed in 1995 at several workshops organized by the ILO in Manila, bringing together representatives of banks, NGOs, self-help organizations, government and donors. A broad consensus emerged to improve the quality in the mobilization and management of financial resources for microentrepreneurs and the self-employed. In response to these recommendations, the ILO has been requested to assist in the creation of a Micro-Finance Service Center, which would assist NGOs and SHOs operating in the micro-finance field in Metro Manila.

The study is part of the ILO's Interdepartmental Project on the Informal Sector (INTERDEP/ INF). Special thanks are due to George Aryee, the manager of this project, and to Sandra Yu whose infatigable devotion has helped to overcome various obstacles.

This paper will also appear as part of the INTERDEP/INF working paper series.

Bernd Balkenhol

Abbreviations

ATM	Automated Teller Machine
BASIDECO	Bagong Silang Development Cooperative
BSP	Bangko Sentral ng Pilipinas
CCU	Cooperative Credit Union
CDA	Cooperative Development Authority
CML	Cattle Mortgage Loan
DBP	Development Bank of the Philippines
DSWP	Department of Social Welfare and Development
DTI	Department of Trade and Industry
FEDI	Foundation for Entrepreneurial Development Inc.
IRR	Internal Rate of Return
LBP	Land Bank of the Philippines
KMBI	Kabalikat para sa Maunlad na Buhay Inc.
KPP	Grameen Bank — type group
MLIC	Micro-Lending Investor Corporation
MVL	Market Vendor Loan
NBFI	Non-Bank Financial Institutions
NCC	National Credit Council
NEDA	National Economic Development Authority
NGO	Non-Governmental Organization
NSSLA	Non-Stock Savings and Loan Association
PAB	Philippine Amanah Bank
PFI	Participating Financial Institution
REML	Real Estate Mortgage Loan
ROSCA	Rotating Savings and Credit Association
SEAP	Self Employment Assistance Program
SGB	Specialized Government Banks
SHG	Self-Help Group
SWS	Social Weather Stations

Part 1

Introduction

1.1 The Interdepartmental Project on the Urban Informal Sector

Consistent with the need to continue to better understand and find ways and means of improving the situation of the urban informal sector, the International Labor Organization has launched an Interdepartmental Project on the Urban Informal Sector. This study is part of a series of sub-projects on the Urban Informal Sector. The over-all project development objectives are two-fold; the project aims at contributing to:

— improved productivity of informal sector activities and their capacity to provide employment and incomes

— the provision of basic social protection to informal sector producers and workers with a view to the gradual extension of international labor standards to cover them.

The project, designed as an action research project, has three components consisting of:

— Identification and Assessment (seven sub-components)
— Dialogue and Consensus
— Action and Evaluation

The first component aims to provide the factual basis for understanding and analyzing key areas and issues confronting the urban informal sector with the end of being able to identify concrete plans of action to address these. It has seven sub-components consisting of:

— Informal Sector Statistics: coverage and methodologies;

— The Role of the Informal Sector: determinants of stagnation, growth and transformation;

— The legal and regulatory framework: nature, impact, and need for reform;

— Productive resources: access to financial services, skills training and technology;

— Working conditions;

— Social protection;

— Informal sector self-organization.

1.2 Objectives

The main objective of this study is to describe and assess current micro-finance schemes operating in the three pilot areas, namely Kalookan City, Quezon City and Marikina, with the end of identifying areas for possible assistance and intervention that will improve these schemes.

This study will take an in-depth look at specific types of financial intermediaries previously identified as providing alternative financial services to the urban informal sector. These can be categorized into: (1) initiatives taken by the urban informal sector themselves; (2) both formal and informal private for profit individuals and institutions; (3) private non-profit initiatives; and (4) government initiatives.

Rotating savings and credit associations (ROSCAs), informal self-help groups (SHGs) and associations as well as credit cooperatives fall under the first category. Informal professional money lenders, pawnshops, and lending investors comprise the second. Non-profit non-governmental organizations (NGOs) are the subjects of the third category. Government-sponsored directed credit programmes form the bulk of the fourth category.

The study will compare the operations of a pawnshop, a lending investor, a market-vendors' association turned credit cooperative, and two non-governmental organizations involved in the delivery of financial services to the urban informal sector. Observations and conclusions from prior primary studies of professional money lenders and rotating savings and credit associations will be included to provide additional insights into the workings of the urban informal sector. Lastly, a review of existing government credit programmes operating in the three areas will also be made. The specific objectives of this study are:

(1) provide a profile of the urban informal sector with focus on their financial services requirements and access to such sources;
(2) identify the range of financial services and financing sources of the urban informal sector including government initiatives;
(3) describe the characteristics and operations of the following financial service operators:
   — professional money lenders;
   — paluwagan or ROSCAs;
   — cooperative credit unions;
   — pawnshops;
   — lending investors;
   — credit-granting non-governmental organizations;
(4) assess the efficiency and outreach of these financial service providers, particularly the latter four; and
(5) identify areas for possible intervention to strengthen these alternative micro-finance schemes and institutions.

1.3 Methodology, scope and limitations

Due to resource and time constraints, the case-study method has been the primary mode used to describe and assess the outreach and efficiency of micro-finance schemes servicing the urban informal sector in the Quezon City, Kalookan and Marikina areas. The scope of finance schemes has been limited to those that are providing services to microenterprises.[1] This resulted in an initial list of nine possible types as subjects for case study. The choice of the types of financial service providers was based on previous studies which have already identified the spectrum of credit sources. Specifically, Lamberte's 1988 *Integrative report on the urban informal credit markets* lists the major credit sources (other than friends and relatives) in the urban informal credit markets as: (1) professional moneylenders; (2) the "paluwagan"; (3) the cooperative credit union; (4) input suppliers; and (5) pawnshops. More recently, Lamberte (1995) also identified the lending investor as a supplier of credit competing with the money lenders and pawnshops in the small borrower segment. Another likely credit supplier is the non-stock savings and loans association.

Assessment of efficiency and outreach required an in-depth look into the financial profile of the case-study subjects and, thus, needed their total cooperation and willingness to share data. This has been a primary consideration in the identification of prospects for case-studies. Two other factors used in identifying prospects were experience (at least five years of operations) and the presence of informal sector clients.

Aside from the above, non-governmental organizations have also emerged as an active participant in delivering financial services. The Cory Aquino government brought with it an open acknowledgment of the role of non-governmental organizations as partners in development and translated this into concrete efforts, some of which in the area of credit delivery. Thus NGO and government directed credit programmes were also identified as potential subjects for case study.

As previous studies have already amply described the professional money lender and the "paluwagan", the review of these two types will be based primarily on available studies. Their situation in the field was complemented by a rapid appraisal of the areas of the study.

[1] The Small and Medium Enterprise Development Council uses a five level classification for enterprises: micro, cottage, small, medium, and large. It defines a micro-enterprise as having total asset size of not more than Ps.100,000; cottage from Ps.100,000 to Ps.1 million; and small from over Ps.1 million to Ps.5 Million. The ceilings have recently been increased with that for micro-enterprise raised to Ps.150,000. Alonzo (1990) in his survey of urban informal enterprises used employment of less than ten persons as an additional criteria for identifying micro-enterprises.

In an attempt to capture the dynamics of informal finance in a specific area, the initial strategy in prospecting specific case-study subjects was to focus on different players in a specific locality. As there was already a major credit-granting NGO operating in Bagong Silang, Kalookan willing to cooperate, an attempt was made to identify other micro-finance providers in the area. This resulted in the preliminary selection of two credit cooperatives in Bagong Silang. One of the two cooperatives identified had been unoperational and was encountering problems. While a detailed study of this particular subject was not possible, a profile was prepared as a case in contrast to the more successful experiences.

Difficulty was encountered in gaining the cooperation of pawnshops and lending investor operators in Bagong Silang. Thus, as a fallback, the choice of case-study subjects for these two types was based on prior contacts with owners. A multibranch pawnshop with operations in both Kalookan and Quezon City and a lending investor in Quezon City were chosen on this basis.

In the case of non-stock savings and loan associations (NSSLAs), a listing from the Bangko Sentral ng Pilipinas was obtained. There were only 11 listed and all of these were in Quezon City. Verification of the nature of these NSSLAs revealed, however, that they were all institution-based NSSLAs catering to government employees. This limited the prospects of their having linkages with the informal sector (unless the government employees themselves, their spouses and children are part of the sector).

The fifth case-study subject was chosen on the basis of its involvement with the Kaunlaran Pangkabuhayan Programme which was an adapted Grameen model designed and tested initially in the Department of Social Welfare and Development.

1.4 The conceptual framework: Effectiveness, reach, efficiency, viability and sustainability

Effectiveness is defined to mean the ability of the service provider to design and deliver financial products and services that meet the needs and requirements of the target client system. Ease of access to credit would mean that the product is characterised by:[2]

— small loan size
— reasonable cost
— short processing time
— reasonable collateral requirements.

The second issue is that of **outreach**. Given the magnitude of the need for financial services among the informal sector, the ability to reach significant numbers of clientele is very important. Secondly, scarce resources dictate the need for earmarking those to reach the intended target groups, who need the resources the most, and to avoid the leakage to unintended clients.

Efficiency is defined as the ability to maximize output per unit of input. Operational indicators would include the ratio of staff to clients, staff to loan amounts, and costs per unit of output such as number and amount of loans released. Micro-finance poses a special challenge due to the small size of loans, the frequency of repayment and the short maturity. In fact, high transaction cost of retail loans are frequently cited by banks as one of their main reasons for not entering the market. Following the same rationale, banks have also set minimum deposit levels for savings accounts.

Viability means the ability to cover costs of operations from revenues. It can be described by the following equation:

$$+ \quad +$$

where Y = income, OC = operating costs, CK = cost of capital, and CBL = cost of bad loans

2 These criteria are based on *Analyzing the efficiency of credit-granting NGOs: A technical guide* by Martin Holtmann and Rochus Mommartz. Interdisziplinare Projekt Consult GmbH.

Interest income from loans and related fees and charges must be greater than total operating costs, the cost of the capital employed, and the cost of bad loans. Operating costs include all personnel and non-personnel expenses incurred in the course of providing the service. Cost of capital include not only actual costs incurred on borrowings but also the imputed cost of capital. Imputed cost of capital accounts for inflation indicating the extent to which the real value of capital employed is maintained. Viability is thus a function of pricing (interest rates and fees), operational efficiencies, cost of capital, and quality of the loan portfolio. Except for the cost of capital, the other three variables are within the control of the service provider.

Sustainability goes beyond the issue of financial viability. It is the ability of the organization to grow and adapt to changes. It is the ability to ensure the continuity of its services, to expand, and to adjust to changing circumstances. The issue of sustainability has to do with good leadership, organization and strategic management.

Part 2

The urban informal sector and the finance constraints

The informal sector employs[3] a significant majority of the population. Alonzo (1991) cites estimates of informal sector employment accounting for as much as 73% of non-agricultural employment in 1983. Past studies (Lamberte, 1990) have indicated a positive relationship between access to financial services and small enterprise growth. Studies (Getubig et al, 1993; ACPC, 1994) have also shown that access to and appropriate investment of credit by the informal sector had a significant impact not only on increasing incomes but also on improving the quality of life in general through physical and social investments.

