



**APRACA FinPower Program**

**No. 6**

**COMPLETION REPORT:**

**FinPower Microfinance Development Forum – Dialogue in Thailand**

**Facilitator:**  
**Benedicto S. Bayaua**

**Documentor and Expert:**  
**Eduardo C. Jimenez**

An APRACA FinPower Publication with the Special Sponsorship of  
the International Fund for Agricultural Development (IFAD)



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The Secretary General  
Asia-Pacific Rural and Agricultural Credit Association (APRACA)  
39 Maliwan Mansion, Phra Atit Road  
Bangkok 10200, Thailand  
Tel: (66-2) 280-0195  
Fax: (66-2) 280-1524  
E-mail: [apraca@apraca.org](mailto:apraca@apraca.org)  
Website: [www.apraca.org](http://www.apraca.org)  
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## Acronyms and Abbreviations

ACCU	Association of Asian Confederation of Credit Unions
ACPC	Agricultural Credit and Policy Council
AFF	Agriculture, Fishery and Forestry
APPEND	Alliance for Philippine Partners in Enterprise Development
BDS	Business Development Service
BAAC	Bank for Agriculture and Agricultural Cooperatives
BOT	Bank of Thailand
BSP	Bangko Sentral ng Pilipinas (Central Bank)
CAD	Cooperative Auditing Department
CAF	Corporacion Andina de Formento
CB	Commercial Bank
CCRD	Credit Committee for Rural Development
CPD	Cooperatives Promotion Department
CDA	Cooperative Development Authority
CISA	Credit Information System Act
DBP	Development Bank of the Philippines
DOF	Department of Finance
EIU	Economist Intelligence Unit
GNP	Gross National Product
GSB	Government Savings Bank
IADB	Inter-American Development Bank
IC	Insurance Commission
IFC	International Finance Corporation
KTB	Krung Thai Bank
LBP	Land Bank of the Philippines
MAC	Ministry of Agriculture and Cooperatives
MBO	Micro-Banking Office
MCPI	Microfinance Council of the Philippines, Inc
MFI	Microfinance Institution
MOF	Ministry of Finance
NBC	National Bank of Cambodia
NCC	National Credit Council
NGO	Non Governmental Organization
NIC	Newly Industrialized Country
OBO	Other Banking Office
OFW	Overseas Filipino Workers
PCFC	People's Credit and Finance Corporation
PFI	Private Financial Institution
SBGFC	Small Business Guarantee Fund Corporation
SEC	Securities and Exchange Commission
SFI	Specialized Financial Institution
SHG	Self-Help Group
SMEs	Small and Medium Enterprises



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## A. Introduction

The Republic of Thailand, Cambodia and Philippines are three distinct countries but at the same also share some commonalities. Thailand has been considered as a newly industrialized country (NIC), both Cambodia and the Philippines are still classified as developing countries. These two countries have successful microfinance practices which Thailand may want to consider in order to support its new initiative to promote financial inclusion.

The Philippines is an archipelagic country while Thailand and Cambodia share together with Lao PDR and Vietnam, the Vietcong region, which is a landlocked area connected by the Vietcong river. The Philippines has also a number of landlocked areas that are considered very hard to reach. Some of these areas, locally known as “frontier areas” are not easily accessible by government services and by the private sector. Thailand and Cambodia are multi-party democracies under constitutional monarchies. The Philippines on the other hand, is considered one of the oldest republics in Asia.

Agriculture plays a vital role in these three countries and a big chunk of farmers rely on credit as a vital input to their respective agricultural production. The Bank for Agriculture and Agricultural Cooperatives (BAAC), a government bank in Thailand mainly supports the financial requirement of the rural farmers. In the case of Cambodia, the Credit Committee for Rural Development (CCRD), also a government agency was created in 1995 to support rural development in the country. Meanwhile, the Development Bank of the Philippines (DBP) and the Land Bank of the Philippines (LBP), both state banks, have extensive networks of branches supporting the farmers and other agrarian based workers in the Philippines. These Philippine state banks and other government-owned controlled corporations help address the needs of the farmers and other entrepreneurial poor by providing wholesale funds to accredited private financial institutions (PFIs). Just like in Cambodia, before credits or loans are given by retailers, whether NGOs, cooperatives or banks, value laden training and capacity building sessions are provided to potential borrowers in the Philippines. On the other hand, Thailand has begun crafting regulations to further position and promote Specialized Financial Institutions (SFIs) to serve the needs of the poor people in the rural areas.

The incidence of rural poverty in Cambodia and the Philippines remain large in proportion to their respective total populations, hence, the need for government banks to support the requirements of the poor. Thailand due to its booming economy has significantly reduced to single digit (8.48 percent) the number of its poor people but still a significant (5.4 million) number need appropriate financial services. All countries adhere to the notion of Gross National Product (GNP), per capita income and poverty incidence as measurements of economic development.

The papers presented by the Central Bank and Ministry of Finance (MOF) officials from Cambodia, Philippines and Thailand provided relevant insights as to the state of rural and microfinance exposures in the three countries. The papers also highlighted the disparity of financial services in urban and rural areas and laid down the challenges, developments and lessons learned in the field of rural credit and microfinance.

## B. Synthesis of Country and Institutional Papers

### 1. Thailand

In Thailand, commercial banks, specialized financial institutions (SFIs and state owned banks), cooperatives, including credit unions, and non-bank operators provide direct financial services to the low income groups. In providing the needed financial services, these financial institutions have to observe and comply with certain prudential regulations, thus hampering the flow of micro-credit to the borrowing public.

To gain financial resources as well as financial intermediaries, the Thai people pooled their financial resources to set up savings group in their communities. These savings groups acts as the financial intermediary serving all people in the community despite the disparity in financial and wealth status of individual households. Currently, there are more than 35,000 savings groups spread all over the country and the number is still increasing.

The government recognizes the importance of the financial accessibility for all people and the soundness and sustainability of the microfinance system for Thailand. In December 2006 the cabinet approved the *Microfinance Master Plan* with the main objective to strengthen the capacity and operation of the community-based financial system in order to enhance the sustainability of the savings group and well-being of the people.

With respect to expanding the role of commercial banks in dealing with microfinance, the *Financial Sector Master Plan Phase II* has been crafted to help the poor community in rural areas access the needed financial services by improving efficiency of financial institutions through reducing system-wide operating cost, promoting competition and financial access, and strengthening financial infrastructure.

The Ministry of Finance also launched the *Specialized Financial Institutions Master Plan* (SFIs Master Plan) to enhance the role of SFIs in fulfilling financial gaps and operational overlaps.

With these plans, the government aims to strengthen rural communities, increase financial access for low-income group and alleviate the social disparity problem.

#### Microfinance System in Thailand

The paper categorized microfinance service providers into three divisions namely:

- 1) **Formal category** consists of institutions which operate under prudential regulations such as Commercial Bank (CB) and SFIs. The total microcredit supplied by formal financial institutions is approximately 1.8 trillion baht (17 percent of total credit).
- 2) **Semi-formal category** includes institutions whose aims are to promote community-based savings and investment, and are supported by the public sector. These include cooperatives and Village and Urban Community Funds. The amount of funds provided by this category is about 940 billions baht or roughly 8 percent of the total credit.
- 3) **Informal independent and Self-help group** founded by the community members to mobilize savings and provide financial services for their own community members. These groups are usually established with the support from external organizers, including Community Development Department, NGOs, local governments, and monks. Most of them follow either the village bank model or the solidarity group operating model. Although there is no specific data on the number and amount of funds, the Fiscal Policy Office estimated that credit supplied by MFIs in this group is around 33 billions baht.

## **Rural Finance in Thailand**

Rural finance is one of the significant parts of microfinance which aims to provide financial services to the low income group. The following are the five institutions responsible for providing financial services to the rural people as well as promoting sustainable rural development through various activities.

- 1) Bank for Agriculture and Agricultural Cooperatives (BAAC) – established by the Government of Thailand in 1966 as the primary agricultural bank providing credit to the agricultural sector.
- 2) Government Savings Bank (GSB) – In 1913 GSB became the first government-owned Bank to focus on “micro” savings. Its main purpose is to educate the Thai people on banking services and promote savings habit among the Thais. It is presently one of the Specialized Financial Institutions (SFIs) under the supervision of the Ministry of Finance (MOF). It has 930 branches all over the country.
- 3) Village and Urban Community Fund – launched in 2001 and aimed to provide 1 million Baht to every village in urban communities in Thailand as working capital for locally-run rotating credit associations. The fund’s main objectives are to create financial sources, develop capital management ability and promote self-reliance among people towards sustainable economic development. As of December 31, 2009, there are 79,255 community funds with 12.8 million committee and members with resources aggregating 124,729 million Baht.
- 4) Cooperatives – are member-based organizations making up the second largest group of microfinance service providers in Thailand. This group provides savings and credit services, as well as product distribution services through member shops. Cooperatives are regulated under the Cooperatives Act of 1968 and oversight and supervision are provided by the Cooperatives promotion Department (CPD), Cooperative Auditing Department (CAD), and Ministry of Agriculture and Cooperatives (MAC). At present there are seven types of cooperatives namely, Agricultural, Fishery, Land Settlement, Consumer, Service, Thrift and Credit, and Credit Union. As of December 31, 2009, there are 7,737 audited cooperatives with 10.6 million members, 321,050 million Baht deposits and 739,498 million Baht loans.
- 5) Self-help group (SHG) – started in 1965 as joint efforts of members and community leaders to promote access to formal financial services. Most of the self-help groups apply village bank or solidarity group methodologies. Many of them started as community development projects with financial assistance and technical support from external organizers, including Community Development Department, NGOs, local governments, and monks. Apart from providing savings and credit, some of these groups also use their surplus profit to set up multi-purpose welfare funds covering health, education, occupation, support for the vulnerable, and pension. Presently, there are more than 35,000 savings group spread all over the country and the number is still increasing.

## **2. Philippines**

### **Socio-Economic Profile**

The Philippines, is an archipelagic nation of about 7,100 islands, with 3 major island concentration, i.e, Luzon, Visayas and Mindanao. In its unofficial census report as of 2009, the population of Philippines reached 92.0 million. The Philippines is politically and administratively divided into 16 regions with Metro Manila as the center of business and commerce as well as political activities. Metro Manila reports a current population of about 11 million.

The big challenge for the Philippine economy is for growth to continue, however modest, and not fall into recession. The Philippines in the last few years have made inroads in battling poverty through pro-

poor and middle class programs, including access to financial resources, which are generally hard to access by the poor from the regulated financial sector.

About half of the country's population lived in rural areas where poverty is most severe and widespread. Dependence on agriculture, mostly subsistence farming and fishing are generally the only source of income for the poor rural people. The roots of poverty in the rural areas differ from island to island but generally, the causes of rural poverty can be traced to the decline in the productivity of farm activities, unsustainable practices that led to environmental degradation well as absence of economies of scale due to smaller farm sizes.

## **Rural Finance and Microfinance Policy Development**

The Philippine financial system is made up of formal, semi-formal and informal financial institutions and providers. As of 30 June 2010, the Philippine banking system is composed of 773 institutions, made up of universal and commercial banks, thrift banks, rural and cooperative banks. The 38 universal and commercial banks is the largest single group in terms of assets and other resources. These banks offer the widest choices of banking services in the banking sector.

The thrift banking sector is made up of 74 savings and mortgage banks, private development banks, and stock savings and loan associations. This sector is focused in providing varied developmental type of lending, especially to small and medium enterprises (SMEs). These banks generally provide short-term working capital and medium- and long-term financing to economic activities engaged in agriculture, services, industry and housing, and other allied and financial interests.

The rural and cooperative Banks, on the other hand, totaling 661 are the more popular and closest to the rural communities. These banks are primarily established to promote and expand the rural economy, which are normally run by the local entrepreneurs. Rural banks as well as cooperative banks help farmers by providing the needed financial services so that production, marketing, distribution of agricultural produce can be done efficiently.

Aside from the rural and thrift banks that have strong physical presence in the rural areas, Non-Governmental Organizations (NGOs), cooperatives, lending investors, private moneylenders, traders/millers and other government line agencies also provide financial services to the general public which include farmers, fisher folks and other agrarian based workers.

The Microfinance Council of the Philippines (MCPI), Inc. estimated that around 500 non-governmental organizations (NGOs), out of the more than 30,000 registered with the Securities and Exchange Commission (SEC), are involved in some form of providing microfinance services. The MCPI also said that around 300 cooperatives, from the over 66,000 registered with the Cooperative Development Authority (CDA) are doing some form of microfinance operations but only about 100 or so are doing serious microfinance operations with acceptable operational self-sufficiency ratios.

## **The Philippine National Strategy for Microfinance**

Presently, the approved National Strategy is envisioned to (1) have a viable and sustainable private microfinancial market and (2) provide poor households and microentrepreneurs greater access to microfinancial services. The Strategy adopted four major principles that helped microfinance grow with the support of the private sector as the government laid down the appropriate legal and regulatory environment.

As the National Strategy was approved, several laws and issuances were subsequently enacted that supported the operationalization of the Strategy. The need for a very clear regulatory framework for the practice of microfinance in the Philippines came out as a response to clarify the roles, responsibilities and accountabilities for the institutions providing various microfinance services in light of the increasing commercialization of microfinance in the country.

The growth of rural and microfinance financing in the Philippines can be traced, to a large extent, with the approval, acceptance and functioning of a very clear National Strategy as well as the setting up enabling laws and regulations, before and after the National Strategy was approved.

The practice of microfinance in the Philippines has been cited as one of the most advanced in the world, from a list of 54 countries. In the 2010 index and study done by the Economist Intelligence Unit (EIU) as commissioned by the International Finance Corporation (IFC), Inter-American Development Bank (IADB) and by the Corporacion Andina de Fomento (CAF), the Philippines ranked number 2, largely due to a very clear and supportive regulatory framework.

### **III. Lessons Learned/Future Directions and Issues**

As bankers, policy makers, regulators, development workers and users of funds commit themselves to the technical as well as financial principles in ensuring that rural and microfinance program effectively work to reach the intended clients, the following points should be considered:

- COMMITMENT to Financial Inclusion.
- BOLDNESS to think outside of the box when providing poverty solutions
- ADAPTIVE means to be flexible without sacrificing prudential standards
- NATIONALISTIC means to keep the interest of the country at heart, even as the world is becoming flat
- KNOWLEDGE FOCUSED is to encourage evidence based studies
- “EARTHY” MIND means to be grounded in reality and not be confined in ivory tower.
- RESPONSIVE to the need of the market

Some of the challenges facing the practice of financial inclusion and microfinance in the Philippines can be summed up in the following:

1. Credit pollution – As microfinance institutions expand their respective microfinance programs and services, the tendency to be lax in client selection and in preparing their clients, whether individuals or groups have become an issue. In a number of anecdotal reports as well as some official reports of MFIs, the quality of portfolio was reported to be going down
2. Financial Literacy and Consumer Protection of Clients – Clients need to be aware of their rights and responsibilities in the use of credit as well as savings; Budgeting, planning and investing skills are needed by the clients and there is a need to capacitate the clients on these skills. Finally, consumer protection of clients must be an on-going concern by all.
3. Need for Business Development Services (BDS) – As clients’ businesses expand, the most common need that is expressed by them is how to help them improve their products and services. Clients need help in product design, marketing, branding, and compliance with standards.
4. Branchless banking/phone banking – The Philippines is known as the “texting capital of the world”, with over 1.2 billion texts that go around everyday. More than 55 percent of the population own cellular phones. Along this line, the BSP and in partnership with the Rural

Bankers' Association of the Philippines has allowed the use of cell phone for loan payments, deposits and withdrawals of savings by microfinance clients. Allowing the use of this technology has brought down the cost of such transaction and increased convenience for both the institution and the client.

5. Increase delivery channel – 37 percent of the total municipalities in the Philippines remained without banking presence. In line with this, the BSP introduced the concept of Other Banking Office (OBO) in 2005. As a result of expansion of good performing Banks using this non-transactional banking unit, the BSP decided this year to allow the opening of transactional Micro-Banking Office (OBO) which is expected to take micro-deposits and serve the needs of the unbanked clients in the countryside.

### **3. Cambodia**

Cambodia is very much dependent on agricultural production to nurture its population of approximately 14 million people, about 80 percent of which live in rural areas. Garment, tourism and construction are the other important drivers of the Cambodian economy allowing the country to enjoy an average annual growth rate of around 9 percent from 2001 to 2008. In 2008 the GDP per capita reached US\$739, but the poverty incidents remained high.

Given the above economic figures, microfinance sector played an integral role in the country's economic development. Cambodian rural finance started in the early 1990s as part of financing projects of Non-Governmental Organizations (NGOs). Loans and savings services were delivered to rural poor alongside other humanitarian goods and services. During that time, Cambodia also gone through a significant economic reform and later pursued a strong banking system.

The growth of the microfinance sector has been recognized globally as a major inclusive financial tool to tackle poverty. With access to financial services, the marginal people can participate actively in the economy of the countries, create employment for themselves and others, and realize their full potential. The benefits received by the family members of microfinance clients also positively secure the foods, health, education, and social engagement of the rural citizens in Cambodia. The microfinance sector experienced a faster growth after the declaration of 2006 as "The Year of Microfinance". The public awareness has thereafter increased noticeably. The regulatory and supervisory framework has been established to support the growing momentum of the microfinance sector in terms of outreach, governance structure, diversified products and services, funding sources and others. The National Bank of Cambodia (NBC), the supervisory authority, has implemented the supervisory strategy in a prudential way in order to create a convenient and favorable environment that helps further expand transactions of microfinance institutions.

Even though the significant development of the microfinance obtained both national and international recognition, the industry encounters a number of challenges. Those challenges fell in the areas of promoting new product; enhancing commercial and sustainable microfinance operations; strengthening corporate governance; developing and implementing credit information systems; strengthening regulatory and supervisory framework, and building capacity of both regulators and the practitioners

### **4. Bank for Agriculture and Agricultural Cooperatives Paper**

Thailand's economy is dominated by Industry sector accounting for 39.0 percent of the gross domestic product in 2009. It was followed by Service (33.8 percent), Wholesale and Retail Trade (13.7 percent), Agriculture (8.9 percent) and Construction and Mining (4.5 percent). Although, it seems that the agriculture sector has reduced its contribution to the country's GDP, it remains as the main source of foreign currency, involves 40 percent of the population, and still the main source of food and fuel.

The Bank for Agriculture and Agricultural Cooperatives (BAAC) was established in 1966 as the government's specialized financial institution dedicated to provide financial services to farmers and farmer institutions. Its mandate was amended in 2006 to allow BAAC to provide non-farm credit to non-farmers and non-farmer institutions. As a result, it became a Universal Rural Development Bank. The Bank has initiated the Community Bank Project to provide financial services to the poor people without the restrictions of the normal banking operations.

The Bank's operating funds as of December 31, 2009, totaled 764,945 million Baht. Deposits aggregated to 642,499 million Baht, Loans stood at 504,884 million Baht and Equity is healthy at 73,557 million Baht.

BAAC is at the forefront of the agriculture development. Its agricultural loans accounted for 89.1 percent of the total loans with a satisfactory repayment rate of 92.7 percent. It also lend to institutional accounts such as cooperatives and farmer associations. It implemented government projects such as Islamic banking, marketing support for cooperatives and social welfare. The Bank is also the leading implementer of the National Village and Urban Community Fund Program which is touted as the informal debt solution scheme.

To become the Rural Development Bank, BAAC needs to cover those who live in the rural area. While not abandoning its farmer-clients which it serves since the start of its operations, the Bank also needs to expand services to cover non-farmers and poor people. As such, it needs to introduce new paradigm, methods or even new organization. The establishment of the Community Bank Project is the prospective mechanism to pursue this challenging goal. Thus, it needs to take into account all factors to help poor people access financial services and help them get out of poverty.

## **5. Krung Thai Bank Public Company Limited Paper**

### **Introduction**

Krung Thai Bank Public Company Limited (KTB) is the state-owned bank under the license issued by the Ministry of Finance. It was incorporated on March 14, 1966 through the merger of Agriculture Bank Limited and Mondhon Bank Limited, with the government as the major shareholder. Its Headquarter is located at No.35 Sukhumvit Road, Wattana District, Bangkok.

In 1988, KTB became the first commercial bank to have branch network and ATMs in all provinces nationwide. It was also the first state enterprise listed in the Stock Exchange of Thailand on August 2, 1989. Through it all, the Ministry of Finance remains as the majority shareholder of the Bank accounting for 55 percent of the total voting shares.

Apart from conducting commercial banking, KTB also serves as the government's channel to render financial services supporting government policies through lending to businesses of certain type, such as, One-Tambon-One-Product (OTOP) loan, ICT Computer loan, and Education loan. During Thailand economic crisis, the Bank fully supported the government policy in stimulating national economy by providing the "Thai Khem Kheng stimulus package 2012" to boost the liquidity of Thai entrepreneurs.

### **Microfinance Philosophy**

KTB has a two-pronged approach to address the needs of its poor clients. The first is the poverty lending approach addressing the poorest of the poor by introducing poverty alleviation programs and the other is the financial system approach wherein the economically active poor may become clients of commercial microfinance.

It also introduces the Community Bank partnership project to effectively deliver the needed service to the poor clients. This project is envisioned to achieve (a) partnership relation development; (b) information and target need; (c) co-research and design; (d) pilot test and knowledge base; and (e) co-operate, training and co-acting.

The microfinance framework of KTB targets community financial organization, and group and individual microentrepreneurs. It has 3 stages which shall eventually develop the skills of microentrepreneur becoming an owner of microenterprise, SME and corporation.

## **Conclusion**

Overall, KTB hopes to instill savings discipline and responsible borrowing culture to its target consumers in the microfinance sector. To achieve this, the Bank is looking at the following strategies:

- a) create and expand access to financial services;
- b) focus on alliance rather than competition;
- c) create partnership coordination service;
- d) focus on innovating/creating new forms of services; and
- e) set activity system, create differentiation and provide low-cost service.

KTB is hopeful that it shall contribute to the government's efforts to address the financial needs of the remaining poor community in Thailand which is now one of the lowest in East Asia.

## **6. Association of Asian Confederation of Credit Unions Paper**

### **Introduction**

Credit Unions and financial cooperatives are by tradition and history the first and original microfinance institutions in the world. They are the oldest form of civil society organizations and the first to demonstrate the power of social entrepreneurship and innovation. In its more than 160 years of history, it has contributed to the restructuring of society in directions which serve the long term interest of the poor.

### **Credit Union History**

Friedrich Wilhelm Raiffeisen formed credit unions in 1864 patterned after the Shultze-Delitzch model which promoted the principle of "people helping themselves". These institutions raised capital through member deposits and elected management committees to approve loans and conduct the routine business of the society. Raiffeisen originated the concept of the first credit union central bank and the first to design self-regulating organizations in the form of regional and national structures and establish prudential standards through its auditing services.

The idea of small groups in credit unions is not new. Dr. Leon Wollemborg established the first of many small credit unions (40-60 members) in Loreggia, Italy in 1883. In Asia in the 1960s, the joint liability group concept was adopted by the Bank for Agriculture and Agricultural Cooperatives in Thailand, as principal form of security for small loans. The joint liability groups are self-formed by people based on character and trust in sizes of 5-30 averaging 15 members. The group organization is simple with only a group leader acting as a liaison officer.

In a sense, the first self-help groups (SHGs) which approximate today's people's organizations with an economic-project in microfinance terms, are the 28 weavers of Rochdale, the forerunners of the



Cooperative System. This classic case is the prototype to today's SHGs. The Rochdale's organizing work begun from a series of group discussion on socio-economic issues, observations on the local situation and the decision that the only way to liberate themselves from the deplorable condition was to go into business themselves.

### **Credit Unions in Asia and Microfinance Innovation**

In today's free market economy, the credit unions and cooperatives are seen as distinct economic enterprises with ground rules to follow such as cost-competitiveness, concentration on a set core of activity, re-engineered membership relations and governance structure, improved management capability through effective organizational design and stresses internal capital formation and accumulation.

More than the service and product innovation, the Microfinance innovation in Credit Unions is best seen in itself as a 'strategic renewal'. This is described as birth of new business (microfinance) with the existing organization (Credit Union), internal venturing and the transformation of the organization through renewal of key ideas in which they are built. Credit Union as model of social entrepreneurship came up not only with a product/service but a particular organizational design – self-help groups (SHG) with sociopolitical and economic empowerment as end point. The strategic importance of microfinance in the Credit Union role of a voluntary organization whose aim is advocacy of public interest and the importance of these wide horizontal networks of SHG to the movement is now known.

The critical factors in a globalizing economy are flexibility, turn around times and decision-making channels, with fewer bureaucratic structures to react fast. Flexibility to the general environment in small units and decentralized structures has a distinct competitive edge. The traditional disadvantage of small enterprises due to small size is neutralized by development in the communications and information.

### **Credit Union Microfinance Innovation Program**

The Association of Asian Confederation of Credit Unions (ACCU's) microfinance innovation program is implemented in 11 member-countries, in the Philippines, Indonesia, Vietnam, Nepal, Bangladesh, Sri Lanka, India, Laos, Mongolia, Cambodia and Myanmar. It has the following activities.

1. Development of the Microfinancing Program
2. A Strategic Planning Workshop
3. Microenterprise Planning and Management Training
4. Social Mobilization and
5. Technical Assistance on Institutional Development of Credit Unions

Development of the Microfinancing Program observes a "bottoms-up" approach which highlight innovative approaches to traditional productive lending. It ensures flexible financial services regarding savings and loan, focusing on net savings and keeping a prudential balance with net borrowings. This also emphasizes capacity based lending with the loan amount unassociated with the share capital so as not to limit access of poor to CU services. This definitely shifts productive lending to a focus on entrepreneurial cash flow which is familiar even to practicing small entrepreneurs.

## C. Highlights of Dialogue with Thailand Stakeholders

In light of the papers presented, the Consultant held a dialogue with various microfinance stakeholders in Thailand. The attendees in the dialogue are BAAC, KTB and BOT. The consultation focus on lessons learned from other countries and challenges facing the microfinance industry in Thailand. The discussion resulted to the following highlights:

### Lessons Learned:

- 1) Poor are Bankable – the poor has a place in the Financial System. Through microfinance methodologies and market-oriented approach, the poor people may be as worthy a client like the middle and upper classes.
- 2) Poverty cannot be solved by economic development alone – economic development is measured in macroeconomic terms and does not fully reflect the effect on the lives of the underprivileged. In fact, the macroeconomic determinants must trickle down to the micro level in order to impact the lives of the poor members of the society.
- 3) Inequality is the main obstacle of economic development – unequal treatment of the different economic classes remains as the single biggest hindrance to economic development. With microfinance methodologies, the empowered people became aware of their rights, privileges and responsibilities. As such, they have a potential to fight for what should be rightfully accorded to them.
- 4) Microfinance activities help alleviates poverty – microfinance activities which do not rely on external intervention really help alleviate poverty. This is the sector that is immune to the global effects of economic meltdown, foreign exchanges volatilities and other market factors that rely so much on global imbalances.
- 5) Sound regulatory policy promotes microfinance development – regulatory policies present the roadmap for effective microfinance services. Experiences of global microfinance leaders showed effectiveness of policies towards creating a truly developmental microfinance system. Ideally, regulations shall not hamper the market development but intervene to ensure sustainability and efficiency.
- 6) Microfinance lending methodology should be client-oriented – lending methodology should be a product of market research to determine if it really focuses on client needs. Testimonies around the world highlight the need for market-oriented approach towards effective delivery of financial services. Microfinance taps customers' sensitivity and self-pride to make them viable and responsible clients.
- 7) Financial inclusion is the larger platform in addressing the unbanked people insofar as products, distribution channels, etc. are concerned – recent developments in mobile banking proved to be effective in widening the outreach of microfinance. Wide channels of distribution which are not limited to physical banking presence may prove effective in bridging the gap between banking and the unbanked, unserved and underserved members of the society.
- 8) Financial literacy helps increase microfinance activities – financial literacy remains one of the biggest inadequacies in providing microfinance services. Poor clients remained fearful of the affluent status of big Banks. Through financial education, especially for non-financial consumers, the outreach of the formal financial system may bring astronomical improvement. This may lead to increase the number of availing formal financial services more particularly the depositing and the borrowing public.