The financial requirements of the informal sector differ significantly from those of the formal sector and even from enterprises classified as cottage or small. Loans are needed for start-up and working capital primarily in the trade of goods and services. Loan size requirements are very small, starting from as low as Ps 1,000 or even lower. Opportunity windows can be seasonal and very short in duration. An example would be the opportunity to sell food items during a feast day in a community. Turnaround can normally be expected within the day or at most a week. Those who sell barbecue on the streets, for example, borrow their capital in the morning to buy the necessary materials and turns around at the end of the day to pay off his/her loan.

Because of low capital intensity, the rate of return on equity can be very high as no personal financial capital is employed. This partly explains the willingness of the informal operators to borrow from professional money lenders at high rates of interest. While this may be so, the absolute amount of income generated is still barely enough to meet daily needs, making it very important to have continuous access to credit as a means of generating cash. This also limits the ability of the informal sector to save. As informal sector operators have few physical assets, their cash inflows and small savings also make them vulnerable to sudden fluctuations in flow requirements brought about by emergencies or sickness. Even predictable or planned expenses may not be met because of this cash flow uncertainty.

The informal sector's financial needs are largely being met by informal sources. Most studies of both the rural and urban informal sector identify friends and relatives as the main source of borrowed capital followed by professional money lenders.Several informal credit sources have emerged to meet this need and continue to operate through the years. These are the professional money lenders, the local "paluwagan" which is a form of rotating savings and credit associations (ROSCAs), and the cooperative credit union. Tied credit was also observed to be significant in specific industries where input suppliers provide raw materials on credit in exchange for a fixed price purchase contract (Lamberte, 1988a).

Pawnshops and lending investors have been described as fairly akin to the informal system because they are the least supervised and regulated. The minimum capital requirement for pawnshops remain at Ps 100,000 while no limits have been set for lending investors. These two types of non-bank financial institutions (NBFIs) have found their niche in servicing the financial requirements of the small borrower.

The formal financial system, in particular the banking system, has remained unable to respond to the financial service needs of the informal sector. Even in Metro Manila which has the highest density of banks in the country, surveys indicate that access to the formal financial services remains very limited. This is basically brought about by the mismatch between the requirements of the informal sector and the structure, methods, technology of the formal banking sector which pose peculiar problems for the screening and enforcement of loan contracts. Even with the recent thrust towards consumer banking, loan sizes have barely gone below Ps 200,000 per loan. The banking sector in general, perhaps with the exception of rural banks, are more attuned to servicing large companies with large loan requirements and to wholesaling of loans.

Even with the advent of financial deregulation such as the lifting of ceilings on interest rates, the liberalization of bank branching, etc., the informal sector continues to remain beyond the reach of the formal financial system. Recognizing this gap, and the potential impact of access to credit on the situation of the informal sector, there have been private and government initiatives to address the problem. Some NGOs have focused on providing financial services to the "unbankable" entrepreneur with the objective of increasing incomes and generating jobs and employment. Others have adapted the Grameen Bank approach of providing credit to the ultra-poor as a poverty alleviation strategy.

Government initiatives have included directed credit policies requiring the formal financial system to set aside a proportion of their resources for lending to special sectors such

[3] The term employment is used in the broader sense of including those that are self-employed.

as farmers, agrarian reform beneficiaries and small entrepreneurs. Various guarantee schemes have been set up to encourage the formal financial sector to lend to these special sectors. Government response has also included participation in the financial markets through directed credit programs aimed at special sectors implemented by both government financial institutions and even non-financial line agencies. The Department of Trade and Industry's-Microenterprise Credit Program is one such example.

Part 3

The Philippine financial system

3.1 Overview

The Philippine financial system consists of financial intermediaries with varying degrees of supervision and regulation by government agencies. This spectrum consists of entities ranging from those subject to very close supervision and regulation such as banks to the professional money lenders who are totally unregulated and unsupervised (see figure 3.1).

There are also entities that are not under the regulation of the Central Bank but registered with other government agencies. These include credit cooperatives (registered and supervised by the Cooperative Development Authority) and non-government organizations engaged in lending.

With the reforms instituted over the past decade and a half, the activities of the formal financial intermediaries have expanded rapidly. In terms of resources, the formal financial system has been experiencing double-digit growth yearly since 1987. At the end of 1993, its total assets stood at P 1.3 trillion with the banking system accounting for 74% of total resources. However, despite the rapid growth of the formal financial sector, it still rations out a substantial number of borrowers, particularly the small farmer and the small entrepreneur. Such rationing results because of several factors. One, the formal institutions' relatively high cost structure does not motivate it to make small sized loans needed by small farmers and entrepreneurs. Second, because of the formal system's unfamiliarity with the small borrower sector, it finds it difficult to determine the creditworthiness of these borrowers. Third, these small borrowers are unable to put up the needed collateral to prove their creditworthiness.

There has also been some rapid growth of small formal non-bank financial institutions (NBFIs) such as the pawnshops and the lending investors, and of informal entities such as the credit unions and the proliferation of non-government organizations. The recent increase in the number of credit unions and of credit-granting non-government organizations can also be attributed to the government's directed credit programs using these entities as intermediaries.

3.2 The formal financial system

Two broad categories of intermediaries form the formal financial system — the banking system (commercial banks, thrift banks, rural banks and specialized government banks) and the non-bank financial intermediaries (insurance companies, investment institutions, fund managers and other financial intermediaries). All these institutions are under BSP (Bangko Sentral ng Pilipinas) supervision with the exception of insurance companies which are governed by the Insurance Commission. Starting in 1980, the Central Bank introduced various reforms to deepen the financial markets. Interest rate ceilings were removed, the rediscount window was rationalized, interest rates on special credit programs were aligned with market rates, bank branching policy was liberalized and the areas of allowable equity investments of universal banks were expanded.

More recently, the entry of foreign banks into the domestic market was liberalized allowing 10 foreign banks to set up shop in the country. This move is aimed at intensifying the competition in the domestic financial market.

3.2.1 The banking system

The banking system, with total assets amounting to a little over P1 trillion, controls 74% of the resources of the financial system in 1993 (table 3-1). Its principal activity involves accepting deposits from surplus units and lending these funds out to deficit units. The 1993 figures show that deposits form 65% of banks' fund sources while loans make up 55% of fund usage. There are a total of 4,343 bank offices, 912 of which are head offices and the rest of which are branches.

Commercial banking dominates the domestic banking industry. Its resources, at P759 billion, form 76% of the assets of the banking system and 56% of the entire formal financial system in 1993. Its activities range from the traditional deposit taking and money lending functions to trust, investment and money market operations.

Universal banks, a special category of commercial banks, are allowed to engage in securities underwriting and to invest in the equities of non-allied undertakings, which are prohibited for ordinary commercial banks (i.e. those without expanded commercial banking authority). Table 3-2 tabulates the authorized activities of the banking system. In terms of minimum capitalization requirements, universal banks have the highest minimum capitalization among all intermediaries while the rural banks have the lowest (table 3-3).

There are in all 32 commercial banks (14 of which are universal banks and another four of which are foreign banks), 97 thrift banks (eight savings and mortgage banks, 37 private development banks and 52 stock savings and loans associations), 780 rural banks and three specialized government banks (SGBs) as of 1993. These banks have a total of 3,445 branches, more than two-thirds of which are commercial bank branches (table 3-4).

The National Capital Region enjoys the highest density ratio of 87.8 for all bank types in 1993. The ratio for the other regions drops sharply by comparison with Region III having the next highest density ratio at 3.9. In contrast, Regions VIII, XIII and XIV have density ratios less than one. The ARMM has the lowest density ratio of 0.5 or five one office for every two cities/ municipalities (tables 3-5 and 3-6).

Unlike commercial banks which cater to individuals and institutions from all walks of life, the other bank types target specific client groups. For instance, private development banks focus more on the needs of the industrial and commercial enterprises while savings and mortgage banks attend to the consumer market. Rural banks were originally conceived as unit banks with one bank for every city and municipality. However, with the massive bank failures in the 1980s, this policy was dropped. Still, rural banks today are scattered all over the country and are more evenly distributed among the regions than other bank types.

The activities of the SGBs, on the other hand, are geared towards special groups. The Philippine Amanah Bank (PAB) caters to the Muslim community and follows Muslim banking practices. Land Bank of the Philippines (LBP) specializes in the delivery of credit to the countryside and the Development Bank of the Philippines (DBP) gives support to the government's industrialization effort by providing medium- and long-term loans to the industrial sector.

Such differences notwithstanding, the financial sector reforms have over the years pushed these institutions into competing against each other irrespective of bank type. This competition is most pronounced in deposit generation. Banks offer, nowadays, a range of deposit instruments with diverse features and varied rates of interest. For each instrument, different income groups are targeted.

Backed by a more dynamic deposit generation structure, commercial banks account for nearly 80% or P515 billion of the deposits mobilized by the banking industry. The strength of commercial banks is further enhanced by their automated teller machine (ATM) networks, a plus feature of their deposit instruments.

In the loans market, commercial banks are likewise ahead. Of the P553 billion loans outstanding of the banking system in 1993, 75% are commercial bank loans. However, most of these are short-term loans (i.e. with maturity of one year or less, table 3-7). Medium- and long-term loans constitute a mere quarter of their total loan portfolio. In contrast, savings banks are oriented towards loans with longer-term maturities.

Seventy percent of commercial bank loans go into the manufacturing, trade and finance sectors of the economy. On the other hand, private development banks allocate more than 1/3 of their loans to the manufacturing industry and another quarter to the agricultural sector while savings banks have a 61% exposure in the real estate and community, social and personal services sectors (table 3-8).

3.2.2 Non-bank financial intermediaries (NBFI)

Aside from the 132 insurance companies, 2213 pawnshops and 1404 lending investors, there are 88 investment houses and companies, 124 finance companies, 126 securities dealers and brokers, and 105 other institutions consisting of venture capital corporations, specialized government non-banks, mutual building and loan associations and non-stock savings and loans associations. These bring the total number of NBFIs to 4205 in 1993 (table 3-9).

NBFIs are a major source of credit for small borrowers who have no access to bank credit. Except for investment companies, venture capital corporations and mutual buildings and loans associations which use their funds for investment purposes, the rest of the NBFIs channel the bulk of the funds to lending programs. NBFIs are able to manage small loans better due to their lower transactions costs and their familiarity with their targeted clients. Loan processing is at the same time faster with less paperwork. For instance, pawnshops are a popular source of loans as borrowers can present any item of value as collateral. Also, clients can borrow as low as P100 with no questions asked. Lending investors, on the other hand, serve the credit needs of small businesses and employees. Salary loans can range from P3,000 to P20,000 while loans secured by real estate could go as high as P1 million.[4]

Finance companies are involved in consumer credit, lease financing, receivable financing and securities trading. Receivable financing constitute the biggest share of financing companies' activities (48% in 1991), followed by direct lending (20%), securities trading (17%) and leasing (15%).[5]

Securities dealers and brokers as well as investment companies and investment houses attend to another sort of need. They cater to individuals and institutions with surplus funds and use these for acquiring various types of debt or equity securities. Hence, the operations of these intermediaries include trading and sale of securities, financial consulting and portfolio management.