## Key Challenges of Thailand Microfinance Industry

- 1) Financial Infrastructure – Thailand’s financial infrastructure focus on the upper and middle class and the corporate clients. Although, there are banks and SFIs addressing the financial needs of the entrepreneurial poor, the outreach of these institutions are still very small compared to the total exposure of the banking sector. In addition, there is the existence of a limited number of people organizations (NGO, etc.) that also cater to the underprivileged.
- 2) Semi-formal MFIs and Self-Help Groups (SHGs) – These are unique form of people’s organization that support the financial needs of the poor especially women. They are supported by the government but have no clear accountability and monitoring of the usage of funds.
- 3) Government Agencies – there is an apparent lack of coordination and information sharing among relevant government agencies addressing the needs of the poor. Sometimes, even government-supported organizations compete with one another stifling the efforts to really address the financial needs of poor clients.
- 4) Management and Governance – semi formal MFIs and SHGs suffer from lack of good management and governance. A lot of efforts need to be channeled to the management team of these organizations to ensure proper handling of assets and smooth delivery of services.

## D. Summary of Findings and Recommendations

In light of the papers presented and the ensuing discussions during the forum, several key findings were noted and observed. Pursuant to these, the consultant proposes the following recommendations to address these concerns, namely:

1. Absence of an updated and comprehensive microfinance strategy document that will guide all the major stakeholders in Thailand. The strategy document may include defining the respective roles of commercial and specialized banks, SFIs, NGOs, SHGs and the cooperative sector. Towards this end, there is a need to develop a very clear document / strategy that delineates the various roles of different organizations in order to address the aforementioned issue.
2. High cost of doing microfinance loans brought about by the lack of a clear, contextualized credit delivery model, taking into consideration the geographic nature of the country. Thailand may benefit from the access of its population to mobile phone technology which can provide additional delivery channel for financial services such as savings, loans, etc.
3. The low quality of the credit portfolio of the loans provided to the borrowers of semi-formal MFIs and SHGs. Thailand MFIs should develop a microfinance model that shall focus on ideal recovery rate. They should strive for zero or near-zero tolerance for delinquency. Semi-formal MFIs and SHGs shall conform to the tenets of sound management and good governance principles.
4. Lack of close coordination and information sharing among government institutions. Synchronized government efforts to address the needs of the entrepreneurial poor should be pushed. Studies and researches should be presented so that the government shall respond to the actual market needs of the underprivileged.

## **E. Annexes**

Speeches

Texts of all papers

List of Participants

Programme of activities

**An Opening Remark  
by Dr. Chitkasem Pornprapunt  
Division Executive, Bank of Thailand  
at the National Microfinance Development Forum  
22 November 2010**

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Ladies and gentlemen,

It is a pleasure to welcome all of you to the Bank of Thailand. For some of our speakers who have travelled from abroad, welcome to Bangkok and I wish you a memorable stay.

On the subject of financial inclusion, I am sure that “microfinance” is one of the first keywords that policy makers and practitioners think of. There are many microfinance initiatives around the world and every day we hear about their successes, and in some cases, failures. I am sure that we have been puzzled by what recently happened in India. I think it just goes to show how important it is to ensure that all relevant policy building blocks be woven together, while efforts of all relevant institutions, government and private, are well integrated and aligned.

The National Microfinance Development Forum provides a great opportunity for Thai policy makers and practitioners from both commercial banks and Specialized Financial Institutions (SFIs) to come together to discuss and share ideas on this subject. We are also very lucky to have experts from Bangkok Sentral ng Pilipinas and National Bank of Cambodia here, to share their views and experiences with us. The program of speakers look wonderful, as we begin with the views of policy makers, then moving on to experiences of our leading microfinance service providers, and finishing with selected microfinance cases. I would like to take this opportunity to thank our co-host, APRACA, for your initiation and effort in organizing this event.

I am going to make this remark brief as I am sure our speakers have a lot of interesting things to say. So, I am going to focus on two points. First, Thailand’s financial inclusion challenge. Second, the Bank of Thailand’s plan to promote financial inclusion under the Financial Sector Master Plan Phase II. (FSMP II)

**First**, on financial inclusion challenge. There are many different types of financial service providers in Thailand, ranging from those in the formal sector such as banks and SFIs, those in the semi-formal sector such as credit unions and cooperatives, and those in the informal sector such as local saving groups. Until now, the financial inclusion mandate has largely been led by SFIs, for example the Bank for Agriculture and Agricultural Cooperatives (BAAC) to promote rural finance and the Government Savings Bank (GSB) to promote urban and low income savings. And they have been quite successful. The BAAC, in particular, has done a good job in reaching rural Thais and their network has expanded considerably over the years. The model used by the BAAC is well known and recognized by international standards, focusing on offering financial services that are suitable for the cyclical needs of farmers and flexible in terms of conditions and collateral requirements. I am sure that our speaker from BAAC will have many interesting things to share with us this afternoon.

According to our nation-wide survey on financial inclusion conducted in 2006, more than 80 percent of Thai households can already tap into financial services from the formal sector. And less than 10 percent of households do not use any kind of financial services from any providers. At first glance, the numbers appear satisfactory. However, some gaps still remain. First, household savings remain

inadequate because even for those with access to bank accounts, some are not saving enough, not to mention earning. During our field studies of rural microfinance arrangements in the north and north-east earlier this year, we found that households still struggle to save and easily become short of cash whenever an emergency strikes. This brings me to the second challenge as getting credits remains difficult for many and some households still resort to borrowing from sources outside our formal, organized banking sector, such as money lenders whose daily interest rate can be rather extreme. As a result, we need to do better in improving financial security of these people by making financial services more accessible, safe, and user-friendly to them. At the same time, we also need to help them use these services to manage their financial needs better.

With recent technological advancement and innovative business models, tackling these financial inclusion challenges becomes easier. This is exactly what the FSMP II intends to address by creating an enabling environment for innovative business solutions, strong and committed service providers, and supportive infrastructure. In this process, we hope to see banks going deeper down the pyramid; small, local microfinance service providers strengthening their operation and networking with larger players; and SFIs continuing to enhance efficiency and filling the gaps in cases of market failure.

This brings me to the **second** part of my remark, the Bank of Thailand's plan to promote financial inclusion under the FSMP II. Here, I am going to leave out the details since we have already held several meetings on the subject since its launch in November last year. So let me quickly go through the important points, focusing on the relevance to financial inclusion.

In short, the FSMP II aims to promote financial system efficiency so that financial institutions can perform their functions more efficiently, thus becoming more competitive to handle further globalization challenges. It is a 5-year plan beginning in 2010 and finishing in 2014. At the end, we hope that our financial institutions system would have the following characteristics.

First, it would be efficient, with operating cost at a level conducive for economic growth.

Second, it would be strong, resilient and able to withstand various shocks that would stem from the fast changing environment.

Third, it would be capable of delivering financial services that are more diversified and deep, able to provide financial intermediation for a wider group of the population

Essentially, the FSMP II comprises three main pillars.

The first pillar aims to improve the regulatory environment and to reduce unnecessary regulatory and legacy costs, namely those stemming from NPA and NPL.

The second pillar aims to enhance efficiency by promoting competition within the financial system. Measures under this pillar include liberalization, increasing competition from the current and new players, and promoting greater financial access. Before I elaborate on this agenda on financial access, let me quickly outline pillar 3.

The last pillar of the FSMP II is to improve Thailand's financial infrastructure, including those relating to risk management, credit information system, legal reform, information technology and upgrading the quality of human resource. Enhancement of such infrastructure would further aid banks to attain greater efficiency in their operation as well as more effective risk management at lower cost.

Coming back to the agenda on financial access. In order to increase the opportunity for micro businesses and low-income individuals to access financial services that are appropriate to their needs at a reasonable price, the BOT aims to implement the following measures.

First, we would encourage existing commercial banks to adopt business models that are suitable in reaching the group of population that currently lacks the opportunity to access financial services. This would be achieved by making regulatory environment more fitting with microfinance business models of banks to allow greater flexibility in their operation, subjected to good risk management. This is in process now during 2010-2011.

Second, after assessing the adequacy of existing commercial banks' interest in microfinance, we could then provide opportunities for new microfinance service providers with expertise and good management to enter the market under a restricted license to fill remaining gaps. This would be during 2012-2013.

Third, we would work on improving and developing necessary infrastructure to enhance financial access for those presently underserved or excluded from services such as credit products. Such development could include, amongst others, improvement in the credit information system, efficiency enhancement of the credit guarantee mechanism, and a study to develop microfinance service provider rating system for Thailand.

Finally, we would work on supporting the role of SFIs in addressing gaps left by commercial service providers. This would be achieved by enhancing the efficiency of SFIs, and developing clear business plans that are consistent with their long-term goals.

This is about all I have to say. In closing, financial inclusion is an important mandate and the challenges of inclusion definitely go beyond promoting access. As mentioned earlier, to ensure that people can safely access financial services that meet their needs, as well as help them use these services to manage their financial needs better, we also need to work on financial literacy and consumer protection. In meeting these tough challenges, we must work together in bringing to the table ideas and experiences that would help shape practical solutions.

I wish you all a successful conference. Thank you for your attention.

## Overview of Microfinance and Rural Finance in Thailand

### Overview of Microfinance Sector

In Thailand, there are several types of financial institutions providing financial services to the low income group such as commercial banks, specialized financial institutions (SFI: state owned bank), cooperatives including credit union and non-bank operators. However, in providing financial services, financial institutions have to observe and comply with certain prudential regulations governing their operations. Therefore, these financial institutions could not provide, particularly, the micro-credit to all people due to the required prudential standards.

In order to have financial resources as well as financial intermediaries in community, people in several communities throughout Thailand have pooled their financial resources together by setting up savings group in the community. These savings group are performing as the financial intermediary for all people in the community despite the disparity in financial and wealth status of each individual household. Therefore, the savings group is considered as community-based financial institute. Currently, there are more than 35,000 savings group spread all over the country and the number is increasing.

The government recognizes the important of the financial accessibility of all people and the soundness and sustainability of microfinance system for Thailand. Therefore, in December 2006 the cabinet has approved the *Microfinance Master Plan* with the main objectives to strengthen the capacity and operation of the community-based financial system in order to enhance the sustainability of the savings group and well-being of the people.

Moreover, with respect to expanding the role of commercial banks in dealing with microfinance, the *Financial Sector Master Plan Phase II* has been made to help the poor and community in rural area accessing to finance by improving efficiency of financial institutions through reducing system-wide operating cost, promoting competition and financial access, and strengthening financial infrastructure.

The Ministry of Finance has also launched the *Specialized Financial Institutions Master Plan* (SFIs Master Plan) to enhance the role of SFIs in fulfilling financial gaps and operational overlaps.

With these plans, the government aims to strengthen rural communities, increase financial access for low-income group and alleviate social disparity problem.

### General characteristics of microfinance system in Thailand

The financial service provider for microfinance sector can be divided into three categories:

- 1) **Formal category** consists of institutions which operate under prudential regulations such as Commercial Bank (CB) and SFIs. The total microcredit supplied by formal financial institutions is approximately 1.8 trillion baht (17 percent of total credit).
- 2) **Semi-formal category** includes institutions whose aims are to promote community-based savings and investment, and supported by the public sector. These include cooperatives and Village and Urban Community Funds. The amount of funds provided by this category is about 940 billions baht or roughly 8 percent of the total credit.
- 3) **Informal independent and Self-help group** founded by community to mobilize savings and provide financial services for community members. These groups are usually established with



the support from external organizers, including Community Development Department, NGOs, local governments, and monks. Most of them follow either village bank or solidarity group operating model. Although there is no specific data on the number and amount of funds, the Fiscal Policy Office estimated that credit supplied by MFIs in this group is around 33 billions baht.

**Table 1: Thailand Financial System**

Loans and Savings As of March 2010		
	Loans (million baht)	Deposits (million baht)
1. Formal	10,322,277	9,489,109
2. Semi-formal	940,010	418,927
3. Self-help group	*33,000	*37,000

Source: Bank of Thailand, Fiscal Policy Office

Note: \*Estimate by the Fiscal Policy office, there is no official data to date.

**Table 2: Micro-credit supplied by formal financial institution**

Micro-credit As of March 2010	
	(million Baht)
<b>GHB</b>	
Housing Loans (under 1 mil. Baht) & Baan Eua thon*	533,039
<b>GSB</b>	
SMEs Loans	38,024
Housing Loans	134,574
Personal Loans	167,244
Village and Urban Community Fund Loans	6,613
Loans to Community Enterprise	292,021
Micro-credit	27,675
	666,151
<b>BAAC</b>	
Agricultural Loans	245,924
Loans to support job creation in rural area	55,159
Community Development Loans	103,116
	404,199
<b>Personal loans</b>	
Commercial Bank (register in Thailand)	104,000
Foreign Bank Full Branch	18,197
Non-banks	95,050
	217,247
<b>Total</b>	<b>1,820,636</b>

Source: Bank of Thailand, BAAC, GSB, GHB

Note: \*Baan Eua Athon (meaning in English is "Generous Housing") was aimed at providing affordable home ownership for low-income groups in Thailand.

## Overview of Rural Finance

Rural finance is one of the significant parts of microfinance as microfinance aims to provide financial services for low income group. There are five institutions responsible as the key players for providing financial services to the rural people as well as promoting the sustainable rural development through various activities: Bank for Agricultural and Cooperatives (BAAC), Government Savings Bank (GSB), Village and Urban Community Funds, cooperatives and savings group.

### 1. Bank for Agriculture and Agricultural Cooperatives (BAAC)

BAAC was established by the Government of Thailand in 1966. As primary agricultural bank in Thailand, BAAC plays the major role in providing credit for agricultural sector. As the end of year 2009, BAAC extended credit services to individual farmers, agricultural cooperatives, and farmers' associations totaling 277,767 million Baht, 54,145 million Bath, and 88 million Bath, respectively. BAAC also supported government-secured loan projects amounted to 58,454 million Bath in year 2009 such as the project to restructure and adjust agricultural production system, the agricultural products and crops pledging schemes, and the revolving fund to provide loans to farmers and the poor.

Focusing on the essential role of BAAC in driving microfinance in rural area, BAAC is starting "the community banking program" aiming to strengthen network sharing and expand financial services in rural area. To achieve the program, BAAC is in the process of feasibility study to transform the existing village fund, savings groups and informal creditors in rural areas into the community bank.

Not only providing financial services to the grassroots' people, but BAAC also has mission to promote the sustainable rural development through various activities; for example,

**Table 3: BAAC activities to promote rural development**

Farmers' Revenue Assurance Scheme	Participants would be promised compensation in cash directly from the government for the difference between guaranteed and referred mean prices
Rice Price Stabilization Scheme	Providing credit support to farmers, agricultural cooperatives, farmers' associations, groups of individuals, the general public and business entrepreneurs as funds for rice seeds accumulation and sale as well as white rice processing and sale
Fast Track Credits Services	Specific measures to support fast track credits services to stimulate the economy and enhance occupational investment or funding under special conditions for farmers, small- and medium-sized enterprises, business entrepreneurs, and cooperatives
Weather Index Insurances	Farmer clients would be compensated in times of drought
The Project to Strengthen Agricultural Cooperatives	To enhance the productivity of cooperatives' personnel in the areas of management and basic business management so that assistance would be rendered to their farming members
The Project to Develop BAAC's Agricultural Marketing Cooperatives (AMC)	Supporting AMC's role as the collector of farm produce from among its members for sale and value creation as well as the link between production and marketing

Source: BAAC

## **2. Government Savings Bank (GSB)**

In 1913, the GSB was introduced to Thailand and was the first government owned bank to focus on “micro” savings. The main purpose was to educate Thai people on banking services and to promote saving habit among Thai. Nowadays, GSB is a state enterprise which operates as one of Specialized Financial Institution under the supervision of Ministry of Finance. GSB is now running 930 branches all over the country.

As of July 31, 2010, GSB maintained the total assets of 1,223.24 billion Baht. The total outstanding deposit and loans are 1,032.78 billion Baht and 898.52 billion Baht respectively. The GSB Capital Adequacy Ratio stood at 13.44 percent while the Non Performing Loan Ratio was 2.11 percent. The profit for first 7 months of this year is THB 10,267 million. These figures confirm the soundness and strength of GSB.

Focusing on the essential role of GSB driving microfinance in rural area, GSB has introduces “People’s bank program”, one of the most popular microfinance products, which aims to reduce poverty problem for unemployed and poor people in order to stimulate employment and earnings for them. The People’s Bank Program was piloted in 2000. The product design has received support from the Consultative Group to Assist the Poorest (CGAP). The People’s Bank program was fully implemented in 2001 to focus on providing low interest rate credit (less than 1 percent per month) for investment activities and/or businesses among people within lower income group, with a 72 million Baht supporting budget from the government.

As of July 2010, the People’s Bank program had over 2.31 million clients with a total loan value of THB 71.05 billion or 8 percent of the GSB’s total loan portfolio.

## **3. Village and Urban Community Fund**

In 2001, the government launched the Village and Urban Community Revolving Fund, which aimed to provide 1 million baht to every village and urban community in Thailand as working capital for locally-run rotating credit associations. The main objectives of Village and Urban Community Fund are;

- 1) to create a financial source for such purposes as investment, career development, income-generation and job formation, and paying for emergencies and public utilities
- 2) to develop capital management ability among the village and urban communities
- 3) to promote self-reliance, learning, and initiative taking as well as sustained economic development.

In order to establish the fund in a village, members of that community must set up a village fund committee to operate the fund and draft regulations such as the interest rate to be charged and the repayment process to be followed in line with the guidelines of the Village Fund Act. The central regulations determine only that the term of a loan should be two years and the amount approved should not exceed 20,000 baht per person, although this can be extended to 50,000 baht in certain cases. Every village fund member is eligible to apply for a loan. After a village fund has been established, the committee registers the fund with the GSB or BAAC. After village fund passes capacity evaluation, the bank transfers 1 million baht to the village fund account within 30 days. Additional to revolving fund provided by the government, the Village and Urban Community Funds can also borrow up to an additional 1 million baht from BAAC and GSB. In 2010, the money was disbursed to locally committees in almost all of Thailand 74,989 villages and around 4,200 urban communities (including military). The fund was designed and intended to help boost household-level non-farm enterprise.

**Table 4: Number of village and urban community fund, number of member, and funding amount**

<b>Village and Urban Community Fund</b>	
As of 31 March 2010	
1. Number of village and urban community fund	<b>79,255</b>
– Village	74,989
– Urban Community	3,528
– Military	738
2. Number of committee and member	<b>12,801,444</b>
3. Funds (Mil. Baht)	<b>124,729</b>
– Working Capital	81,581
– Members' savings	24,773
– Additional Loan from BAAC and GSB	18,375

Source: Village and Urban Community Fund Office

#### 4. Cooperatives

Cooperatives are member-based organizations which make up the second largest group of microfinance service providers in Thailand. The main businesses of this group are providing savings and credit services, as well as product distribution services through member shops. Cooperatives are regulated under the Cooperatives Act of 1968 and overseen by the Cooperatives promotion Department (CDP), Cooperative Auditing Department (CAD), Ministry of Agriculture and Cooperatives.

At present there are seven types of cooperatives in Thailand as follows: Agricultural Cooperative, Fishery Cooperative, Land Settlement Cooperative, Consumer Cooperative, Service Cooperative, Thrift and Credit Cooperative, and Credit Union Cooperative.

**Table 5: Number of member, deposit and loan of Cooperatives**

(As of 31 March 2010)

Cooperatives	Number of Audited Cooperatives	Number of Members	Deposit (million Baht)	Loan (million Baht)
Agricultural	4,338	6,126,960	4,077.61	3,423
Fishery	102	16,069	134.64	62.95
Land Settlement	95	189,250	17.55	41.93
Consumer	287	770,463	8.62	60.86
Service	1,044	374,832	1,038.69	2,026.35
Thrift and Credit	1,363	2,606,376	310,475.18	727,589.32
Credit Union	508	562,793	5,297.37	6,293.4
<b>Total</b>	<b>7,737</b>	<b>10,646,743</b>	<b>321,050</b>	<b>739,498</b>

Source: Cooperatives promotion Department

#### 5. Self-help Group

The self help savings groups in Thailand started in 1965 as a joint effort of members and community leaders due to the lack of access to formal financial services. Most of the self-help groups apply village bank or solidarity group methodologies, which have been proven to be successful at raising and mobilizing funds. Many of these groups were started as community development projects with assistances and support from external organizers, including Community Development Department, NGOs, local governments, and monks. Most of the self-help groups are usually small and locally based, offering savings and credit for

community. Apart from providing savings and credit, some of these groups also use their surplus profit to set up multi-purpose welfare funds covering health, education, occupation, support for the vulnerable, and pension.

The community base savings have grown rapidly because of the expansion of community networks and the support from outside agencies by providing information on available financial services, matching funds, and enterprise skills. Currently, there are more than 35,000 savings group spread all over the country and the number is increasing.

According to the Fiscal Policy Office research (2006), the key factors contributing to the success of self-help savings group include the following:

- 1) The success of the strong self-help group is the outstanding leadership and unique charisma of their individual leaders. As such, the groups are vulnerable without an adept leader.
- 2) Transparent and systematic operating and management process.
- 3) Discipline among members.
- 4) The support from outside agencies, especially from the government, is crucial at the beginning stage, when community momentum may be triggered and nurtured. The microfinance scheme must incorporate community capacity building and include consultative process with the communities. In addition, the rules and regulations of the scheme should be adjusted to suit communities.
- 5) Networking that enhances the exchange, transfer, and dissemination of knowledge among communities and outside agencies is essential for community development.

## **Government role to support microfinance development**

To strengthen grassroots communities and increase financial access for low-income group, the Ministry of Finance has developed three-Master Plan as follows:

### **1. The Microfinance Master Plan (2008-2011)**

This Plan aims to support and strengthen the capacity of Microfinance Institutions (MFIs) so that they can be self-reliant, function as important mechanism in community-wide capacity building, and build network to lend mutual support to one another. The Microfinance Master Plan consists of 3 main strategies;

#### 1) *Human resources and capacity building*

This strategy aims to support capacity building to the MFIs, instill awareness of self-reliance, ethics and good governance, and develop sound management and information technology system.

#### 2) *Synergy of the public sector support*

This strategy aims to streamline the work and more clearly define responsibility of each public sector and partners to reduce the duplication of works.

#### 3) *Networking*

The strategy aims to foster synergy between the public sector and communities as well as support knowledge-sharing to scale up good practices among MFIs.

## 2. The Financial Sector master Plan Phase II (2010-2014)

The plan aims to enhance the efficiency of the financial institutions by 1) Reducing system-wide operating cost 2) Promoting competition and financial access; and 3) Strengthening financial infrastructure. The measures to promote financial access to microfinance group:

**Table 6: Measures in Financial Sector master Plan to promote financial access to microfinance group**

1 <sup>st</sup> period (2009-2010)	2 <sup>nd</sup> Period (2012-onwards)
<p><i>Current Service Providers</i></p> <ul style="list-style-type: none"> <li>– Promoting microfinance business in commercial banks by arranging a seminar for global player and domestic partners to exchange knowledge on this matter</li> <li>– Encourage Commercial Banks to adopt microfinance business models suitable to serve low-income group such as; <ul style="list-style-type: none"> <li><i>Mono-line</i>; set up internal specialized unit to take care of super small enterprise (SSE)/micro customer</li> <li><i>MFI as Agent</i>; outsource loan operation to MFIs i.e. cooperative and community savings group</li> <li><i>Service Company</i>; outsource loan operation to service providers such as retail stores, telecom stores to act as Commercial Banks agent</li> </ul> </li> <li>– Support SFIs in focusing on providing services to the population group without access to commercial banks</li> </ul>	<p><i>New Microfinance Service Providers</i></p> <p>Introduce new service providers with expertise and proven success in microfinance into the system (MOF and BOT would consider new licenses on a case-by-case basis). The new service provider which might have a joint venture with MFIs or local investors in order to gain a benefit from local expertise and familiarity with domestic environment.</p>

## 3. The SFIs Master Plan (2010-2013)

- The plan aims to develop the role of SFIs to efficiently fulfill the financial gaps and eliminate operational overlaps.
- Market segmentation: The BAAC and the GSB have clearly defined responsibility in providing financial services to microfinance sector to reduce duplication.
- To this end, the operation of SFIs must concentrate on policy-based transactions rather than commercial-based, profit seeking transactions. In addition, the operation must be conducted under the scope of transactions determined by SFIs supervisory committee.

**Table 7: Market segmentation of SFIs**

	Sorted by industry			Sorted by client	
	SMEs	Housing	Agriculture	Community finance/ Microfinance/ informal loans	Islamic Finance/ informal loans
<b>Primary SFIs</b>	<b>Export:</b> EXIM	GHB, SMC	BAAC	<b>Agriculture:</b> BAAC	Islamic Bank
	<b>General:</b> SME & SBCG			<b>General:</b> GSB	
<b>Secondary SFIs</b>	GSB	GSB			

**CONDUCTIVE  
RURAL AND MICROFINANCE POLICY ENVIRONMENT  
AND REGULATORY FRAMEWORK  
IN THE PHILIPPINES**

**BY**

**EDUARDO CABRAL JIMENEZ\***

**And**

**GERARDO A. BUTARDO\*\***

**(Bangkok, Thailand, 22 November 2010)**

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\* BSP Microfinance Consultant

\*\* BSP Deputy Director, MSME Finance Specialist Group





## I. Socio-Economic Profile

The Philippines, is an archipelagic nation of about 7,100 islands, with 3 major island concentration, i.e, Luzon, Visayas and Mindanao. In its unofficial census report as of 2009, the Philippines reached 92.0 million. The Philippines is politically and administratively divided into 16 regions with Metro Manila as the center of business and commerce as well as political activities. Metro Manila reports a current population of about 11 million.

The seasonally adjusted estimates of GDP and GNP confirm that the Philippine economy has recovered from the global financial crisis as GDP inched up to .09 percent from .08 percent in the previous quarter. Notwithstanding the double whammies whacked by 2 devastating typhoons (Ondoy and Pepeng), the country registered a GDP growth of 1.8 percent in the fourth quarter of 2009, bringing the full year GDP growth to .9 percent from 3.8 percent in 2008. These growths was brought about by the push from government spending and double digit growth in retail trade, Banks and Non Banks, recreational Services and Mining and Quarrying as well as the recovery of the Manufacturing sector that offset the decline by 2.8 percent of the Agriculture, Fishery and Forestry (AFF) sector. Consumer spending accelerated slightly to 5.1 percent in the 4<sup>th</sup> quarter of 2009 from 5.0 percent the same period last year while Government Consumption Expenditure (GCE) posted a double digit growth of 12.1 percent from 2.6 percent last year due to the disbursement of funds for relief and rehabilitation of areas affected by the 2 tropical storms as well as the continued release of funds for the automated 2010 elections.

The US dollar inflows sent by the Overseas Filipino Workers (OFWs) continuously helped stabilize the Philippine economy. Compensation inflow in 2009 was US\$ 25.9 billion averaging more than US\$2B a month, a 15.6 percent increase over the last year's US\$22.4 billion. The dollar inflow cushioned the impact of reversal growth both in Merchandise and Non-Merchandise Exports. Total Exports went down by 10.0 percent from the negative 11.5 percent growth registered in the 4<sup>th</sup> quarter of the previous year.

Secretary General Romulo A. Virola of the National Statistical and Coordination Board (NSCB) in the agency's economic report, pointed out that the domestic economy could not keep pace with the population growth in 2009 as per capita GDP declined by 1.0 percent from a 1.8 percent growth in 2008. However, per capita GNP continues to grow by 1.0 percent from 4.1 percent, as well as per capita PCE, by 1.8 percent from 2.6 percent.

On the immediate short-term, the big challenge for the Philippine economic managers onwards to see to it that growth would continue, however modest, and not fall into recession. The Philippines in the last few years have made inroads in battling poverty through pro-poor and middle class programs, including access to financial resources, which are generally hard to access by the poor from the regulated financial sector.

About half of the population of the Philippines is living in rural areas where poverty is most severe and widespread. Dependence on agriculture, mostly subsistence farming and fishing are generally the only source of income for the poor rural people. The roots of poverty in the rural areas differ from island to island but generally, the causes of rural poverty can be traced to the decline in the productivity of farm activities, unsustainable practices that led to environmental degradation well as absence of economies of scale due to smaller farm sizes.

As we look at poverty in the Philippines, the NSCB official poverty statistics for 2000, 2003 and 2006 show that ironically, farmers and fishermen, the producers of our basic food commodities, rice and fish, are two of the poorest sectors because of insufficient income. Indeed, responding to the needs of our fishermen and farmers should be a major issue that must be addressed by any poverty reduction program.

We need to increase the production/supply of rice and fish to ensure affordable prices but at the same time, we need to increase the income of our farmers and fishermen.<sup>1</sup>

The unabated population growth continues to exert pressure not only for the policy makers and government in general, but practically on the whole country as limited resources are strained to the maximum. As can be gleaned in Table 1, the average annual population increase stood at 2.04 percent, which is much lower compared to the last 6 censuses made; a lower growth rate is very much desired. On the average, the population growth in the last 4 decades is 2.52 percent.