Pawnshops and lending investors are popular sources of loans. These institutions are able to manage small loans better due to their lower transactions costs and their familiarity with their targeted clients. Loan processing is faster and involves less paperwork. Furthermore, among the formal functional institutions, the pawnshop and the lending-investor are the least targeted. With the extent of government regulation as a means of formality, Lamberte classified these two types of NBFIs as being close to the informal financial system. Pawnshops[6] are business establishments engaged in lending money on personal property delivered as security or pledge. With a low minimum capital requirement of P10,000.00, there is practically free entry and exit in the pawnshop industry. Although they are small asset-wise (the average size of pawnshops is P1.7 million), they play an important role in the credit markets. Pawnshops have an edge in terms of accessibility as they are found almost everywhere in the country. About 60% of the total number of pawnshops are located outside Metro Manila. They are also ahead in terms of transaction cost because there is hardly any paper work to be done by borrowers. Loans can be released quickly, usually less than 15 minutes after filling an application. With competition getting stiffer, pawnshops accept anything of value such as television sets, calculators, etc. as collateral. On the side of borrowers, they can borrow as low as P100.00 without being questioned by pawnshops. At the same time, the interest charged by pawnshops at 3% to 5% a month is lower than what informal money lenders charge.

Lending investors are in the business of extending secured or unsecured small loans at interest. They are active in public market places and offices, providing business and consumption loans to small enterprises and employees. Lending investors in rural areas very seldom lend to farmers. They prefer to lend to salaried employees and small enterprises. Salary loan can range from P3,000.00 to P20,000.00 while loans secured by real estate could go as high as P1 million. Lending investors are competing with informal lenders, finance companies, pawnshops and other lenders to small borrowers. Based on a study by Penalba et al., lending investors charge interest rates ranging from 36% to 45% per annum. Documentary requirements are minimal, loans are quickly processed and repayment rates are generally high.

3.3 Informal financial system

3.3.1 Informal credit

A survey by the Social Weather Stations (SWS) - Ateneo University in 1987 indicated the relative importance of informal sources of credit in the Philippines. Of the 1/3 of the total voting age population of the country that borrowed in 1987, as much as 66% resorted to

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4 See also section 4.3.3 (p. 25).

5 Mario B. Lamberte and Gilberto M. Llanto, *Financial Sector Development in Asia*, ADB, September 1993, p. 79.

6 The following discussions on pawnshops and lending investors is culled from Mario B. Lamberte, *A Study of the Philippine Financial System*, January 1995, pp. 32-43.

informal sources of credit (table 3-11). In terms of loan amount, these informal borrowings form 59% of total loans granted (table 3-12). In rural areas, 3/4s of the borrowers sourced their funds from the informal market. Total borrowings from the rural informal market reached P17.7 billion in 1987, equivalent to 70% of total rural credit. Lamberte (1995) lists various studies which show that between 59% and 99% of farmer-borrowers resorted to informal sources of credit. At the same time, Bautista notes a shift of informal financing sources from landlords in the 1960s to traders, millers, input dealers and farmers themselves in the 1970s and 1980s.

The urban informal market plays a less prominent, yet significant role. In the case of micro and cottage enterprises, Lamberte (1995) cited a study by Lapar which showed that of the 54% who borrowed from the credit markets, only 25% obtained loans from formal credit institutions including credit union and cooperatives. Another 23% borrowed from both formal and informal institutions while the rest resorted to the informal markets. Hence, only about 1/4 of the sample firms have access to the formal credit markets. 45% of those who borrowed in the urban areas depended on informal credit. These borrowings form 38% (P4.7 billion) of total urban credit extended. A relatively large number of borrowers in Metro Manila rely on informal credit, which is surprising considering that Metro Manila has the highest density ratio of financial institutions to total cities and municipalities. Borrowings from the informal market comprised 58% of total borrowings compared to 42% from the formal sector. This may be explained by the nature of formal loans in Metro Manila which are largely corporate accounts (table 3-13).

Informal loans are primarily small loans of less than P1,000 with maturities no longer than one year (predominantly less than six months). The lenders charge varied rates of interest ranging from a low of zero to a high of 200%.[7] The high interest rate charged by some lenders may serve as a risk premium since the borrowers they serve have a higher probability of default. It may also reflect the cost of funds as money lenders sometimes source funds from deposits paying high interest rates.

3.3.2 Savings mobilization

The informal sector is also involved in deposit generation. The ROSCAs (or paluwagan) serve as a good example, where members contribute to a common kitty which goes by turn to every member of the association, the sequence of the rotation being determined by consensus, lottery or a system of bidding in each round.[8]

In the Philippines, Ghate cites a study by Lamberte and Balbosa of Cooperative Credit Union (CCU) members that participate in various paluwagans. He further notes that based on a study by Lamberte and Bunda, there are several business-oriented (with market vendors as their members) and consumption-oriented (for purchase of appliances and to pay for children's education) paluwagans running at a time. There are, however, no estimates of the total number of paluwagans.

Money lenders also participate in mobilizing savings. Ghate tells of a money lender in Sapang Palay who gets 70% of her total loanable funds from mobilized savings. The minimum size of the deposits generated was P100 with a fixed term of one year and an interest rate of 80% per annum.

Cooperative credit unions (CCUs) likewise offer deposit instruments in the form of fixed deposits (which their members are required to subscribe to and which cannot be withdrawn) and savings and time deposits (which pay interest and may be withdrawn). CCUs are categorized as informal institutions in the sense that they are not under Central Bank authority. CCUs are supervised by the Cooperative Development Authority (CDA). CCUs have no

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[7] Ernesto D. Bautista, *Impact of Public Policies on Rural Informal Credit Markets in the Philippines: Synthesis of Survey Results and Lessons for Policy*, Journal of Philippine Development, vol. XVIII, #1, p. 8.

[8] Prabhu, Ghate, *Informal Finance: Some Findings from Asia*. Asian Development Bank, Manila, 1992, p. 41.

minimum capital requirement, no reserve requirement on deposits and are exempted from taxes imposed on financial institutions.[9]

3.4 Government response

In order to ensure a flow of credit to underserved sectors of the economy, i.e. the agricultural sector and the small enterprises, the BSP has put in place measures to oblige banks to allocate credit to these small borrowers. These include:

(1) requiring 75% of the deposits generated from a regional grouping to be invested in that area;
(2) mandating banks to set aside 25% of their net incremental loanable funds for agricultural lending, 10% of which is to be lent to agrarian reform beneficiaries and 15% for general agricultural lending;
(3) mandating all lending institutions to lend at least 10% of their total loan portfolio to small enterprises whose total assets amount to P10 million and below;
(4) liberalizing bank branching regulations; and
(5) direct government participation via special credit programs. These programs are implemented through government agencies, non-bank government financial institutions and government banks.

In addition, the government has increasingly recognized the importance of informal institutions in extending credit, especially in the rural areas. Informal credit is viewed as not only more equitably distributed (i.e. small loans to poor people) but, to the extent that it flows to borrowers with productive ventures who are deemed unprofitable by the formal market due to the imposed credit controls, it serves efficiency objectives as well. Hence, the government now makes use of NGOs as credit conduits instead of coursing credit funds solely through banks. There are 111 policy-based lending programs of the government, of which 13 are targeted for the ultra-poor (see tables 3-14 — 3.20).

Out of the 13 programs classified under the ultra-poor category, 8 are being implemented by DSWD as interest free loans, 2 under the NLSF using NGOs as conduits, 2 under the ACPC for Grameen Bank Replicators and one through the Land Bank, also using NGOs as conduits.

Of the 21 programs under the self-employed and salaried category, most would require membership in SSS or GSIS. Only one program implemented by the Department of Labor and Employment Bureau of Rural Workers seem accessible to the ultra-poor.

While the DTI-Tulong sa Tao program has been classified under the Small and Medium group, it was intended to fund off-farm micro-enterprises of the poor. However, recent evaluation of the DTI-Tulong sa Tao Program indicates that the poor are not effectively being reached.

Out of the 111 programs listed by the National Credit Council, a review and prelisting of those most likely to cater to the urban informal sector, specifically in the three areas, i.e. Kalookan, Marikina and Quezon, was done. The list consists of 3 categories as classified by the National Credit Council. These are 1) the ultra poor, 2) the livelihood category and 3) small and medium enterprises. These are listed in tables 3-16, 3-17 and 3-18. The inventory was conducted for the DTI programs, the PCSO and the National Livelihood and Support Fund. A review of the magnitudes (table 3-20) shows that the outreach is still limited.

9 Gilberto M. Llanto, *A study of Philippine Credit Cooperatives*, unpublished paper 1994.

Part 4

The lending investor, the pawnshop, the cooperative and two NGOs: A comparison

4.1 Introduction to the case-studies: Origin, objectives, areas of operation and target clientele

4.1.1 Micro-Lending Investor Corporation

The Micro-Lending Investor Corporation (MLIC) was set up in May, 1993 as a family-owned and controlled corporation. It started with an initial paid-up capital of Ps.300,000 which was raised to Ps.2,000,000 in the third month of operations. Its areas of operations were in Barangay Tatalon, Quezon City and in Rosario, Cavite. The idea of setting up a lending investor corporation resulted from the founder's observation that ordinary people had difficulty in accessing loans from banks to underwrite their financial needs.

As the founder worked in a government corporation, it was a natural first step to start off the lending business by providing salary loans to his former colleagues. From a single office, MLIC expanded its reach to other government offices and eventually included employees of private corporations. It gradually expanded its market to include loans for businessmen and market vendors. It also entertained loans from professionals and housewives, provided the necessary loan application requirements were met.

4.1.2 Pagkakaisa Pawnshop

Pagkakaisa Pawnshop was set up as a single proprietorship in 1988 with the minimum required capitalization of Ps.100,000. It has since expanded to 11 branches operating in Tondo, Sampaloc, Caloocan, Quezon City and Pasig. An average of two branches were set up per year since its inception in 1988. Pagkakaisa did not consciously define its target market. It simply set up shop in areas where there is heavy pedestrian traffic and in areas where competitors had already tested and developed a market.

4.1.3 Kabalikat para sa Maunlad na Buhay Inc. (KMBI)

Kabalikat para sa Maunlad na Buhay Inc. (KMBI) started out in 1986 as a local church project providing individual loans to small entrepreneurs with the aim of job creation and income generation. It eventually spun off into an independent entity focusing on lending to the "non-bankable" small businessmen and entrepreneurs. These were individuals with existing businesses capitalized from Ps.50,000 to Ps.100,000 but who were nevertheless still considered unbankable. These enterprises had to have potential for growth and job generation. Legally, it was registered as a non-stock, non-profit corporation.

In 1991, KMBI launched the Ugnayang Kristianong Mangangalakal or UKMA (Federation of Christian Business Persons). UKMA is the federation of all KMBI chapters. A conscious effort was made to gradually move away from individual lending to group loans. In 1990, 100 per cent of its loans were lent to individuals. At end 1994, there were only 18 individual loans and 1,783 group loans. With this shift of focus, KMBI tightened its eligibility criteria: a borrower's capitalization should not exceed Ps.35,000. It also began to give priority to women.

4.1.4 Bagong Silang Development Cooperative (BASIDECO)

Bagong Silang Development Cooperative (BASIDECO), which was originally named Bagong Silang Market Services Cooperative, started out in 1985 as a market vendors' association managing the upkeep of makeshift stalls located on government land in Bagong Silang, a government urban squatter resettlement area. The market had grown spontaneously with people converging and selling their wares in the traffic area. The uncertainty of the market vendors' tenure in the market place was a key force in motivating them to organize themselves. One of the cooperative's very first services was to provide maintenance and upkeep of the market stalls.