**Table 1: Population of the Philippines Census Years 1903 to 2007**

Year	Population	Ave. Annual rate of increase (%)	Source of data
1903	7,635,426		Census
1918	10,314,310	2.03	Census
1939	16,000,303	2.11	Census
1948	19,234,182	2.07	Census
1960	27,087,685	2.89	Census
1970	36,684,486	3.08	Census
1975	42,070,660	2.78	Census
1980	48,098,460	2.71	Census
1990	60,703,206	2.35	Census
1995	68,616,536	2.32	Census
2000	76,504,077	2.36	Census
2007	88,574,614	2.04	Census

## II. Rural Finance and Microfinance Policy Development

### The Philippine Financial System

The Philippine financial system is made up of formal, semi-formal and informal financial institutions and providers. The formal financial system, which is dominated by banks and non-banks institutions with quasi-banking activities is supervised, monitored and regulated by the Bangko Sentral ng Pilipinas (BSP) otherwise known as the Central Bank of the Philippines. Insurance companies, on the other hand, which are part of the formal regulated financial system is under the ambit of the Insurance Commission.

Table 2 shows that as of 30 June 2010, the Philippine banking system is composed of 773 institutions, composed of universal and commercial banks, thrift banks, rural and cooperative banks. The 38 universal and commercial banks is the largest single group in terms of assets and other resources. These banks offer the widest choices of banking services in the banking sector. Aside from the regular commercial services that they can offer, these banks are also allowed to engage in underwriting and related investment functions. They can also invest in equities of non-allied undertakings.

The thrift banking sector is made up of 74 savings and mortgage banks, private development banks, and stock savings and loan associations. This sector is focused in providing varied developmental type of lending, especially to small and medium enterprises (SMEs). These banks generally provide short-term working capital and medium- and long-term financing to economic activities engaged in agriculture, services, industry and housing, and other allied and financial interests.

<sup>1</sup> Statistically Speaking: [www.nscb.gov.ph/headlines/StatsSpeak/2009/091409\\_rav\\_bbb\\_food.asp](http://www.nscb.gov.ph/headlines/StatsSpeak/2009/091409_rav_bbb_food.asp)

**Table 2: Financial Institutions under BSP Supervision/Regulation**

TYPE OF FINANCIAL INSTITUTIONS (FIs)	End-March 2010			End-June 2010		
	TOTAL	HEAD OFFICE	OTHER OFFICES	TOTAL	HEAD OFFICE	OTHER OFFICES
BSP SUPERVISED/REGULATED FIs	23,897	7,249	16,648	24,072	7,249	16,823
I. BANKS	8,663	779	7,884	8,685	773	7,912
A. Universal and Commercial Banks	4,545	38	4,507	4,596	38	4,558
Universal Banks	4,019	19	4,000	4,063	19	4,044
Private Domestic Banks	3,578	11	3,567	3,621	11	3,610
Government Banks	424	3	421	425	3	422
Branches of Foreign Banks	17	5	12	17	5	12
Commercial Banks	526	19	507	533	19	514
Private Domestic Banks	441	7	434	444	7	437
Subsidiaries of Foreign Banks	71	3	68	75	3	72
Branches of Foreign Banks	14	9	5	14	9	5
B. Thrift Banks <sup>1</sup>	1,339	74	1,265	1,329	74	1,255
C. Rural and Cooperative Banks	2,779	667	2,112	2,760	661	2,099
Rural Banks <sup>1</sup>	2,617	624	1,993	2,603	620	1,983
Cooperative Banks	162	43	119	157	41	116
II. NON-BANK FINANCIAL INSTITUTIONS	15,229	6,465	8,764	15,382	6,471	8,911
A. With Quasi-Banking Functions	37	14	23	37	14	23
B. Without Quasi-Banking Functions	15,192	6,451	8,741	15,345	6,457	8,888
NSSLAs <sup>2</sup>	164	70	94	166	70	96
Pawnshops	14,953	6,321	8,632	15,105	6,328	8,777
Others	75	60	15	74	59	15
III. OFFSHORE BANKING UNITS	5	5	0	5	5	0

<sup>1</sup> Including Microfinance-Oriented Banks

<sup>2</sup> Refers to non-stock savings and loan associations

**Source:** Supervisory Data Center, Supervision and Examination Sector

The rural and cooperative Banks, on the other hand, totaling 661 are the more popular and closest to the rural communities. These banks are primarily established to promote and expand the rural economy, which are normally run by the local entrepreneurs. Rural banks as well as cooperative banks help farmers by providing the needed financial services so that production, marketing, distribution of agricultural produce can be done efficiently. Generally, rural banks are organized by private individuals and families while cooperative banks are set up and managed primarily by cooperatives or federations of cooperatives.

A total of 8,685 units comprising the head offices, branches and other banking offices support the banking requirements of the Filipinos. Most of these units however are located in highly urbanized and developed centers, thus the big need to address the requirements of those in the rural and other areas outside of the urban centers.

The BSP also regulates and monitors 6,471 non-bank financial institutions. The non-bank financial institutions with quasi-banking functions is very small, totaling only 14 institutions plus 5 offshore banking units. The big bulk of the non-bank financial institutions (without quasi-banking authority) sector, is mostly composed of pawnshops numbering about 6,238. Pawnshops typically provide credit accommodations to the general public on a collateralized basis and with a higher interest rates compared

to the regulated banks.

Aside from the rural and thrift banks that have strong physical presence in the rural areas, Non-Governmental Organizations (NGOs), cooperatives, lending investors, private moneylenders, traders/millers and other government line agencies also provide financial services to the general public which include farmers, fisher folks and other agrarian based workers.

The Microfinance Council of the Philippines (MCPI), Inc. estimated that around 500 non-governmental organizations (NGOs), out of the more than 30,000 registered with the Securities and Exchange Commission (SEC), are involved in some form of providing microfinance services. The MCPI also said that around 300 cooperatives, from the over 66,000 registered with the Cooperative Development Authority (CDA) are doing some form of microfinance operations but only about 100 or so are doing serious microfinance operations with acceptable operational self-sufficiency ratios.

### **The Philippine National Strategy for Microfinance**

One of the government's strategies in poverty alleviation is to provide households engaged in microenterprise and income generating activities access to production and consumption smoothing credit. A number of directed credit and guarantee programs, especially focused on agriculture were started in the 1970s up to middle of 1980s. These credit and guarantee programs were either funded by the national government through budgetary allocation or foreign borrowings and implemented by national line agencies and through the rediscounting windows of the then Central Bank of the Philippines. Most of these credit and guarantee programs were provided at highly concessional rates to the end users. These programs, with all good intentions to help the poor, through the provision of credit and related services, did not fare well, that is, outreach were low, financial sustainability was poor and the fiscal cost to the government was enormous. Furthermore, its replicability could not be sustained and the desired positive impact to the intended users of funds was low. Several studies and evaluations made pointed out these negative findings.

Presently, the approved National Strategy is envisioned to (1) have a viable and sustainable private microfinancial market and (2) provide poor households and microentrepreneurs greater access to microfinancial services.

The National Strategy has the following four core principles:

1. Greater role of private microfinance institutions (MFIs) in the provision of financial services
2. Provision of an enabling policy environment that will facilitate the increased participation of the private sector in microfinance
3. Adoption of market-oriented financial and credit policies, e.g., market oriented interest rates on loans and deposits
4. Non-participation of government line agencies in the direct implementation of credit and guarantee programs

As the National Strategy was approved, several laws and issuances were subsequently enacted that supported the operationalization of the Strategy. These laws and issuances, with their features are:

1. Social Reform and Poverty Alleviation Act or RA 8425
  - Rationalization of government directed credit and guarantee programs
  - Emphasis on savings mobilization
  - Capacity-building assistance to MFIs but excluding any and all forms of capital seed funding, equity infusion and partnership funds from government to MFIs

2. Agriculture and Fisheries Modernization Act or RA 8435
  - Consolidation of government directed programs in the agriculture sector in the AMCFP
  - Adoption of market-based credit and financial policies
  - Government financial institutions as wholesalers
  - Private sector MFIs as conduits and retailers
3. General Banking Act of 8791
  - Recognition of the peculiar characteristics of microfinance (e.g., non-collateralized loans, short-term, frequency of payments, etc)
  - Use of household's cash flow as a basis in the design of microfinance product
4. Executive Order No.138
  - Transfer of directed-credit programs of government line agencies to government financial institutions
  - Discontinuance of interest rate subsidies
  - Government financial institutions to act as wholesaler of funds to avoid competition with MFIs
  - Use of sustainable community-based private MFIs in the actual delivery of microfinance services
5. Barangay Micro Business Enterprises Act or RA 9178
  - Government financial institutions to set up wholesale credit windows for accredited MFIs
  - Private sector MFIs will be tapped to provide credit support to micro enterprises
  - Small Business Guarantee Fund Corporation (SBGFC) and Quedan Corporation to provide the necessary credit guarantee cover to Barangay micro businesses
  - Loans under the BMBE window shall be computed at twice the amount of its face value in complying with the Agri-agra Law and the Magna Carta for Small and Medium Enterprises

### **The Philippine Regulatory Framework for Microfinance Institutions**

The need for a very clear regulatory framework for the practice of microfinance in the Philippines came out as a response to clarify the roles, responsibilities and accountabilities for the institutions providing various microfinance services in light of the increasing commercialization of microfinance in the country. The regulatory framework is also in answer to the increasing competition among the microfinance players as well as to uphold certain performance standards in governance and operations. As in other countries, microfinance services are given by the following three major providers of retail microfinance services: cooperatives, banks and NGOs.

The regulatory framework encompasses all types of microfinance institutions, whether bank or non-bank. The Emphasis of the framework is on: (1) Portfolio Quality, (2) Outreach, (3) Efficient and Sustainable Operations and (4) Transparent Information.

Insofar as the regulatory structure is concerned, the framework affirms that the CDA is the regulatory authority of the credit cooperatives while the BSP will continue to regulate and supervise banks doing microfinance operations. The NGOs on the other hand, which are not regulated, will have the MCPI as its repository of information.

A uniform set of standards that cuts across all types of MFIs, applicable to the peculiarities of each institution were crafted and approved. The performance standard is known by its acronym PESO: Portfolio Quality, Efficiency, Sustainability and Outreach. The regulatory framework has also incorporated the principle of “compensating balance” for those NGOs that are not allowed to mobilize savings but would take capital build-up from their clients. The compensating balance basically means that at any

point of time during the partnership between the NGO and its clients, the NGO would always be a net lender to the clients; hence, the risk is much bigger as compared to the clients of the NGO.

## **The Key Rural and Microfinance Players**

The growth of rural and microfinance financing in the Philippines can be traced, to a large extent, with the approval, acceptance and functioning of a very clear National Strategy as well as the setting up enabling laws and regulations, before and after the National Strategy was approved. The National Strategy as well as the regulatory framework, especially for microfinance will be discussed later in this paper. The three major players are the policy makers and regulators, wholesalers and retailers.

### **1. Policy Makers and Regulators**

*National Credit Council (NCC)/Department of Finance (DOF)* – The National Credit Council was created by an Administrative Order No. 86 signed by then President Fidel V. Ramos last October 8, 1993. It is tasked mainly to rationalize and optimize government credit and guarantee programs. It aims to institutionalize consultations and policy dialogues so that a higher level of private sector participation in the delivery of credit in the countryside. The Secretary of the Department of Finance concurrently Chair the Council with the Land Bank of the Philippines as Co-Chair. It is composed of government regulators, government financial institutions and other government line agencies as well as representatives from the private sector. Under the leadership of the NCC, several policy dialogues and consultations were made that resulted in the crafting of the National Strategy for Microfinance. The NCC was also instrumental, together with Agricultural Credit Policy Council (ACPC) in crafting and supporting changes in laws, regulations and policy framework that supported growth of credit in the rural areas.

*Agricultural Credit and Policy Council (ACPC)* – The ACPC is an attached agency of the Department of Agriculture (DA). It is the agency tasked to oversee the country's rural financial system, by adopting a holistic approach towards an efficient, effective and sustainable delivery of rural financial services in the countryside<sup>2</sup> Executive Order No. 113 signed by President Aquino in 1986 mandates ACPC to provide policy directions on agricultural credit towards a healthy and sustainable rural financial system. The ACPC in support of its mandate assist in credit facilitation so that credit can flow to the countryside. The ACPC is also the lead agency that developed a system whereby government credit resources were used when all directed credit programs were terminated and subsequently replaced by virtue of the Agro-Fishery Modernization Credit and Financing Program (AFMCFP) under the AFMA Law of 1997.

*Bangko Sentral ng Pilipinas (BSP)* – The Bangko Sentral ng Pilipinas or Central Bank of the Philippines is the regulator, supervisor and examiner of all banks in the Philippines. The BSP also regulates a number of non-bank institutions, either with quasi-banking functions or not. The BSP employs a three-pronged approach to microfinance in the banking sector, i.e., (a) Development of a “Microfinance-friendly” Policy and Regulatory Environment, (b) Capacity Building through Microfinance Training within the BSP and the banking sector and (c) Promotion and Advocacy.

*Cooperative Development Authority (CDA)* – The CDA is the government agency tasked to register, monitor, develop and supervise all cooperatives in the Philippines. The Congress of the Philippines recently amended the Cooperative Code of the Philippines, thus, empowering the CDA to do more supervision and regulatory functions over the cooperatives.

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<sup>2</sup> Creating a Conducive Rural Finance Policy Environment and Regulatory Framework in the Philippines: A Paper by Jocelyn Alma R. Badiola.

*Securities and Exchange Commission (SEC)* – The SEC is the government registering agency for all non-governmental organizations (NGOs). The SEC only registers and gives legal personality to an NGO but monitoring and supervision activities over NGOs are not done. However, the SEC has required all NGOs providing microfinance loans to categorically state in their respective charters and by-laws that microfinance is part of the services that the NGOs are providing.

*Insurance Commission (IC)* – The Insurance Commission, which is administratively under the Department of Finance (DOF), supervises all insurance activities in the Philippines, including the provision of Microinsurance products. The IC is currently reviewing its policies and regulations insofar as the practice of Microinsurance is concerned, especially by Mutual Benefit Associations or MBAs. Hopefully, within the next year or so, a very clear framework would evolve.

*Microfinance Council of the Philippines (MCPI)* – The MCPI is not a government agency but a duly registered NGO with the Securities and Exchange Commission. In the approved microfinance regulatory framework in the Philippines, the MCPI is viewed as the repository of data of microfinance practitioners. It is envisioned, that over time, the MCPI, will act as a self-regulatory organization (SRO), especially for the NGOs doing microfinance programs in the Philippines.

## **2. Wholesalers of Funds to Retailers**

In the Philippine setting, as enunciated in the National Strategy and the regulatory framework, the wholesalers of microfinance funds are the government financial institutions. Private commercial banks are strongly encouraged to act as wholesalers but there is no prohibition for them to do direct retail. So far, commercial banks have established their own subsidiaries like rural and/or thrift banks that provide retail microfinance services. A couple of commercial banks have asked the BSP for licenses to set up microfinance oriented branches to service the requirements of their clients. The People's Credit and Finance Corporation (PCFC) is the microfinance Apex institution in the Philippines. It is a government owned and controlled corporation and is an attached agency of the Land Bank of the Philippines (LBP). The LBP, Development Bank of the Philippines and Small Business Corporation are the three major government financial institutions doing wholesale lending to conduits and retails.

## **3. Direct Retailers to End Users**

Cooperatives, rural and cooperative banks as well as microfinance NGOs are actively servicing the requirements of both urban and rural clients. Some of the best performing microfinance banks and NGOs are members of the MCPI and the Alliance for Philippine Partners in Enterprise Development (APPEND), Inc., the oldest network of microfinance NGOs in the Philippines. The APPEND is a network of faith-based microfinance institutions, mostly NGOs affiliated with the Opportunity International. This network counts Opportunity Kauswagan (the merged bank of Opportunity Microfinance Bank and Kauswagan Bank) as a member. This bank is considered the first microfinance Thrift Bank in the Philippines.

The MCPI as the network organization has some of the largest and oldest microfinance institutions in the Philippines. It reported that as of 31 December 2009, the total number of active borrowers of its member organizations (Table 3) registered 1,938,337 with a total outstanding volume of PhP12.083 billion. Top Philippines MFIs in terms of loan portfolio and outreach are shown in Tables 3.1 and 3.2, respectively.

**Table 3: MCPI Microfinance Profile**

Total Reporting MFIs	36
Gross Loans	PHP 12.083 billion
Average Loan Size	PHP 6,234
No. of Active Borrowers	1,938,337

Source: Microfinance Council of the Philippines

**Table 3.1: Top 10 Philippines Microfinance Institutions – Loan Portfolio (in million pesos)**

Rank	Institution	Gross Loans
1	CARD NGO	PHP 2.130
2	CARD Bank	1.440
3	TSPI	1.403
4	GM Bank	1.369
5	FICO Bank	1.095
6	TSKI	0.976
7	KMBI	0.521
8	ASKI	0.446
9	NWTF	0.416
10	Peoples Bank of CARAGA	0.345
<b>Total (Top 10)</b>		<b>PHP 10.141</b>

Source: Microfinance Council of the Philippines

**Table 3.2: Top 10 Philippine Microfinance Institutions – Outreach**

Rank	Institution	No. of Borrowers
1	CARD NGO	497,431
2	TSPI	264,089
3	CARD Bank	228,460
4	KMBI	186,170
5	TSKI	161,299
6	CCT	112,485
7	NWTF	78,025
8	ASKI	41,451
9	GM Bank	36,655
10	Peoples Bank of Caraga	35,168
<b>Total (Top 10)</b>		<b>1,641,233</b>

Source: Microfinance Council of the Philippines

In the formal financial sector, microfinance services are given directly by the rural, cooperative and thrift banks. Wholesale lending by commercial banks, universal banks as well as by government specialized banks are given to microfinance institutions (cooperatives, non-governmental organizations and to other rural finance institutions, including rural banks) who in turn do the retailing of microfinance loans. As can be seen in Table 4, total microfinance loans by 212 rural and thrift banks registered at PhP6.677 billion and assisted a total of 882,692 households. Similarly, a total of PhP2.977 billion as savings was generated from the same number of microentrepreneurs and small farmers.



**Table 4\***

As of 31 December 2009

(In Million PhP)

Microfinance Exposures of Rural/Cooperative/Thrift/Microfinance Oriented Banks

	Number of Banks	Number of Borrowers	Loan Amount (In Million)	Savings Component
Microfinance Oriented Rural Banks	5	188,413	1,130.81	912.22
Microfinance Oriented Thrift Banks	3	32,992	205.77	116.39
Sub-total	8	221,405	1,336.58	1,028.61
Microfinance Engaged Rural Banks	159	568,665	4,117.14	1,569.82
Microfinance Engaged Cooperative Banks	25	76,075	768.08	243.16
Microfinance Engaged Thrift Banks	20	16,547	455.26	135.31
Sub-total	204	661,287	5,340.48	1,948.29
Grand Total	212	882,692	6,677.06	2,976.90

**Source:** BSP – MSFG report on the operations of banks with microfinance

The performance of these banks would have not been possible if the Bangko Sentral ng Pilipinas did not seriously undertake the pursuit of sustainability but with prudential standards in microfinance operations. The BSP was mandated by the General Banking Act of 2000 through sections 40, 43 and 44 to recognize microfinance as a legitimate banking activity. Since then, 24 circulars have been issued by the BSP to support the practice of microfinance in the banking sector. The BSP has also taken proactive and significant initiatives and activities to promote the development of sustainable microfinance programs in the Philippines. Prior to 2001 when the first BSP circular on microfinance was issued, only a handful of banks were reporting microfinance loans.

The growth of microfinance in the formal regulated sector was enhanced with the issuance of 24 circulars to date. These circulars cover a wide range of prudential as well as regulatory practices that made possible such growth of microfinance in the banking sector. These circulars with their respective subjects are:

- Circular 272 (January 2001) provided the operating guidelines of the General Banking Law Provisions. Specifically it recognized cash-flow based lending as a peculiar feature of microfinance, defined microfinance loans and provided for the exemption of microfinance loans from rules and regulations issued with regard to unsecured loans.
- Circular 273 (27 February 2001) partially lifted the moratorium on the establishment of new banks as long as the new banks are microfinance- oriented.
- Circular 282 (19 April 2001) opened a rediscounting facility for rural banks/cooperative rural banks engaged in microfinance.
- Circular 324 (2 March 2002) opened a rediscounting facility for thrift banks engaged in microfinance.
- Circular Letter 2002 – required the reporting of banks with microfinance operations.
- Circular 340 (30 July 2002) provided the rules and regulations concerning the establishment of branches or loan collection and disbursement points (LCDPs).
- Circular 365 (16 January 2003) liberalized select provisions of Circular 340.
- Circular 364 (19 January 2003) provided for the reduction to 75 percent of the risk weight applicable to small and medium enterprises (SMEs) and microfinance loan portfolios that meet prudential standards.
- Circular 369 (17 February 2003) liberalized select provisions of Circular 340.

- Circular 374 (11 March 2003) provided guidelines for the implementation of the Barangay Micro-Business Enterprise Law.
- Circular 409 (14 October 2003) provided the rules and regulations for the portfolio-at-risk (PAR) and the corresponding allowance for probable losses which depend on the number of days of missed payment.
- Circular 505 (22 December 2005) revised branching guidelines by allowing qualified microfinance oriented banks and microfinance oriented branches of regular banks to establish branches anywhere in the Philippines.
- Circular 549 (09 October 2006) exempted microfinance from the required submission of additional documents for the granting of loans.
- Circular 570 (24 May 2007) allowed wholesale loans of universal, commercial and branches of foreign-owned banks to non-bank microfinance institutions as compliance to the 6 percent mandatory credit allocation to small enterprises.
- Circular 607 (30 April 2008) provided the reportorial Requirements for Microfinance Loans.
- Circular 624 (13 October 2008) stipulated amendments to branching regulations with incentives for microfinance oriented banks or microfinance oriented branches.
- Circular 625 (14 October 2008) provided the implementation of Mandatory Allocation to MSMEs as per Republic Act 9501.
- Circular 649 (March 2009) covered the regulations on the issuance of electronic money.
- Circular 669 (22 October 2009) amended the existing rules on loan collection and disbursement points of microfinance-oriented banks and microfinance-oriented branches by allowing the servicing of deposits and withdrawals only of microfinance clients.
- Circular 678 (6 January 2010) provides rules and regulations that govern the approval of banks' housing microfinance products.
- Circular 680 (03 February 2010) provides rules and regulations on the approval of banks' micro-agri loans.
- Circular 683 (23 February 2010) provides rules and regulations in the marketing, sale and servicing of microinsurance products by banks.
- Circular 685 (7 April 2010) provides rules and regulations for the recognition of Microfinance Institution Rating Agencies.
- Circular 694 (14 October 2010) amended the regulation on the establishment of other banking offices and notes on microfinance.

### **Status of the Philippine Microfinance “Sector”**

What is microfinance? The Philippines define it as the provision of a broad range of services which include savings, credit, remittance, transfers and insurance to poor and low-income households.

Related to the provision of microfinance loans and savings, some of the Philippine microfinance institutions are also providing Microinsurance products, to their clients. MFIs either partnered with insurance companies to provide insurance products or directly provided limited types of Microinsurance products to their clients.

A handful of MFIs, on the other hand, facilitated the establishment of mutual benefit associations or MBAs that are owned by the clients of MFIs. Some of the Microinsurance products being offered to the

clients are either life or non-life in nature, agricultural insurance linked with weather based data/index, or plain insurance of loans. The government is currently reviewing the legal, regulatory framework of these activities, and hopefully, in the next year or so, a very clear, sound and prudentially focused framework would evolve to help the poor, whether in the rural or urban setting.

The practice of microfinance in the Philippines has been cited as one of the most advanced in the world, from a list of 54 countries. In the 2010 index and study done by the Economist Intelligence Unit (EIU)<sup>3</sup> as commissioned by the International Finance Corporation (IFC), Inter-American Development Bank (IADB) and by the Corporacion Andina de Fomento (CAF), the Philippines ranked number 2, largely due to a very clear and supportive regulatory framework. The study focused on three broad categories: regulatory framework, investment climate and institutional development. The Philippines landed number 1 in regulatory framework with index score of 87.5 in a tie with Cambodia and Pakistan. The Philippines got an overall index score of 71.8 trailing Peru with overall index rating of 74.3.

The selection of the Philippines as number 2 (and number 1 in Asia), after Peru, the acknowledged leader in sound microfinance regulatory environment is a testament to the commitment of the key Philippine stakeholders to see a vibrant, dynamic and sustainable microfinance environment at work in the Philippines.

According to the report, the countries at the top of the index share several characteristics:

1. Their governments seek to foster market development through policies that address microfinance activities directly.
2. In cases, where the “sector” is not specifically addressed by laws and regulations, the more general framework that govern microfinance still allows it to grow.
3. Governments in these countries also refrain from implementing large scale and distorting subsidy programs.
4. In cases where subsidies exist, they have not crowded out microfinance provision by specialized microfinance institutions like NGOs and cooperatives.
5. In some cases, central banks in these countries have created specialized microfinance units in their organizations.

In the pilot 2009 EIU index and study among 55 countries, the Philippines was ranked number 3 behind Peru and Bolivia overall. It was tied for first place with Cambodia in the regulatory framework category.

One may surmise that, with this recognition, the Philippine microfinance outreach would be in the millions, approximating the reported outreaches of Bangladesh, India and other Latin American countries. The Philippine outreach and volume, however, are not in the same league due to contextual reasons. For one, the total population in the Philippines is much lower than that of the countries reporting outreach by the millions. The physical terrain in the Philippines coupled with the little infrastructure to physically reach with financial services those in the hard-to-reach areas is another factor to consider. The microfinance practice in the Philippines, however, is making inroads and is now substantially reaching a greater number of poor clients as against the total population.

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<sup>3</sup> Global Microscope on the Microfinance Business Environment: An Index and Study by the Economist Intelligence Unit

### III. Lessons Learned/Future Directions and Issues

The world of rural finance and microfinance is a very dynamic and a very challenging one. The commitment to serve the poor, whether in the urban or rural setting in a viable, replicable and sustainable manner brings tensions, pressures and challenges to the players involved. The tensions and pressures to produce profit at the end of the day coupled with the social dimension of bringing down poverty and creating more incomes and resources for the poor will always be in the mind of the providers of credit and other financial resources. Regulators and policy-makers have a common objective, i.e., protect the soundness of the system and to craft policies and regulations that will not exclude people, especially the poor, but would rather move towards financial inclusion for all.

As bankers, policy makers, regulators, development workers and users of funds commit themselves to the technical as well as financial principles in ensuring that rural and microfinance program effectively work to reach the intended clients, the following points should be considered:

- COMMITMENT to Financial Inclusion should be a guiding principle that must be integrated in crafting policies, rules, guidelines and regulations.
- BOLDNESS, which basically means to think outside of the box when providing poverty solutions to address growing poverty. Solutions must be sustainable, viable, replicable and with focus to greater outreach and depth.
- ADAPTIVE means to be flexible without sacrificing prudential standards and the safety of the financial system as well as the general public
- NATIONALISTIC means to keep the interest of the country at heart, even as the world is becoming flat and inter-connected in terms of operations and business dealings.
- KNOWLEDGE FOCUSED is to be aware of what is happening globally in terms of technology, sound practices, development and socio-cultural changes. Evidence based studies should be encouraged.
- “EARTHY” MIND means to be grounded in reality and not be confined in ivory tower.
- RESPONSIVE to the need of the market, thus appropriate and proportionate regulations can be made.

With these points in mind, we can then look at the challenges ahead with greater resolve and certainty that we would be able to hurdle them. Some of these challenges that we are facing in the Philippines may or may not be present in the context of Thailand, but it would be worth looking at them, so that in the event that they manifest in your country context, then you would be in a better situation to address them.

- 1) Credit pollution – As microfinance institutions expand their respective microfinance programs and services, the tendency to be lax in client selection and in preparing their clients, whether individuals or groups have become an issue. In a number of anecdotal reports as well as some official reports of MFIs, the quality of portfolio was reported to be going down. As MFIs tend to “poach and capture” good clients of their comparator MFIs, preparing the clients in the old fashioned way of credit discipline and savings habit have been forgotten. Community organizing and community development preparation have been shortened too, thus increasing the risk of bad portfolio over time.

A solution to this problem is to employ the use of credit bureau. Although there are at least 3 functioning private credit bureaus in the Philippines, their operations are not covering microfinance loans. On top of these, these 3 credit bureaus do not share information among themselves and they only focus on the negative list, i.e., clients who have bad credit history.