The first attempts at providing credit to members were made in 1985 with Ps.50,000 as start-up. However, this was stopped after two months because of problems with collection. They did not have any full-time staff managing their lending programme. Credit services were revived in 1989. The organization, however, gained strength only in 1992 when, with the assistance of the National Market Vendors' Confederation of Cooperatives (NAMVESCO), they were able to negotiate a deal to purchase the land from the National Housing Authority (NHA) which owned the land. The organization reregistered itself with the Cooperative Development Authority in November of 1993 as a multipurpose cooperative.

BASIDECO initially started out with members consisting entirely of the market vendors in their area of operation. They have since expanded their membership to include other small businessmen, employees and students.

4.1.5 Foundation for Entrepreneurial Development Inc. (FEDI)

The Foundation for Entrepreneurial Development Inc. (FEDI) was initially set up as an incorporated non-governmental organization that served as the organizational vehicle for the Department of Social Welfare and Development's (DSWD) Self-Employment Assistance Programme (SEAP). The SEAP was a national programme that featured livelihood loans to needy individuals and groups. FEDI provided the organizational vehicle for DSWD to channel the loan funds of the SEAP. This was because non-financial government agencies were generally not allowed to engage in lending. FEDI was eventually spun-off as an independent entity in 1988. It started implementing the Kaunlaran Pangkabuhayan Project (KPP) in 1993 with a Ps.1.5 million grant from the Philippine Charity Sweepstakes Office. The KPP was a Grameen inspired group lending model developed by DSWD staff under the SEAP. The KPP programme targets those living in poverty. Its first member eligibility requirement was that family incomes should fall below the poverty line as defined by the National Economic Development Authority (NEDA). FEDI has organized six KP groups in three areas: Tatalon in Quezon City, Calookan, and Dasmarinas Cavite. FEDI is the youngest among the case-study subjects in terms of its experience in lending.

4.2 Membership policies and processes and client organization

A key difference in the thrusts of the lending investor and the pawnshop with that of the other three subjects is in the area of membership. For the former two, there is no binding or formal relationship between the borrower and the lender other than that of the lending contract. For KMBI, FEDI, and BASIDECO, on the other hand, membership in an organization is a prerequisite for eligibility for a loan. Membership entails a more long term relationship between the borrower and the lender. In fact, in the case of the cooperative, the borrower is co-owner of the lending organization. On the other hand, the KMBI and the FEDI programmes require prospective borrowers to organize themselves into mutual accountability/guarantee groups where not only loan liabilities but loan administration functions are expected to be shared.

Before one can borrow, a prospective client must first go through a membership application and qualifying process. All three organizations have explicit eligibility criteria for membership. In addition, applicants are required to undergo training and abide by the policies, rules and regulations of the organization. These can be seen as methods that serve to screen borrowers and to homogenize the membership. They represent steps in reducing borrower risk and in collecting information about the prospective member. These two NGOs have an added feature of targeting only the poverty groups.

BASIDECO, KMBI and FEDI emphasize the training of members. These training sessions usually have both a value formation component where ideals and principles are inculcated, and a technical component where the group is oriented and prepared to take on parts of the savings mobilization and lending functions. This is particularly true of the NGO programmes where part of the programme objective is the organizing and development of self-managing groups. Both also feature "tests" to check on the readiness of the group to take on loans.

All three also tie eligibility for credit to the amount of savings mobilized. The savings requirement is so designed as to be manageable for the members. In the case of BASIDECO a minimum fixed deposit of Ps.500 and a 25-day holding period on the deposit is required before a member can borrow. Furthermore, 2 per cent is deducted from each loan to serve as the member's capital build-up. The FEDI programme requires each member of an association to save Ps.3.00 daily for 12 weeks.

In the case of the FEDI, there is a trial period of at least two months where the associations are expected to show their capability for self-management by meeting weekly and managing their savings programme. A prerequisite for loans release is the mobilization of at least Ps.5,400.00 by each association. This translates to a Ps.3.00 daily savings for six days per week per member for 12 weeks. The associations are evaluated after this period; then a Ps.100,000 interest free loan is given to the association. KMBI requires members to have weekly savings.

BASIDECO does not explicitly target the poverty groups. In fact, one of its eligibility criteria is for a prospective applicant to have an existing business in BASIDECO's area of operations or to show evidence of stable employment.[10]

Beyond the issue of membership and of financial services delivery, both KMBI and FEDI aim at developing self-managing groups at the community level. In KMBI's case, its basic unit of organization is the "centre". A centre is composed of three to seven subgroups consisting of five to seven members per group. Centres are further grouped into chapters with a chapter consisting of five to seven centres. KMBI plans to encourage the centres to eventually

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[10] Specifically, BASIDECO's membership eligibility criteria are:

(1) residence and place of business must be in the area of operations of the cooperative — Bagong Silang, Tala, and Camarin all in Calookan City;

(2) must own a business operating in the cooperative's area of operations or be an employee with relatively stable employment;

(3) must be between 18 and 54 years of age.

From the basic criteria, a prospective applicant has to comply with the following requirements:

(1) filled up application form;

(2) pay one time membership dues of Ps.50.00;

(3) attend a pre-membership seminar and pay seminar fee of Ps.50.00;

(4) pay for passbook — Ps.20.00;

(5) place initial fixed deposits of a minimum of Ps.500.00;

(6) sign a five-year subscription agreement for Ps.5,000-worth of share capital.

The applicant is screened by the Education Committee. This committee is responsible for interviewing and doing the background check on a prospective applicant. Processing time from submission of application to acceptance is estimated to take around 25 days. Before an accepted member can avail of a loan, there is a further requirement that his/her fixed deposits must have been with the cooperative for at least 25 days.

organize themselves into cooperatives. In FEDI's case, the basic unit at the community level is the KP Association which consists of 25 members. This is similar to KMBI's centre.

The basic steps and requirements common to both KMBI and FEDI in setting up and organizing a centre consist of:

(1) screening for eligibility — means test or equivalent, home and site visits and interviews;
(2) formation of mutual accountability groups;
(3) formation of centres or associations;
(4) training of mutual accountability groups;
(5) election of officers;
(6) start of compulsory savings;
(7) testing and approval of mutual accountability groups;
(8) loans proposal preparation and evaluation;
(9) loans processing;
(10) loans release;
(11) loans collection;
(12) weekly group meetings.

The next step requires the prospective applicants to organize themselves into mutual accountability groups of five to seven members each. The members of a mutual accountability group must know each other, must live close to each other, must be willing to guarantee each other's loans, but must not be related to each other.

All in all, it takes from two to three months before an applicant in either FEDI or KMBI is accepted as a client and is able to access a loan. In the case of BASIDECO, it takes 25 days.

4.3 Products and services

Due to legal restrictions, both MLIC and Pagkakaisa's only provide lending services. While MLIC takes deposits, this is limited to a maximum of 19 persons. BASIDECO, KMBI, and FEDI, on the other hand, have more flexibility in their operations as they basically remain unregulated. Aside from extending loans, both BASIDECO and KMBI have evolved a number of services for its members which include capital build-up schemes, a life insurance scheme and an educational fund. In addition, BASIDECO has gone into bulk buying of goods for its members.

4.3.1 Savings mobilization and social protection schemes

KMBI collects 5 per cent of the loan proceeds as capital build-up held in trust by KMBI for the members. A 1 per cent charge is also collected for a Redemption Fund which serves as a contingency fund to cover the outstanding balance of members in cases of death. Aside from this, members are also required to have a capital build-up and contribution to the centre fund. The amount of contribution is mutually agreed upon at the centre level. This fund is managed by the centre officers and is intended to be used for centre level activities including joint projects.

KMBI has also introduced several optional group funds which serve the purpose of social protection. These are the "Pondong Damayan" or Death Fund, the Educational Fund, and a newly set up Jubilee Fund intended to cover the emergency needs of members. These funds are held in trust by KMBI as bank time deposits. As of December, 1994, total funds in KMBI's account amounted to over Ps.2.204 million or an average of Ps.1,854 per member. The Pondong Damayan functions like a group insurance scheme. Participating members maintain a fixed deposit amounting to Ps.200. This can be built up over a period of ten weeks consisting of Ps.20 weekly contributions. A member or his/her beneficiary can claim the fund upon the death of the member, or the death of a spouse or parent.

In BASIDECO, aside from the share capital and fixed deposit requirement, BASIDECO also requires a 2 per cent capital build-up from its members which is deducted from the borrower's loan proceeds and credited to his/her fixed deposit account. Those with fixed deposits below Ps.1,000 are required to set aside 5 per cent. BASIDECO also provides voluntary savings and time deposit services to its members. Savings deposits earn an attractive 6 per cent per annum tax free.

BASIDECO also has set up a providential or "Damayan" Fund intended to serve as a life insurance. New members make an initial contribution of Ps.200. Upon the death of a member, another Ps.50 contribution is collected. This is not a compulsory scheme and only 88 members have participated in this fund. In 1993, 169 members contributed a total of Ps.33,800 out of which Ps.9,600 were donated. The number of participants dropped to 88 in 1994 with total contributions amounting to Ps.17,600 and donations amounted to Ps.3,275. BASIDECO has also set up a health care fund. This plan is similar to the Medicare system of the Philippine Government. When members get ill, they are entitled to medical benefits such as free hospitalization and medicine expenses. Upon membership, members are asked to pay Ps.200.00 and Ps.25.00 a month for succeeding months. Started in June 1994, a total of 76 members have joined. The balance for the health care fund is about Ps.15,200.00.

In the case of the FEDI programme, aside from the weekly amortization of Ps.40 which is turned over to the FEDI on a monthly basis, KP association members are required to match the weekly amortization with a Ps.40 weekly obligatory savings. This forced savings is used to build up the associations fund base and is allocated as follows:

Capital build-up	50 per cent or Ps.20/week
Group fund	40 per cent or Ps.16/week
Operating fund	10 per cent or Ps.4/week

The capital build-up fund is intended to replace the loan from the NGO so that by the end of 100 weeks, the KP association would have built-up their own loan funds amounting to Ps.100,000 (Ps.50,000 for the capital build-up fund, Ps.40,000 for the group fund and Ps.10,000 for the operating fund). The operating fund is intended to cover the operating expenses of the association.

In addition, members are required to contribute to a Social Development Fund which is intended to fund social projects to be initiated by the Associations (see table 4-2).

Comparing the three programmes' savings mobilization, the FEDI groups had the highest average amount of savings mobilized at Ps.3,989 per person followed by Ps.3,569 for BASIDECO and Ps.1,854 for KMBI (table 4-3). As data on the socio-economic profile of the members are unavailable, a direct comparison across the three organizations cannot be made without some qualifications. Nevertheless, these numbers point to a huge potential for savings among the informal sector. This observation is buffered by Lamberte's (1988) observations about the proliferation of all kinds of ROSCAs among low income urban communities.

4.3.2 Other services

Aside from credit, BASIDECO has recently ventured into bulk buying of merchandise for resale to members. Goods traded by the cooperative include rice, sugar, and cooking oil. This activity is still in its infancy stage. The volume of business in their trading activity remains small. The accomplishments for 1993 and 1994 are shown in table 4-4. The return on capital is low at 5.3 per cent in 1993 and Ps.5.6 per cent in 1994.

4.3.3 Credit

MLIC classifies its loans into three major categories (table 4-5). The first is a collateralized loan which accepts either real estate or chattel mortgage. The second is the market vendor loan which is a relatively new loan product, which uses a deed of assignment on goods as collateral. The third is the salary loan window which is differentiated according to loans that have guarantees from employees associations and those without. The pawnshop does not make any differentiation in terms of loan types. It simply lends against any acceptable pledged item.