The Philippine Congress recently passed the Credit Information Systems Act (CISA) which aims to establish a comprehensive data system and structure that would help systematize relevant data of borrowers. It is envisioned that all borrowers of banks and cooperatives, and later even that of the NGOs would be subjected to the credit information processes that will be handled by Credit Information Corporation, a government owned corporation established by the Act. With the approval of the CISA, access to credit by micro, small and medium as well as agri-based workers would be enhanced as well as address the risks issue involved in multiple borrowings of clients.

- 2) Financial Literacy and Consumer Protection of Clients – As clients get exposed to financial transactions offered by various providers of funds, regulators and providers of funds need to think of ways so that clients can be empowered to become financially literate. Clients need to be aware of their rights and responsibilities in the use of credit as well as savings; Budgeting, planning and investing skills are needed by the clients and there is a need to capacitate the clients on these skills. Finally, consumer protection of clients must be an on-going concern by all.
- 3) Need for Business Development Services (BDS) – As clients’ businesses expand, the most common need that is expressed by them is how to help them improve their products and services. Clients need help in product design, marketing, branding, and compliance with standards. The response of the MFIs is either to link these clients to existing organizations who are focused on these needs. The MFIs need not directly address these particular needs of their clients but by linking them up to appropriate organizations, the services needed by the clients can be met.
- 4) Branchless banking / phone banking – The Philippines is known as the “texting capital of the world”, with over 1.2 billion texts that go around everyday. More than 55 percent of the population owns a cell phone. Along this line, the BSP and in partnership with the Rural Bankers’ Association of the Philippines has allowed the use of cell phone for loan payments, deposits and withdrawals of savings by microfinance clients. Allowing the use of this technology has brought down the cost of such transaction and increased convenience for both the institution and the client. This facility has enabled the clients who are unable to travel to the physical branch office of the bank to transact with the bank.
- 5) Increase delivery channel – 37 percent of the total municipalities in the Philippines remained without banking presence. In line with this, the BSP introduced the concept of Other Banking Office (OBO) in 2005. As a result of expansion of good performing Banks using this non-transactional banking unit, the BSP decided this year to allow the opening of transactional Micro-Banking Office (OBO) which is expected to take micro-deposits and serve the needs of the unbanked clients in the countryside. This will surely increase the microfinance outreach of formal financial institutions and further promote the BSP’s financial inclusion advocacy.

## **Cambodia Microfinance: Development and Challenges**

**By Mr. Kim Vada  
Deputy Director General  
National Bank of Cambodia**

### **I. Social-Economic Profile**

Cambodia is a multi-party democracy under a constitutional monarchy with a total population 14 million, 80 percent of which live in the rural areas. Its main religion is Buddhism. It has total land area of 181,035 square kilometers and share borders with Thailand, Laos and Vietnam. Its Official Language is Khmer. The country has experience a robust annual growth rate 9 percent from 2001 to 2008 and registered a GDP per capita of around 739 USD in 2008.

### **II. Cambodian Financial System**

The Cambodian Financial System started in the early 1990s when the government launched the economic reform program. It is dominated by the banking system, which consists of the central bank, commercial and specialized banks, and MFIs. The banking system had gone through significant reform in 2000 after the promulgation of the Law on Banking and Financial Institutions in the late 1999.

**Central Bank:** the National Bank of Cambodia is an independent autonomous entity with its principal mission to determine and direct monetary policy aimed at maintaining price stability in order to facilitate economic development.

As of September 2010, there are 34 banks, composed of 28 commercial banks, of which 6 are foreign bank's branches, and 6 specialized banks.

**Microfinance:** there are 24 licensed MFIs, of which 5 obtained deposit taking license, 28 registered credit operators and around 60 small NGOs.

**Informal lending sources:** continue to be an important source of rural credit. The interest rates charged by the informal money lenders are extremely variable, sometimes reaching 10 percent per month.

### **III. Rural Financial Policy Framework**

The government has announced 2006 as “a year of microfinance of Cambodia”. Since the 2006 announcement, Cambodian microfinance has grown remarkably. This growth significantly contributes to economic development and poverty alleviation.

With its credit and savings services, MFIs help people, especially the poor to relieve their family burdens and improve their livelihood to some extent.

FSDP 2001-10: identified rural finance as a critical sector requiring development and support.

FSDP 2006-15: has revised the delineation of the sector in the FSDP 2001-10 as “Rural Finance” to become more inclusive, and considers the sector as “Microfinance.”

Government has adopted a series of policy measures, supported by international donors:

- i. establishment of the Credit Committee for Rural Development (CCRD) in 1995;
- ii. introduction of a framework in the Banking Law to enable eligible NGOs and other rural finance providers to become regulated microfinance institutions (MFIs);
- iii. creation of a unit in the National Bank of Cambodia (NBC) to supervise and monitor MFIs; and
- iv. establishment of an apex institution to provide financing for MFIs, namely the Rural Development Bank (RDB).

## **STRUCTURE OF MICROFINANCE IN CAMBODIA**

### **Corporate Structure and Governance**

MFIs have been concentrated on defining their share structure and the value of each share. This requirement had been imposed by the NBC in order to ensure good governance for further enrichment of the microfinance industry.

To ensure operational efficiency, the registered and licensed MFIs have strengthened their operational structure such as organizational chart, human resource development, management information system, financial management, internal audit system and other arrangements, which are aimed at enhancing transparency and good governance.

Establish a commercial enterprise registered at the MOC

Request for Microfinance License or registration from NBC

Those institutions have also ensured their governing body by defining the roles and responsibilities of the board of directors in which they serve as policy maker. The management is also crucial to ensure efficient and well functioning of the institution.

### **Source of Fund**

There are two main funding sources of MFIs. The first is in the form of owners' equity. The second funding source is in the form of liability which is financed by commercial and concessional loans of foreign financial institutions, development agencies or governments of developed countries.

Savings mobilized from the public are also acting as crucial sources to support microfinance operations. But, there are still limited to some potential MFIs because of limited knowledge about savings of rural people and their trust on the institutions.

The amount of saving mobilization does not respond to the amount of credit demand of borrowers.

Recently, the NBC just established a separate legal form for licensed MFIs that want to mobilize savings from the public to apply for additional regulatory status.

### **Lending Methodology**

There are three main types of credit being serviced by MFIs in Cambodia. These are individual loan, solidarity group loan and community bank loan.

The individual loan is normally having bigger loan size and its lending term is shorter than the other two types. This particular loan type does not need a group guaranty, but it requires collateral and a guarantor in order to ensure the repayment ability of the borrowers.

The solidarity group loan requires members to guarantee each other in the same group. This guarantee is provided when a member defaults in loan repayment, and other group members have to take the responsibility for repayment. Normally, this loan size is smaller than individual loans and each group comprises of more than two members.

The community bank loan is targeted to poor clients who are running small businesses and are also new borrowers of the MFIs. This loan size is very small and collateral-free. Generally, the group consists of four members or two solidarity groups in which members join up on a voluntary basis guarantees each other. This loan is categorized as low default risk, but its disadvantage is when a group member is in default, the other borrowers will be reluctant to submit their repayments.

## **Clients**

Having a clear understanding about targeted clients of MFI is very crucial for developing products and services that are definitely serving the benefits of the poor. Normally, microfinance's clients are poor people living in rural areas and do not have access to formal banking services.

Each institution has divided their clients based on credit types and different business of the clients.

Some MFIs have categorized their clients based on geographical areas in which it is aimed at matching loan product to credit demand of a particular resident.

## **Interest Rate**

Interest rate setting is very sensitive issue that has normally been received criticism from public and politics

The NBC has issued a regulation on interest calculation of microfinance loan product in which the basis of this method is to take into calculation only the outstanding principal (so called: declining method).

There is no interest rate cap for all microfinance operators. This means that all institutions have to define their interest rate based on free market movement and environment.

From time to time, the interest rate of microfinance loan product has decreased significantly, which was from the average interest rate of 5 to 6 percent per month at its initial stage to the current average interest rate of 2.5 to 3 percent per month.

## **Regulatory and Supervisory Framework**

Commercial banking and rural finance are both major elements of the financial system of the country.

To implement law on banking and financial institutions, all financial services operators need to be licensed from NBC.

The purpose of the regulation is not to restrict their activities but to promote them.

In 2000, NBC issued regulations on the classification of MFIs into three categories according to the level of their operations, and created criteria for licensing and registration.



Regulation and licensing are necessary for MFIs that collect savings from their members and the public, acquire long-term borrowing from foreign and local organizations.

Concerning to the supervision of MFIs, the NBC also conducts off-site and on-site supervision and inspections on a regular basis in order to ensure that all MFIs are operating professionally and prudentially.

For financial transparency and disclosure, the NBC is strengthening the implementation of the uniform chart of accounts for MFIs and the disclosure requirements in line with the international accounting standard.

All MFIs are required to have annual audited financial statements. Also field visit is conducted to verify applicant for a license or registration MFIs.

The biggest microfinance operators must be licensed by NBC. The regulation is very similar to commercial banks, except that the capital requirement is substantially lower.

The medium-sized microfinance operators are only registered by NBC and are subjected to lighter regulation and in particular, reports sent to NBC are simplified.

The smallest microfinance operators (NGOs) can operate freely with no requirement to be regulated and supervised due to high operating costs.

### **Criteria for Licensing MFIs**

Following are the criteria for Licensing an MFI:

1. The institution should register as a commercial enterprise or cooperative;
2. Minimum registered capital requirement KHR 250 million;
3. NGOs having loan outstanding more than KHR1,000 million and clients more than 1,000;
4. Annual license fee KHR1 million; Apply uniform chart of account;
5. Submission of monthly reports to NBC;
6. Assets and liabilities statement;
7. Profit and loss statement;
8. Loan classification report;
9. Solvency calculation report., etc;
10. Prudential Requirements for MFIs;
11. Registered capital guarantee of 5 percent;
12. Reserve requirement of 5 percent;
13. Solvency ratio of 15 percent;
14. Liquidity ratio of 50 percent; and
15. Large exposure of not more than 10 percent of owners' equity.

Criteria for Registered Rural Credit Operators (RCO):

1. Register as an association or NGO;
2. No minimum registered capital requirement;
3. NGOs having loan outstanding equals to or greater than KHR100 million;
4. No registration fee; and
5. Quarterly reports to NBC.

## **Criteria for Licensing Deposit Taking MFIs**

1. Hold a MFI's license at least 3 years;
2. Have a good financial condition and sound management at a safety level for at least two years before submitting the application;
3. Have a minimum paid up capital equal to KHR10,000 million;
4. Have an effective Management Information System (MIS);
5. Implement NBC's uniform chart of accounts; and
6. Have sustainable profitability of at least two consecutive years in primary operations.

## **Innovative Approaches to Encourage Credit**

Innovation is an integral part of microfinance development in pursuit of promoting financial access to the poor people.

The credit enhancement innovative has not yet been significantly developed by MFIs.

Some MFIs may diversify their financial services in order to accommodate the heterogeneity of the rural people's needs, potential and business capabilities.

The new innovative approaches introduced in the MFIs operations mostly concerning to money transfer and payment services rather than to credit services.

The introduction of mobile phone banking requires regulatory framework in order protect depositors' money.

## **Challenges and Issues**

New Product Development

Enhanced commercial microfinance

Improved financial sustainability of microfinance operators

Corporate governance

Credit Information System (CIS)

Capacity Building

Regulation and supervision

## **Conclusion**

Microfinance activities and outreaches have contributed benefits and good experience for the development and poverty alleviation.

Microfinance sector has been internationally recognized and highly rated since it commenced its path towards a sound regulatory, supervisory, and managerial environment.

The lending methodology of microfinance is more customer-oriented with MFIs designing their products to meet the clients' actual demand.

Adherence to all guidelines and regulations issued by the NBC would lead MFIs to effectively achieve sustainable rural financial services.

These achievements cannot be separated from the support of international donors and investors that encourage the microfinance sector through both technical assistance and funds.

The government's well-directed policy in the Rectangular Strategy and Financial Sector Development Strategy has proven crucial in leading to the successful development of the financial sector, especially in the role of microfinance in poverty reduction.

Thank You!!!

## **“POVERTY IS NOT INHERITED” CREDIT UNIONS AND MICROFINANCE INNOVATION**

### **Introduction**

Credit Unions and financial cooperatives are by tradition and history the first and original microfinance institutions in the world. They are also, in a sense, the oldest form of civil society organizations. By itself, they are the first to demonstrate the power of social entrepreneurship and innovation. As the ‘social economy’ they started a tradition of cooperation seen as both theory of total and authentic human development basically grounded in socio-political and economic empowerment of persons united voluntarily, to redress imbalances in market power. By its participatory principles in its more than 160 years history, it has contributed to the restructuring of society in directions which serve the long term interest of the poor.

Present day literature describes microfinance as the provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban area for enabling them to raise their income levels and improve living standards. Microfinance institutions are referred to as those, which provide such services and products.

From the credit union perspective, Microfinance is defined as the sustainable provision of financial services (savings & credit facilities) to economically active and poor households who lack access to the formal financial sector with the end view of empowering the ‘have less<sup>4</sup>’ economically, socially and politically.

There is also a strong emphasis on entrepreneurship as a continuing dynamic and a mechanism for tightly integrated financial and educational services designed for the entrepreneurial poor (e-poor) capable of engaging successfully in microenterprises.

### **CREDIT UNION HISTORY**

When the existing credit facilities such as banks would not lend to his rural constituency, forcing them to borrow from moneylenders, Friedrich Wilhelm Raiffeisen formed credit unions in 1864 patterned after the Shultze-Delitzch model. It is based on the principle of ‘people helping themselves.’ They raised capital through member deposits and elected a management committee to approve loans and conduct the routine business of the society. Raiffeisen originated the concept of the first credit union central bank and the first to design self-regulating organizations in the form of regional and national structures and first to establish prudential standards through its auditing services thus facilitating central banking.

The idea of small groups in credit unions is not new. Dr. Leon Wollemborg established the first of many small credit unions (40-60 members) in Loreggia, Italy in 1883. More recently in Asia, in the 1960s the joint liability group concept was adopted by the Bank for Agriculture and Agricultural Cooperatives in Thailand, as principal form of security for small loans. The joint liability groups are self-formed by people based on character and trust in sizes of 5-30 averaging 15 members. The group organization is simple with only a group leader acting as liaison officer.