KMBI on the other hand has its loan products classified into those for individuals and those for groups. Individual loans are collateralized whereas the group loans are not.

BASIDECO has three loan types: the personal loan, the emergency loan, and the instant loan. The personal loan is the cooperative's regular loan window which is primarily intended for business. The emergency loan, available on a reimbursement basis, is intended to cover emergencies such as theft, fire, illness, accidents and hospitalization. This also includes expenses incurred in giving birth. The instant loan is also a business loan intended to cover urgent cash flow needs (table 4-7).

The FEDI programme lends out an interest free loan amounting to Ps.100,000 without collateral to an organized group of 25 that has passed specified requirements and performance indicators. The group in turn retails this to its members. Each member gets a loan of Ps.4,000 payable in 100 weeks. This amounts to Ps.40 per week. The loans are to be used only for livelihood activities.

4.4 Lending terms and conditions

4.4.1 Interest rates, service charges

BASIDECO has the lowest nominal interest rates. The interest rates and service charges of BASIDECO in table 4-5 have been converted into its monthly equivalent to allow comparison with the other institutions. BASIDECO sets its rates and service fees based on the duration of the loan which could be 100, 150 or 200 days. Even after adding the service fees, BASIDECO's monthly rate ranges from 1.818 per cent for a 200 day loan to 2.425 per cent for a 100 day loan. The pawnshop charges the highest nominal rate at 5 per cent to 7 per cent.

The FEDI programme did not charge any interest for the loan. Its design allows the NGO to charge 10 per cent or Ps.10,000 upon release of the loan to the group. While the loan from the NGO to the Association is interest free, the members have to double their amortizations for their capital build-up funds. That is, on top of the Ps.40 weekly payment on the principal, another Ps.40 has to be given as part of the capital build-up. Except for the pawnshop, all the other institutions collect service fees.

4.4.2 Maturity, repayment schedule, collection mode

In the case of the pawnshop, the term of the loan is one month with three months grace period. The borrower has to pay the interest during those three months. For KMBI programme, the loan is set at six months. FEDI has 100 weeks loans. The longest loan duration of BASIDECO is 200 days.

The repayment schedule ranges from daily to monthly payments. For the market vendor loan of MLIC, the individual loan of KMBI and all loans of BASIDECO, the loan repayment schedule is negotiable depending on the nature of the business of the borrower. In the case of the salary loan, the fortnightly schedule matches the pay days of the employee. These repayment schedules have been set to match the cash flow pattern of the borrower. The NGO programmes (KMBI, FEDI) have fixed their repayment schedule on a weekly basis.

To reduce collection costs, the issuance of post-dated checks is required by MLIC in the case of their business and market vendor loans and by KMBI in the case of their individual loans. In the case of MLIC's guaranteed salary loan, the employee association is responsible for remitting the collections to MLIC. In the case of salary loan, the borrower pays at MLIC's office fortnightly. BASIDECO receives payments at the office and also has field collectors.

KMBI's group lending programme requires members to meet weekly with a KMBI officer in attendance. Collection is first done at the group level consisting of five members and are turned over to the centre chief or the KMBI field worker during the meeting. FEDI follows a similar arrangement except that the association carries on with business on its own.

The manner of interest collection differs among the four types of institutions (FEDI not included) and therefore affects the effective rate. In the case of the pawnshop, the interest for the first month is deducted upfront. If the borrower goes beyond the first month, he has to settle his interest on a monthly basis. BASIDECO also deducts the interest upfront. For MLIC and KMBI, the interest for the loan period is divided into the number of repayments and is paid/collected together with the principal. Interest due in these two cases is not computed based on the declining balance.

4.4.3 Effective interest rates

The last row in table 4-5 shows the effective annual interest rates prevailing. The rates are computed based on the actual cash flow resulting from the loan terms and repayment schedules. The effect of the capital build-up requirement in case of KMBI and BASIDECO has not been included in the computations.

The pawnshop charges the highest effective interest rate, ranging from 83 per cent to 118 per cent. This is followed by MLIC, whose highest rate (85 per cent to 94 per cent) is for the unguaranteed salary loan, falling in the same range as that of the pawnshop. MLICs business loans carry lower rates at 71 per cent to 78 per cent. It charges the lowest interest rates for the guaranteed salary loan at 55 per cent to 62 per cent. KMBI's effective interest rate is 53 per cent. BASIDECO has the lowest effective rates ranging from 27 per cent to 38 per cent.

For comparison purposes, 90-day T-bill rates were 15.87 per cent at its peak and 8.659 per cent at its lowest in 1994. For 1993 it was high at 16.187 per cent and low at 9.931 per cent. For 180 day bills, high in 1994 was 16.797 per cent and low at 9.674 per cent. Inflation rate in 1993 was 7.6 per cent, and 9.2 per cent in 1994. In 1991, it was 18.7 per cent.

4.4.4 Other charges

MLIC levies other charges related to are collateralized loans. The commitment fee is used to pay for credit appraisers which it hires on a part-time basis. Other fees include notarial fees, insurance premium, and documentary and science stamps. Except for KMBI, which collects 1 per cent as an insurance premium, lenders to the informal sector in Manila do not collect any other fees.

4.4.5 Loan sizes

Minimum loan sizes are considerably lower than in commercial banks (tables 4-6 and 4-7). The pawnshop has the lowest loan size at Ps.200 per loan depending on the item being pawned. The next lowest is KMBI's group loan at Ps.1,000. For BASIDECO, the minimum loan amount is also Ps.1,000 assuming a minimum share capital of Ps.500 at a factor of two. Worth noting is that even for the lending investor, the minimum amount acceptable to the MLIC for a collateralized loan is set at Ps.2,000.

MLIC has the highest ceiling amount at Ps.500,000 for its collateralized loans. For BASIDECO, the maximum is Ps.100,000. The cooperative's loanable amounts are a function of the borrowing member's fixed deposits. Beyond Ps.30,000, however, a collateral equivalent of 50 per cent of the borrowed amount is required. KMBI sets Ps.25,000 as the maximum for its group loans and Ps.50,000 for its individual loans. For the pawnshop, the loan amount of Ps.1,000 is really more an estimate of the most likely maximum amount granted given the type of item being pawned. There are, however, exceptional cases where higher loan amounts are accommodated.

4.4.6 Follow-up loans

In principle, there is no limit set on the number of times a person can borrow. Except for the pawnshop, all lenders reviewed require a good repayment record before approving subsequent loans. The pawnshop is not concerned with track record as the pledged or pawned item serves as the loan guarantee. In BASIDECO, approval of new loan amounts is a function of the members' track record and the amount of fixed deposits held with the cooperative.

Both KMBI and BASIDECO use the promise of higher loan amounts as incentives for the borrower to repay their loans. KMBI's loan ceilings for repeat borrowers are usually increased by Ps.1,000 to Ps.2,000. In the case of BASIDECO, the loanable amount is a function of the member's fixed deposits. Thus, established and well-performing members can borrow funds at three times the fixed deposits. But this is possible only after the member has borrowed twice and has a good repayment record.

4.4.7 Restrictions on loan use

KMBI and FEDI require borrowers to use the loan as originally applied for; the other institutions are indifferent to the actual loan use (tables 4-6 and 4-7). The cooperative requires members to state the purpose of their loans, but it is not monitored at all. Borrowers have a free hand in using the loans as they see fit. The positive side of this is that it effectively reduces the operational cost as loan supervision is not done. However, the possible trade-off is the lowering of the quality of the loan portfolio.

4.4.8 Collateral and documentation requirements, loan processing time

MLIC's salary loans use the future cash inflows (salary) of the borrower as guarantee. In BASIDECO's case, two co-guarantors are required for loan approval. The security is against the guarantors, and also against the borrowers' share capital, fixed deposits, time and savings deposit, and unearned interest and patronage refund payable. BASIDECO also requires borrowers to put up collateral for loans exceeding Ps.30,000. KMBI's group lending programme model uses peer pressure and mutual group guarantee as the substitute for collateral. FEDI follows a similar arrangement.

In terms of speed and documentation, the pawnshop takes the lead as it is able to release a loan in 15 to 30 minutes with only one piece of paper. The salary loan also requires the least documentation. It is interesting to note that KMBI requires about as many documents or even more than the lending investor's collateralized loans. Of course, when it comes to processing time and documentation requirements, the best performing are still the professional money lenders (see tables 4-9 and 4-10).

In terms of membership application time, BASIDECO takes about 25 days to accept a member. It takes much longer in KMBI and FEDI (at least 12 weeks). Here, the point of reference is from the time of application to the time that a member can start the loan application process. Although an applicant may have already been accepted as a member, he/she may still have to go through various training before the loan application process can start.

An issue may be raised about the seemingly long process that the NGOs require prospective members and borrowers to go through. This in fact contributes to the NGO's cost of operations and borrower transaction costs. However, from another point of view, the seemingly rigid and time consuming process is actually an investment that allows the prospective borrowers to become more bankable or at least able to access loans. Another way of looking at the process is that it also serves as a self-screening mechanism that automatically discourages those with a high opportunity cost of time and with access to other sources of credit and financial services.

The institutions normally release loans directly to the borrower. KMBI, however, have started to "wholesale" to the more mature groups. Instead of issuing a check for each loan applicant in a centre, KMBI now issues the check in favour of the centre leader. It is now up to the centre to retail the loans to their members. In the KP, the full Ps.100,000 is released to the Association upon qualifying and it is the Association that takes responsibility for the loans release to individuals.

FEDI adopts a staggered 3-2 loan release schedule. The members of a group should be the first to get their loans. The group chairperson and secretary get their loans after the members have proven themselves by making regular payments. Again, this is a feature which aims at further encouraging mutual accountability by making the loan access of the group officers dependent on member performance.

4.4.9 Comparison with professional money lenders in the areas

FEDI programme participants identified six lending facilities. These included a "bombay" or professional money lender, a pawnshop, two lending investors, a cooperative, and a

Chinese businessman. A similar range of sources were also identified by KMBI's members in Bagong Silang. The effective per annum interest rates of these sources range from a low of 12 per cent in the case of a credit cooperative, to as high as 730 per cent in the case of the "Balikwasan" private money lender in Bagong Silang. The typical 5-6 operation would have effective rates per annum ranging from 226 per cent to 281 per cent.

Key features of the informal moneylenders are the speed with which one can obtain a loan, the minimal paperwork required, and no collateral requirements. Furthermore, they are very accessible as most of them operate in the neighbourhood (tables 4-9 and 4-10).

BASIDECO's and KMBI's loan packages are competitive except for speed of processing and loan release.

4.5. Activities and results: Operational efficiency

Using the total number of staff as the denominator, the average number of loans per staff, the pawnshop has the highest ratio at 2,000 loans per staff. This is followed by KMBI at 60 and MLIC at 49. Using field staff only as the denominator, the ratio increases to 286 for MLIC and 139 for KMBI. The ratios for Pagkakaisa and BASIDECO do not change as the staff number remains the same. KMBI's situation can partly be explained by the fact that it is in the process of training new recruits and have thus lower productivity. KMBI's own estimate of optimum capacity per field worker is at 245 accounts per loan officer.

In terms of amount of loans per staff, it is still highest for the pawnshop at Ps.1.5 million per staff followed by KMBI with Ps.710 million/staff and MLIC at Ps.629/ staff and KMBI at Ps.1.639 million. Taking only field staff, the ratio for KMBI increases to Ps.1.639 million, while it is Ps.2.308 million for MLIC.

In terms of average personnel costs per staff, KMBI had the highest at Ps.54,667.[11] This is followed by the pawnshop with Ps.49,000, MLIC at Ps.47,000 and BASIDECO with the lowest at Ps.32,000 per staff. MLIC, Pagkakaisa, and BASIDECO had a very lean staff. BASIDECO's low personnel costs can be accounted for by its use of voluntary labour. The various committees such as the education committee and the membership committee perform a number of the credit investigation and member screening on a voluntary basis.

4.6. Loan size distribution

Of the four types of institutions, the pawnshop had the lowest estimated loan size which ranged from Ps.200 to Ps.1,000. MLIC's average loan size was Ps.8,061 (table 4-11). Breakdown by loan types show that average loan size was lowest for salary loans at Ps.3,260 and highest for REML/CML which was Ps.49,042. For the Real Estate Mortgage Loan (REML)/Chattel Mortgage Loan (CML), average loan size was Ps.49,042. The figure for the Market Vendor Loans (MVL) was Ps.41,217. Average loan size for KMBI was 11,834 while BASIDECO's average loan size in 1993 was 10,850 in 1994. The sample data from BASIDECO for October, 1994 to May, 1995 had an average loan size of Ps.13,867.

In terms of loan size distribution, the REML/CML and the MVL of MLIC had the most number of loans that was in the range of Ps.10,000 to Ps.50,000 (table 4-13). It was 83 per cent for the REML/CML type with 58 per cent falling in the Ps.10,001 to Ps.20,000 range. For the Market Vendor loan, 74 per cent were within the Ps.10,0001 to Ps.50,000 range with 39 per cent in the Ps.10,001 to Ps.20,000 range and 35 per cent in the Ps.20,001 to Ps.50,000 range. For salary loans, 97 per cent fell below Ps.10,000. In the case of BASIDECO, 90 per

[11] KMBI's higher costs and lower efficiencies can be accounted for by two factors. First, the group formation and training methodology require intensive field worker input. Second, KMBI has been experiencing high staff turnover and had to train new field workers in 1994.

cent of loans were less than or equal to Ps.10,000, 8 per cent in the Ps.10,001 to Ps.20,000 range. All of KMBI's loans were less than Ps.20,000.

The distribution across the different types of loans for BASIDECO indicates that the personal loan was the more popular as it accounted for 99 per cent of the total loan amount released (table 4-11). There seems to be very little patronage of the emergency loans and the instant loans. The fact that the emergency loan functions on a reimbursement basis may be a reason for its low utilisation.

4.7 Types of activities engaged in

Retail trade accounted for over 70 per cent of all the business types.[12] Crafts and manufacturing ranked a far second with 10 per cent for BASIDECO and 15 per cent for KMBI. In the case of MLIC, personal services absorbed 36 per cent of loans, followed by retail trade at 33 per cent. Table 4-19 illustrates that most of the loans for BASIDECO and KMBI went to fund micro-enterprise activities.

For the pawnshop, data from an informal survey of over 800 respondents showed some very interesting results. In terms of income, out of 251 who responded on the question regarding income, over 70 per cent had incomes at Ps.5,000 or less. This indicates that a majority of pawners come from the low income groups. The respondents' replies also indicated that pawning is a regular practice with 57 per cent person doing so at most twice a month. Another 28 per cent did so once every three months while 26 per cent did it once a year. It seems that the low income groups convert some of their savings into relatively high value goods which they use for pawning when the need arises. It would be useful to find out reasons for not saving in cash. In terms of loan usage, the top five rankings in decreasing order were (1) everyday needs, (2) emergency, (3) tuition of children, (4) payment of debts, and (5) business. Thus, it seems that the pawnshop is really used as a source of quick cash to meet basic needs. Use for business ranked relatively low.

4.8 Sources and uses of funds (table 4-21)

The growth of MLIC was funded by a combination of capital infusion, internally generated surplus (33 per cent) and loans from investors (67 per cent). These investors are basically depositors. In the case of Pagkakaisa, the increase in assets, 78 per cent of which were loans receivable, was funded primarily from capital infusion (55 per cent) and internally generated surplus (45 per cent). Pagkakaisa did not incur any debt to fund its growth. KMBI on the other hand relied on a combination of grants and donations (59 per cent), loans (25 per cent) and unearned interest (7 per cent) and other liabilities (14 per cent). The main portion of KMBI's other liabilities consisted of members' savings held in trust by KMBI.

BASIDECO relied primarily on members' share capital (11 per cent), fixed deposits (55 per cent). Income from operations accounted for 25 per cent while savings and time deposits accounted for only 6 per cent of the total fund sources. In the case of cooperatives, the Cooperative Code mandates the setting aside of at least 10 per cent of net surplus for the reserve fund, another maximum of 10 per cent for an education and training fund, and optional funds which are not to exceed 10 per cent of the net surplus. These optional funds could include land and building, community development, and other funds as the cooperative may set up. The remaining 70 per cent is returned to members as patronage refund and interest on fixed deposits. However, the code also allows the deferment of refunds and interest

[12] Table 4-17 lists the types of business activities engaged in by the borrowers. For MLIC, data was taken from the list of the REML/CML and MVL borrowers.The salary loans of MLIC were not included in the tally. The distribution is compared with the findings of the Alonzo and Abrera-Mangahas study. Both BASIDECO and KMBI show a similar distribution with that of Alonzo and Abrera-Mangahas.

payments in order for the cooperative to build up a revolving capital fund. This is basically the nature of BASIDECO's 25 per cent income from operations.

While KMBI experienced net losses in its lending operations, all other three types of financial suppliers have reinvested their earnings into their operations. Earnings comprise a substantial source of funds ranging from 25 per cent in the case of BASIDECO to 45 per cent in the case of the Pawnshop.

In terms of funds application, loans receivable accounted for 63 per cent for MLIC, 78 per cent for Pagkakaisa, 28 per cent for KMBI, and 72 per cent for BASIDECO. Both MLIC and Pagkakaisa had very minimal investments in fixed assets. On the other hand, investments in fixed assets accounted for 36 per cent of total fund use for KMBI. It was 24 per cent for BASIDECO. Worth noting is that KMBI had acquired land and constructed a building in 1994. BASIDECO's fixed investments were in their market place.

4.9 Financial structure

Loans receivable account for the major portion of MLIC and Pagkakaisa's assets. In 1994, loans receivable were 76 per cent of MLIC's total assets. For Pagkakaisa, it was 88 per cent at the end of 1993. This is the highest proportion among the four institutions. MLIC had 15 per cent in other current assets but with 13 per cent of the 15 per cent consisting of uncollected income (table 4-22). Factoring out MLIC's uncollected income, the two types of institutions would have a similar asset structure. The big proportion of loans receivable is to be expected as lending is their primary business.

As pointed out earlier, both institutions have very little investment in fixed assets. Fixed assets were 4 per cent for MLIC and 3 per cent for Pagkakaisa. The nature of their operations do not require substantial investments in fixed assets. Only office space and equipment are needed. This contributes to a more efficient use of resources as it allows the main portion of its resources to be devoted to lending. In the case of the pawnshop, Central Bank regulations require the presence of a vault for the safety of pawned items. Thus, a pawnshop may require more investments in fixed assets than a lending investor. The lower percentage and absolute amount of Pagkakaisa is due to the averaging of its investments which were lower during its initial years of operation.

For BASIDECO and KMBI, both the proportion of fixed assets and its absolute value were more substantial when compared to the MLIC and Pagkakaisa. Loans receivable were 41 per cent of KMBI's assets while fixed and other assets comprised 28 per cent. Cash and investments accounted for 30 per cent. KMBI's liquid position, specially the 25 per cent cash on hand, is due to the inflow of grants which have not yet been moved or invested. The major portion of its fixed assets is the office building and training centre which KMBI had decided to invest in. In the case of BASIDECO, its original function was to own and manage the market site. Thus, fixed assets accounted for 35 per cent of its total assets. Loans receivable were 58 per cent and cash 6 per cent of total assets.

On the liabilities and equity side, MLIC's loans payable were 50 per cent of total liabilities and equity. The balance is accounted for by 32 per cent equity and 18 per cent retained earnings. Pagkakaisa had no liabilities with capital accounting for 51 per cent of equity and retained earnings for 49 per cent. For KMBI, loans payable was 25 per cent of total liabilities and equity. Worth noting is that the mutual fund, which is composed of savings of members, account for 11 per cent of liabilities. This comes to an average of Ps.1,876 per member. Fund balances accounted for the remaining 57 per cent.

BASIDECO had not declared any dividends from 1992 to 1994 which accounts for the 11 per cent in interest and patronage refund payable. In actuality, the interest and patronage refund payable represent the members' additional deposits in the cooperative. Deposits comprise another 15 per cent. Fixed deposits were almost four times the members' share capital at 44 per cent. This can be accounted for by the saving incentive resulting from tying credit limits to fixed deposits. Fixed deposits, share capital, reserves and interest and patronage refund payable account for over 72 per cent of total liabilities. Reserves were 10.4 per cent of total equity and reserves and 6 per cent of total assets. On the average each member in BASIDECO had Ps.804 worth of members' share capital, Ps.2,972 worth of fixed deposits, Ps.402 worth of reserves, and Ps.737 worth of patronage refund and interest payable.

4.10 Financial performance

MLIC has the highest rate of operating income/loans outstanding at 61 per cent. This is followed by Pagkakaisa with 45 per cent, BASIDECO 24 per cent and KMBI 35 per cent. Actual cost of funds for MLIC was 2 per cent of loans outstanding, 4 per cent for KMBI and 1 per cent for BASIDECO. In terms of operating costs to loans outstanding, KMBI had the highest at 34 per cent, followed by MLIC at 25 per cent, BASIDECO at 16 per cent and Pagkakaisa at 14 per cent. Except for KMBI, all other three institutions experienced positive net incomes.

The ratio net income loans outstanding was highest for MLIC at 33 per cent, followed by Pagkakaisa at 29 per cent, BASIDECO at 16 per cent. KMBI's cost exceeded its revenues and had a negative 3 per cent ratio of net income to loans outstanding.

Total cost per unit of loans outstanding was lowest for the pawnshop at Ps.0.16, followed by BASIDECO at Ps.0.17, MLIC at Ps.0.28 and KMBI at Ps.0.38.

The evaluation of costs due to default or bad debts depends on the institution's write-off policy or loan loss provision. It was 1 per cent for MLIC and 2 per cent for Pagkakaisa. KMBI's and BASIDECO's provisions were negligible: all of which indicates inadequate provision for bad debts or loan defaults. Both MLIC and Pagkakaisa would still have a fairly comfortable position even if the write off provision was raised to 10 per cent. However, this would reduce BASIDECO's spread to only 6 per cent and increase KMBI's losses.

Data on loan portfolio quality had not been readily available from MLIC, the pawnshop, and BASIDECO. In the case of a pawnshop, since they regularly clean up their books and do auction sale of unredeemed items, the loan portfolio carried is most likely current. Worth noting is that the pawnshop gets its business not so much on the possession of pledged items but on the interest.

However, in looking at the financial viability, the difference between KMBI's and FEDI's approach and the others is that these NGOs include a social preparation component. In a prior study, KMBI's share of costs that can be chargeable to social preparation were 22 per cent of total costs. Social preparation is defined to include all activities related to preparing the group prior to loans application. If this factor is considered, then KMBI's total costs on loans outstanding would be reduced to 0.296, resulting in a positive 0.054.

Part 5

Conclusions and recommendations

Conclusions and recommendations

1. The market for financial services in the urban informal sector is large and continues to grow, illustrated by the rapid growth rates experienced by the case-study subjects and the double digit growth figures in terms of number and assets of pawnshops and lending investors.

2. "Banking with the poor" can be a very profitable option. The key is finding the right combination of factors to meet credit and savings needs (see pawnshops). One of the keys to success in micro-lending is to keep overheads very low. This is certainly something that non-profit organizations 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.

3. Pawning indicates that there is probably a "chronic" cash flow mismatch at least with those who pawn their items. This merits a more in-depth look with a view to design alternative financial products. The pawnshop owner indicated that the "default rate" in pawnshops is between 10-20 per cent. Again, this shows a high rate of redemption which bolsters diagnosis of a chronic cash flow. Another interesting insight from the pawnshop operations is that people seem to prefer to invest in kind rather than in cash and liquidate the investment when needed.

4. The review of the urban informal sector and the attempts of BASIDECO and KMBI to provide mutual fund support for health, emergencies and education, indicate the need for a package approach for the informal sector, and more particularly the poor.

5. There also seems to be a limit to the maximum number of borrowers a particular money lender can or will want to service.

6. Deregulation and the very low capital requirement on lending investors and pawnshops have contributed substantially to their growth. The main constraint faced by such operators is ready access to additional capital.

7. In the area of pricing, while both the lending investor and the pawnshop charge relatively higher rates, there are indications based on the assessment of the case-study respondents of increasing competition and consequently a push to lower rates.

8. The experiences of BASIDECO, FEDI and KMBI confirm that there is a huge potential for savings mobilization. The BASIDECO experience is a prime example of how savings mobilization, coupled with a lending window, allows money to circulate within the group or community and increase the options for investment. It seems that among the urban informal sector, what is lacking is the technology on how to go about such activities. The package provided by FEDI certainly did stimulate interest and generated substantial savings from the members. In FEDI's case, seed capital is used to stimulate savings and then is gradually withdrawn as the funds are built up. The approach also relies on the self-help and savings of members.

9. Key constraints include funding to cover the initial upfront social investments required in building up groups. Funds for credit are more readily and locally accessible.

10. Another problem is the high staff turnover experienced invariably by all implementors. Low pay combined with hard work seem to take its toll. Thus, NGOs always find themselves with a constant need for continually training new staff.

11. Quite a number of NGOs/POs/cooperatives are involved in the provision of financial services. Most are weak in credit and financial management and do not have a good handle on designing and managing a good credit programme. The survey on self-help groups indicated that while there are a number involved in credit, repayment experience has generally been disappointing and hovered around 60 per cent. Many of these are unaffiliated to a larger network which could provide them with assistance. There are currently a number of progressive and active cooperative networks with good training programmes and outreach. They represent a resource and could serve as a conduit for technical assistance.

12. There is a need and a demand for a capability-building programme for credit NGOs/POs/cooperatives that makes use of existing networks and structures to lower start up costs and ensure sustainability. The capability-building programme should not only consist of training but should include direct consultancy and technical assistance to the implementors so that specific problems are addressed. 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.

Annex A

National Credit Council
Policy guidelines for credit for the poor

Credit is a potent strategy in empowering the poor. The National Credit Council (NCC) has recognized this and in fact initiated efforts to ensure that credit is provided to the most marginalized sectors of society. In the NCC's Policy Guidelines for Credit Programs, specific provisions were drawn up to ensure that all government lending programs are rationalized and better coordinated to void possible duplication and to maximize positive impact on the intended beneficiaries. However, given the policy provisions and the unique constraints of the poor (particularly on credit), the need to establish a complementary set of guidelines to address this concern became apparent. Thus, this document aims to strengthen the already approved Policy Guidelines on Credit Programs by the NCC vis-à-vis the poor. It shall apply to all government lending programs or programs geared towards reaching the poor as the primary client.

On the role of implementing government agencies

(1) Government line agencies as well as local government units must focus on technical assistance, capability-building, project development and packaging services. If the technical assistance is sound, then the projects should be viable, and the banks or any of the participating financial institutions (PFIs) should be more interested to lend to these projects. Costs related to capacity-building such as education and training operation of information centers, etc. may be borne by government agencies.

(2) Government services should be extended in terms of brokering and initiating institutional and financial linkages between borrowers and the PFIs.

(3) Government agencies must primarily focus on providing or facilitating the provision of other critical support services like transportation, irrigation, roads, public markets, electrification, ports, extension services seed and other rural infrastructures and services. These services/facilities are critical components of the Rural Delivery system, only of which is the financial intermediation sub-system.

(4) Government agencies should course all their lending activities through banks/PFIs including credit unions, cooperatives and accredited non-government organizations.

On the role of the banks and participating financial institutions

(1) Banks and PFIs serving as conduits shall provide the loans and perform cash handling and collection functions.

(2) It is expected that the lending/decision criteria of the banks/PFIs to be established jointly with the concerned government agencies and representatives of the target sectors.

(3) PFIs participating as lending conduits may share a portion of the funding requirements and/or the risk involved in the project.

(4) In some instances or when the “fund owner” (i.e. government agency) deems it necessary, the PFIs services may be limited to loan releasing/collecting and/or cash handling.

On the role of non-government organizations

(1) Non-government organizations can take the role of PFIs in servicing the credit requirements of the poor.

(2) In general, non-government organizations should liaise for the needs of the marginalized sectors.

(3) Non-government organizations should be allowed to source its own funds independent of government to support the social preparation activities of the poor towards the formation of self-reliant and self-transcending communities.

On the role of donor agencies and external funding

(1) In general, the Philippine banking/financial system is capable of supplying most of the financial requirements for short and medium-term (less than three years) projects but are inhibited in lending to the poor because of lack of incentives, viable institutional conduits and financially sustainable mechanisms.

(2) Donor agencies and external funding are welcome to support the following components of credit projects:

- development of PFIs in delivering credit to disadvantaged sectors
- project development
- project packaging
- group/organization/training
- feasibility study/preparation
- technical and management assistance
- monitoring cost
- project modeling/pilot-testing
- input assessment costs
- market access
- communication.

(3) Donor funds for relatively large scale (over Ps 10 M), long terms (5 years), heavily technical and usually high-risk projects are welcome.

(4) Start-up funds for projects may be secured to serve as initial funding for projects. Such seed funding should still be coursed through banks/PFIs. These funds provide the additional liquidity for the banks/PFIs to undertake new innovative riskier ventures.

(5) Seed funding for short-term projects may be secured only to the extent that:

- bank and participating financial institutions are demonstrated to be unable to provide full funding;
- seed funding is provided only for strategic interventions for a given period depending on the nature of the project;
- seed funding is provided only for a part of project requirements — with the balance covered by group equity and partial bank/PFI funding.

(6) Donor agencies should reorient their programs for credit to more holistic approaches to appreciate the environment in which the poor should operate a sustainable livelihood project. This should include capability-building, social preparation, social services and basic infrastructure.

On the savings mobilization/capital build-up component

(1) Credit programs must promote a savings mobilization or capital build-up program. The savings performance of borrowers will manifest their savings discipline and readiness to assume the responsibilities of a good borrower.

(2) This (savings mobilization) program may be undertaken before or during the lending phase.

(3) The savings mobilization or capital build-up component is critical in order to develop the sustainability of the credit program and the borrowers.

(4) Savings accounts deposited with the lending banks/PFIs may serve a partial collateral for loans — i.e. specially in cooperatives where loans are multiple deposits. For the poor, however, savings may also serve as a contingency fund to cover expenditures which are emergency in nature, e.g. calamities, sickness, deaths, etc.

(5) Savings accounts deposited with the lending banks/PFIs also serve as partial collateral for loans and this enhance future access to loans — i.e. especially in cooperatives, where loans are multiple deposits.

On the equity contributions of borrowers

(1) Equity contribution shall be established and required from the borrowers. The savings mobilization/capital build-up component may provide the mechanism for borrowers to be able to raise an equity counterpart for the project. Such contributions lessen the debt burden of the borrowers, and also increase the probability of repayment.

(2) The equity contribution of the borrower is not necessarily in cash. Depending on the standards of the financial institution participating in the project, labour raw materials, project sites and other facilities may be acceptable.

On the interest rate

(1) As a general rule, the interest rate borne by a project should not exceed its expected internal rate of return (IRR). Projects with IRRs lower than the prevailing market rate of interest should not, in principle, be undertaken.

(2) As much as possible, the interest rates to be charged should cover the full lending cost including the cost of fund and any transactional, administrative and monitoring costs. Interest rates however should not include activities funded through grants.

(3) In case of loans for small farmers, the maximum rate of interest should not exceed 75 per cent of the commercial rate inclusive of all charges.

On collateral and guarantees

(1) For the poor sector, considering the unique requirements of this group in utilizing credit as a means to sustainable livelihood, the community-based organization with which a poor borrower belongs to shall assume the guarantee for loan repayments in lieu of physical collateral.

Annex B

Tables

Table 4-1. BASIDECO: Time deposit interest rates

Range of deposits (Ps.)	Interest rates per annum (per cent)
5 000-10 000	10
11 000-25 000	11
26 000-50 000	12
51 000-75 000	13
76 000-100 000	14
101 000-500 000	15

Source: BASIDECO record.

Table 4-2. Savings and capital generated by association FEDI: Kaunlaran Pangkabuhayan Project

Area	Tatalon, Quezon City		Calookan	
KP Association	Samahang Kababaihan Sa Barangay Kaunlaran Pangkabuhayan (SKBKP)		Kaunlaran Pangkabuhayan Para Sa Kababaihan (KPPK)	
Date loan granted	13 April 1993		20 August 1993	
Account title	Starting amount (Ps.)	As of December (Ps.)	Starting amount (Ps.)	As of December (Ps.)
Capital build-up	17 965	43 600	6 743	15 731
Group fund		52 495		17 339
Operating fund		12 927		4 711
Social development		38 070		14 562
Total savings		147 092		52 343
Average savings per		5 917		2 094
Amortizations paid		87 300		32 722

Source: FEDI records.

Table 4-3. Savings mobilization status by institution

	KMBI	FEDI	BASIDECO
Type of fund	Member savings	Member savings	Share capital and fixed deposits
Date programme started	1991	1992	1992
Total amount	Ps.2 204 million	Ps.0 199 million	Ps.1 813 million
Number of members	1 189	50	508
Average per person	Ps.1 854	Ps.3 989	Ps.3 569

Source: Organization's records.

Table 4-4. BASIDECO marketing services results (Ps.)

Year	Capital	Sales	Profits
1993	145 400.00	153 076.00	7 676.00
1994	142 380.00	150 390.00	8 010.00

Source: Report of the Chairperson contained in its Annual Report to the General Assembly.

Table 4-12. Comparative highlights: Operational measures

	Lending investor	Pawnshop	KMBI	BASIDECO
	1994	1993	1994	1994
Number of staff:				
Board			7	7
Management				
Part-time	1			
Full-time	2	1	9	1
Finance/Administration				
Part-time	2			
Full-time	2	2	8	2
Credit and collection				
Part-time	1			
Full-time	3		13	2
Total				
Part-time	4	0	0	0
Full-time	7	3	30	5
Total staff	11	3	30	5
Average number of loans/staff	49	2 000	60	
Average amount of loan/staff	629 455	1 500 000	710 433	
Average number of borrowers/members per staff	46	2 000	42	109
Average personnel cost/staff	47 000	49 000	54 667	32 000
Average number of loans/field staff (credit and collection)	286	2 000	139	109
Average amount of loans/field staff	2 308	1 500 000	1 639 000	1 180 600

Table 4-13. Loan size distribution

Organization	Lending investor			BASIDECO	Pawnshop	KMBI
Reference period	1994			Oct.94-May 95	1993	1994
Loan type	REML/CML	MVL	Salary	Personal		
	Number					
0 to 10 000	0	0	742	181	6 000	
10 001 to 20 000	41	9	23	17		1 801
20 001 to 50 000	18	8		4		
50 001 to 100 000	5	4				
100 001 to 300 000	5	2				
Over 300 000	2	0				
Total — 859	71	23	765	202	6 000	1 801
Percentage of total	8	3	89			
	Per cent					
0 to 10 000	0	0	97	90	100	
10 001 to 20 000	58	39	3	8		100
20 001 to 50 000	25	35	0	2		
50 001 to 100 000	7	17	0			
100 001 to 300 000	7	9	0			
Over 300 000	3	0	0			
Total	100	100	100	100	100	100

Table 4-14. MLIC loan size distribution by type of loan

Days	REML/CML	MVL	Salary	Total
	Number			
30	6	0	0	6
60	3	2	0	5
90	21	4	184	209
120	7	1	0	8
180	25	14	445	484
360	9	2	113	124
Total	71	23	742	836
	Percent			
30	8	0	0	1
60	4	9	0	1
90	30	17	25	25
120	10	4	0	1
180	35	61	60	58
360	13	9	15	15
	100	100	100	100

Table 4-15. BASIDECO: Repayment terms availed, 29 October 1994 to 14 March 1995

Repayment term options (days)	Effective number of working days	Number of members who availed	Percentage of total	Amount of loan (Ps.)	Percentage distribution
100	85	138	67.0	1 086 700	45.3
150	129	64	31.1	1 064 700	44.4
200	166	4	1.9	247 200	10.3
Total		206	100	2 398 600	100

Source: Loan portfolio file. Other files were with the External Auditor at time of research.

Table 4-16. BASIDECO: Repayment schedule by frequency for the period 29 October 1994 to 14 March 1995

Repayment frequency	Number of members who availed	Percentage distribution to total	Amount of loan (Ps.)	Percentage distribution
Daily	130	64.0	1 651 200	68.8
Weekly	56	27.6	512 300	21.4
Semi-monthly	17	8.4	235 100	9.8
Total	203	100	2 398 600	100

Table 4-17. Type of economic activity engaged in (Summary)

	Lending		BASIDECO		KMBI		Alonzo	
	No.	%	No.	%	No.	%	No.	%
Retail trade	12	33	129	78	72	89	1 494	70
Crafts and manufacturing	3	8	17	10	15	19	281	13
Livestock raising	0		5	3	1	1	0	0
Personal services	13	36	6	4	1	1	114	5
Transport	2	6	6	4	0	0	98	5
Repair services	2	6	0	0	0	0	84	4
Construction	2	6	1	1	0	0	46	2
Professional services	2	6	2	1	0	0	24	1
Total	36	100	166	100	80	100	2 141	100

Table 4-18. FEDI: Number of loans by area and project type

Project type	New	Existing	Tatalon	Calookan
Ragmaking	7	2	9	
RTW/buy and sell	3	7	2	8
Variety store	2	6	4	4
Service	2	6	5	3
Food items		7	2	5
Plastic bags		1		1
Other	2	5	3	4
Total	16	34	25	25

Table 4-19. Type of economic activity engaged in

	Lending investor		BASIDECO		KMBI		Alonzo survey	
	No.	%	No.	%	No.	%	No.	%
Retail trade		33		78		89	1 494	70
Sari-Sari store	11		46		25		780	36
Cooked food vendor					10		243	11
Banana vendor			4					
Sago vendor			3					
Palamig			2					
Barbecue			1					
Carinderia			9		7			
Raw food							122	6
Meat			12		2			
Fish			12					
Dried fish			4					
Egg vendor			1					
Crops								
Vegetable			16		3		46	2
Fruit			6		2			
Rice					1		30	1
Peanuts			1					
Other food								
Ice							98	5
Salt vendor			2					
Soft drinks/beer								
Dealership								
Health products	1				4			
Cosmetics			2					
Other								
Clothes/garments					4		44	2
General trader			2		4			
Sampaguita vendor			1					
Feeds store			1					
Handicrafts			1					1
Hardware							22	0
Car parts/used cars							17	0
Livestock (pigs)							15	0
Old/scrap items					2		15	0
School supplies/newspaper							11	
Appliances								0
Houseware					2		8	
Jewellery					1			
Plastic ware			3		2			
Unlabeled/other					2			3
							72	

	Lending investor		BASIDECO		KMBI		Alonzo survey	
	No.	%	No.	%	No.	%	No.	%
Crafts and manufacturing		8		10		19	281	13
Dress shop/garments	2		3		2		155	7
Rugmaking					3			
Bakery/cakehouse			8				35	2
Door mat					2			
Slippers					2			
Throw pillow					1			
Glove making					1			
Metal works			2		1		26	1
Decors/artificial flowers							9	0
Rattan furniture	1						9	0
Shoes/leather goods					3		7	0
Food processing								
Togue and wrapper maker			2					
Handicrafts			2					
Unlabeled/other							40	2
Livestock raising				3		1		
Piggery			5		1			
Personal services		36		4		1	114	5
Beauty parlours	3		2				69	3
Tape/video rental			2				7	0
Printing press	3						3	0
Recruitment agency	1							
Entertainment agency	1							
Pawnshop	1							
Money lending	1							
Photographer			1					
Billiard operator			1					
Restaurant	3							
Room rental					1			
Unlabeled/other							35	2
Transport		6		4		0	98	5
Tricycle driver			3				75	4
Jeepney driver			2				22	1
Jeepney operator	2		1					
Taxis							1	0
Repair services		6		0		0	84	4
Vehicle repair							38	2
Electronic repair	1						34	2
Vulcanizing	1							
Unlabeled/other							12	0
Construction		6		0		0	46	2
Carpentry							28	1
Painting							11	0
Contractor	2		1					
Unlabeled/other							7	0
Professional services		6		1		0	24	1
Pharmacy	2		2				10	0
Optical							7	0
Midwifery							7	0
Employees		0	27	0		0		
Total		100		100		100	2 141	100

Table 4-20. Comparative Highlights (thousand Pesos)

	Lending investor	Pawnshop	KMBI	BASIDECO	FEDI
Year started	1993	1988	1986	1985	1984
Number of years in	2	7	10	10	2[13]
Initial start-up capital	300	100	132	50	1,500
Status as of:	Dec. 94	Dec. 93	Dec. 94	Dec. 94	Dec. 94
Number of branches	2	11	None	None	None
Number of members	N/A	N/A	1,189	508	150
Areas of operations	Tatalon Q.C. Rosario. Cavite	Tondo, Sampaloc, Caloocan, Quezon City, Pasig	Valenzuela, Quezon City, Caloocan + 5 other areas	Bagong Silang Tala Camarin (all in Caloocan)	Tatalon, Q.C. Kalookan City GMA, Cavite
Total asset size	6,386	22,810	20,276	3,404	3,677
Amount of loans released (latest year)	6,924	53,600[14]	21,313	5,903	600
Current loans outstanding	4,862	20,300	8,233	1,981	409
Number of loans released	836	71,500[15]	1,801	544	6[16]
Average loan size (1X1 Pesos)	8,282	750	11,834	10,851	100,000
Total loans released/loans outstanding	1.9	2.3	2.5	3.4	1.5
Base year data	1993	1988	1991	1992	N/A[17]
Asset size	2,647	717	6,048	1,292	N/A
Outstanding loans	2,335	612	3,998	409	N/A
Number of loans	N.D.[18]	3,760	510	N.D.	N/A
Amount of loans	5,069	2,821	2,820	N.D.	N/A
Average Annual Growth					**Per cent**
Asset	141.0	107.0	50.0	62.0	N/A
Loans receivable	108.0	108.0	27.0	120.0	N/A
Number of loans	N.D.	2,250	52.0	N.D.	N/A
Amount of loans disbursed	37.0	13,776	43.0	N.D.	N/A

13 Refers only to FEDI's lending operations.

14 Derived figure using annualized Balance Sheet Pledged Loans figure.

15 Derived using Ps 750 per loan.

16 The KP program gives group loans to groups of 25 people. To date, FEDI had released funds to 6 groups at PS 100,000 per group as specified by the KP Guidelines.

17 N/A - not applicable.

18 N.D. - no data/data not available.

Table 4-22. Aggregate financial structure (per cent)

	Lending investor	Pawnshop	KMBI	BASIDECO
Year started	May 1993	1988	1986	1983
Reference year	1994	1993	1994	1994
A. Asset composition				
1. Cash on hand and in banks	3	9	25	6
2. Investments	2	0	5	0
3. Loans receivable	76	88	41	58
Loan loss allowance	0	1	0	0
4. Other current assets	15	0	1	1
5. Fixed and other assets	4	3	28	35
Total assets	100	100	100	100
B. Liability composition				
1. Loans payable	50		25	0
2. Savings deposits			0	10
3. Time deposits			0	5
4. Total deposits				15
5. Mutual funds			11	
6. Interest and patronage refund payable				11
7. Other liabilities	-0		7	14
Total liabilities	50	0	43	41
C. Equity composition and size				
1. Capital	32	51		
2. Retained earnings	18	49	57	
Total equity	50	100	57	
3. Members' share capital				12
4. Fixed deposits				44
5. Undivided earnings				-2
6. Reserves				6
Total members' equity and reserves				59
Total liabilities and equity	100	100	100	100

Table 4-23. Rate of return and costs

	Lending investor	Pawnshop	KMBI	BASIDECO
Reference year	1994	1993	1994	1994
Inflation rate	9.2	7.6	9.2	9.2
T-bill rates 90 days				
High 1994 — 15.87				
Low 1994 — 8.659				
Income composition				
1. Interest income on loans	64%	87%	87%	47%
2. Fees and charges	36%	13%	6%	23%
3. Interest income on investments	0%	0%	8%	0%
4. Other income	0%	0%	0%	29%
Total income	100%	100%	100%	100%
(Total income — other income)/loans	61%	45%	35%	24%
Cost of funds/loans outstanding	2%	0%	4%	1%
Operating expenses/Loans outstanding				
Personnel costs	14%	10%	19%	9%
Administrative and others	11%	4%	15%	7%
Total operating expenses	25%	14%	34%	16%
Cost of defaults/bad debts	1%	2%	0%	0%
Total costs/loans outstanding	28%	16%	38%	17%
Net income/loans outstanding	33%	29%	-3%	16%
Operating expenses/operating income	46%	35%	107%	52%
Total income/average assets	49%	36%	18%	19%
Gross interest income/average assets	31%	32%	16%	9%
Net income/average assets	27%	24%	-1%	9%
1. Net income/equity	37%	21%	-2%	15%
2. Net operating results after reserves/Total				48%
Debt to equity ratio	100%	0%	45%	0%
Total deposits/total assets	0%	0%	11%	15%
Equity/total assets	50%	100%	57%	59%
Past due loans/loans	5-7%		24%	
Repayment rate	85%	80-90%		80-96%
Cost per unit loan	1 858	39	1 795	557
Cost per peso loan	0.15	0.05	0.15	0.05
Cost per loans outstanding	0.28	0.16	0.38	0.17

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