Records of repayment efficiency which is a main feature of the immense popularity of various microfinance institutions today is also not a novel experience. In 1901, Alphonse Dejardins established “La Caisse Populaire de Levis’ (People’s Bank of Levis), a credit cooperative based on the European models.

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<sup>4</sup> Have less, the term use by credit unions to refer to poor.

In a sense, the first self-help groups (SHGs) which approximate today's people's organizations with an economic-project in microfinance terms, are the 28 weavers of Rochdale, the forerunners of the Cooperative System. This classic case is *prototype* to today's SHGs modified accordingly to the particular need of modern times. The Rochdale's organizing work begun from a series of group discussion on socio-economic issues, observations on the local situation and finally the decision that the only way to liberate themselves from the deplorable condition was to go into business themselves.

## **CREDIT UNIONS IN ASIA, AND MICROFINANCE INNOVATION**

In today's free market economy, the credit unions and cooperatives seen as a distinct economic enterprise, has ground rules to follow such as cost-competitiveness, concentration on a set core of activity, re-engineered membership relations and governance structure, improved management capability through effective organizational design and stress on internal capital formation and accumulation.

The development of human and social capital is a primary concern since these are crucial resources needed by the poor to participate in the development process. Today credit unions in Asia engage both private and public institution in collaborative undertakings for social and economic development activities. The credit unions are considered benchmarks for its class since it remains as the institutional form in the grassroots level in terms of number and spread (outreach) and with proven capability to involve the poor in poverty alleviation and developmental initiatives.

The Microfinance innovation in credit unions is organized and with an institutional character. It is a tightly integrated financial and educational service designed to catalyze entrepreneurship among the poorest of the economically active emphasizing wide horizontal group network integrated vertically upon progress in the entrepreneurship ladder.

The maturation of the Microfinance industry in a very competitive market economy gave reasons to service providers of Microfinance to focus on development of new products. The Credit Unions are not unaware of these developments. The CEO workshops of ACCU in the mid 1990s built awareness on strategic marketing as operations oriented which begins with development of a new service or change and repackaging of a current service. It is member oriented that it starts with the needs of members, towards developing a service that fulfill members need. The member is central and focal. Both product and organization is positioned adequately and well in the marketplace.

More than the service and product innovation, the Microfinance innovation in Credit Unions is best seen in itself as a 'strategic renewal'. This is described as birth of new business (microfinance) with the existing organization (Credit Union), internal venturing and the transformation of the organization through renewal of key ideas in which they are built. Credit Union as model of social entrepreneurship came up not only with a product/service but a particular organizational design – self-help groups (SHG) with sociopolitical and economic empowerment as end point. The strategic importance of microfinance in the Credit Union role of a voluntary organization whose aim is advocacy of public interest and the importance of these wide horizontal networks of SHG to the movement is now known.

The methodology of the self-help groups is rationalized as basically a response to the anonymity of globalization. This 'new tribalism' is understood as the desire of individuals to preserve the native bonds of solidarity among them, preserving both tradition and identity. As globalization has globalized poverty the logical response is also a globalization of Solidarity.

This is the basis of the credit union innovation and strategic renewal. The critical factors in a globalizing economy are flexibility, turn around times and decision-making channels, with fewer bureaucratic structures to react fast. Flexibility to the general environment in small units and decentralized structures has a distinct competitive edge. The traditional disadvantages of small enterprises due to small size are neutralized by development in the communications and information.

## **CREDIT UNION MICROFINANCE INNOVATION PROGRAM**

The Microfinance Innovation in Credit Union is best seen in itself as a “strategic renewal”. This strategic renewal can be mapped out as two parallel, dominant streams.

ACCU’s Microfinance Innovation program is implemented in 11 member-countries, in the Philippines, Indonesia’ Vietnam, Nepal, Bangladesh, Sri Lanka, India, Laos, Mongolia, Cambodia and Myanmar. It has the following activities.

1. Development of the Microfinancing Program
2. A Strategic Planning Workshop
3. Microenterprise Planning and Management Training
4. Social Mobilization and
5. Technical Assistance on Institutional Development of Credit Unions

Development of the Microfinancing Program observes a “bottom-up” approach which highlight innovative approaches to traditional productive lending. It ensures flexible financial services regarding savings and loan, focusing on net savings and keeping a prudential balance with net borrowings. This also emphasizes capacity based lending with the loan amount unassociated with the share capital so as not to limit access of poor to CU services. This definitely shifts productive lending to a focus on entrepreneurial cash flow which is familiar even to practicing small entrepreneurs.

The Strategic Planning Workshop exposes management and leadership to the present challenges of credit unions and also, the challenges on poverty, development and the strategy of microfinancing to create wealth through self-employment and enterprise development for the poor.

On the organizational level, said workshop reviews the financial performance of credit unions to analyze the effectiveness and efficiency of products and services in relation to a diverse membership background. This includes the poor market segment outreach.

A strategic plan will be the workshops main output. As policy changes will be introduced innovative loan and savings products will be developed for the credit unions as it was but it now puts significant attention to developing policies and products to reach out to more poor members of the Cooperative.

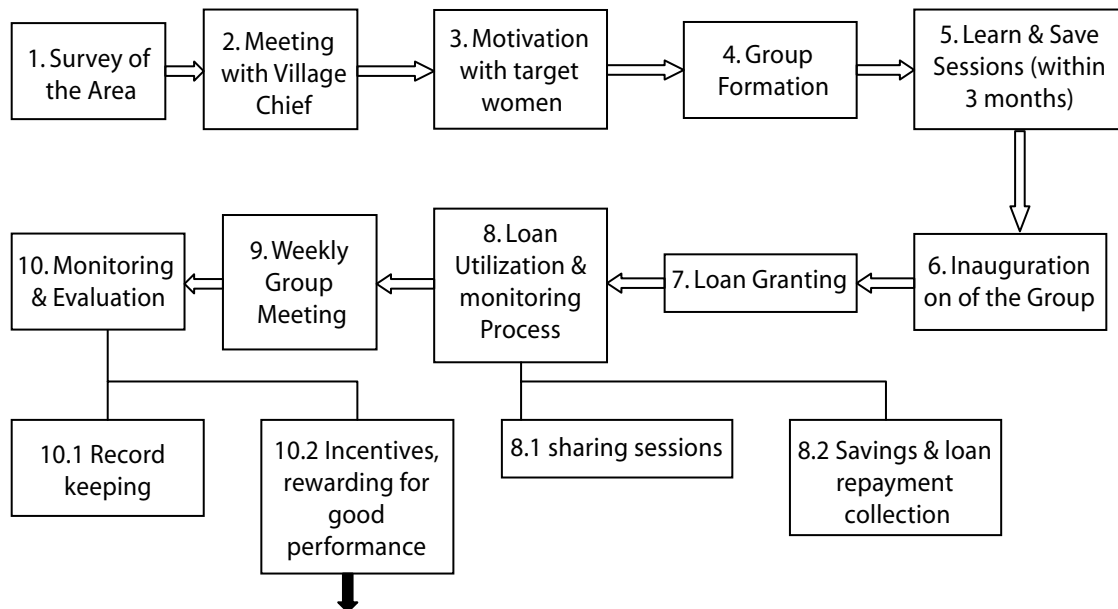
Microenterprise Planning and Management Training. This training is the necessary capacity building program for key staff and personnel regarding delivery of effective learn and save sessions for self-help groups. The mechanism of weekly center meeting is an appropriate venue most often under utilized and unappreciated, for the routine business activity of credit unions, trainings are usually one shot affairs. Microfinance Management requires not only short term repayments and microsavings but a regular dose of “growth hormones” for continuing viability of the microenterprise and opportunity for diversification. The Microfinance Field Staff aside from being credit repayment specialists doubles up more precisely in the role of development educator and change agent.

Today this social research methodology is associated as a corporation’s social audit. It recognizes that social research is not only inquiring into social phenomenon but it is a social phenomenon on its own right. It is where the participant-change agent- researcher enters the very social fabric they intend to study and partly because what they observe.

## THE CREDIT UNION MICROFINANCE INNOVATION (CUMI) METHODOLOGY

The Credit Union Microfinance Innovation – methodology revolves around self help and solidarity groups and enhances and nurtures its social, political as well as its economic empowerment. This methodology illustrated below is grounded on the following principles of financial services delivery to the poor.

### MICROFINANCE METHODOLOGY



**Empowerment = Graduation as Regular Member of CU**

### Principles of Financial Services Delivery to the Poor

- 1) **SOLIDARITY GROUPS** – it has been proven by most of the microfinance programs that forming a solidarity group is an effective and efficient mechanism. The poor could develop sense of responsibility, belongingness and develop leadership as well as entrepreneurial skills. On the part of the credit unions, administration of loan is more cost effective and more impact could be generated.
- 2) **TRAINING** – there should be a continuous training for the poor. It is not enough to provide them of the needed financial services but they should be trained on the concept of development, social values, skills and leadership.
- 3) **LOCALIZE SERVICES, FOCUS ON ECONOMY OF SCALE, LOCATE CLOSE TO ENTREPRENEURS.** Select staff from local communities, including people with lower levels of education, rather than from staff of formal banks. Locate where there is a critical mass of clients in order to reduce transaction costs. Lending outlets can also be located near the client and decentralizing approval process which would significantly reduce costs of transaction. Microfinance programs reach sustainability in part by making large volumes of loans.
- 4) **RECOGNIZE THAT THE POOR DO SAVE** – Credit programs are more sustainable when they are financed with personal savings. Savings are often the forgotten half of informal finance. However, accepting deposits is labor-intensive and therefore quite costly. Most microenterprise programs with savings elements used some form of compulsory savings, whereby borrowers are required to save portion of its earnings from the microenterprise.

- 5) **OFFER SHORT-TERM LOANS** – offer initial loans of three to six months with frequent repayment period. Long-term repayment is not advisable for a start.
- 6) **OFFER SMALL INITIAL LOANS** – Start with very small loans appropriate for meeting day-to-day financial requirements of microenterprises and motivate repayment by offering larger loans as incentives for repeat loans. A big amount of loan would not help the poor. They have to learn how to manage a business. If they have shown their capability to manage and operate the microenterprise and able to repay the loan, that is the time to extend a little bigger amount. It should be increased gradually.
- 7) **CHARGE FULL-COST INTEREST RATES (*factoring in inflation, loan losses and delinquency, transaction cost and the cost of loan funds*)**. The administrative costs of lending to the poor require interest rates that are substantially higher than the rates charged by commercial banks but low compared with typical informal-system rates. Microentrepreneurs have shown a willingness to pay high rates for services that meet their needs.
- 8) **SHORTEN TURNAROUND TIME** – Limit the time between loan application and disbursement. Since the majority of microloans are for working capital, speed is ideal for borrowers and saves administrative costs for lending institutions. Turnaround time can be lowered by relying on solidarity groups to screen clients and by decentralizing loan approval and based on readily verifiable eligibility criteria rather than business appraisal. Borrower groups often handle much of the loan processing burden.
- 9) **MOTIVATE REPAYMENT** – Motivate repayment via group solidarity and joint liability. Group lending is efficient because it externalizes costs. Character-based lending to individuals can be effective where the social structure is cohesive and there is little potential for political abuse.
- 10) **SIMPLIFY SERVICES**. Make the credit program credit unions customer-friendly. Use a simple application process (often less than one page) appropriate to low levels of literacy and numeracy and streamline operations to minimize staff time per loan. The institution can design a form that is easy to fill up. In case the borrower has difficulty of filling up the forms, the staff should provide help to accomplish the necessary forms. Moreover, the institution should have a tailored microenterprise project proposal readily available for the target clients.
- 11) **SPECIALIZED SERVICES DIVERSIFY PORTFOLIO, IGNORE THE TEMPTATION OF TARGET**. The institution should diversify its loan portfolio but not the range of services provided to microenterprises. Loan portfolios should be diversified to counter supply-driven, targeted credit programs and to reduce the risks associated with a homogenous portfolio.
- 12) **CONCENTRATE ON WORKING CAPITAL TO BORROWERS WITH A PROVEN TRACK RECORD**. Since financing would be small, financing, fixed assets acquisition would not be advisable because of the risk involved. The borrower would be burdened too much of having a big cost to recover out of the operation.

The CUMI methodology puts into action the original values of self responsibility in a self help organization, Self-help for credit unions focusing on savings and mutual help convertible to the activity of credit. Previously, the traditional sequence was self-help, mutual-help and self-responsibility, tied up with group joint liability (group responsibility). Traditional microfinance's self-responsibility bears the influence of the liberal tradition of individual efforts. Today's microfinance innovation radically shifts for credit unions to the group on a more communitarian form of solidarity. This social democracy of the group related to the dynamic enterprise life cycle or social entrepreneurship is one of the emerging new languages of development economics. In civil society discourse it is referred to as the finance of solidarity.

The CUMI methodology is the methodology of the power of partnership and association. Organizing work is geared towards sustainability through member economic participation where people become directly



involved in the process of development, building independent member-controlled credit unions. Participation comes in different stages and in a myriad of ways-in decision-making, implementation, economic, social and political participation and in evaluating activity. This dynamic provides space for innovation and creativity on a continuing basis on a nurturing environment of relationship. It provides exciting methodologies for village level involvement in development decision-making and involving development discipline based on group responsibility, self-help, mutual help and finally self-governance.

The CUMI methodology is a system of pre-cooperatives/pre-microenterprise for credit unions providing self-help group services. It increases efficiency of credit union services. The SHG/Solidarity groups provides active input into important decision-making, experience in managing small groups and maintain a sense of solidarity, mutual trust and caring. It consists of member networking in credit union levels of sustainability. This wide horizontal network of self-help groups federated to solidarity centers provide the grassroots grounding from which the credit union stands upon vertical integration.

## **SAVINGS PRODUCTS AND LOAN PRODUCTS**

### **Savings Products**

From the CUMI perspective, savings and credit are taken together to co exist with the other. An intricate balance is the ongoing concern of management and leadership. For the methodology sequence however, savings take priority as preliminary activity.

This rationalization of Microfinance is basically grounded on a rediscovery of the power of savings. As a tool for empowerment savings is a counterpoint to erratic market forces.

The training manual for member economic participation in credit unions emphasizes and clarifies that savings is the action of the self-help principle. It is defined as the first expense. It is the often forgotten part of the credit continuum. The same manual reformulates the western equation of  $\text{Income} - \text{Expenditures} = \text{Savings}$  to a more oriental application of  $\text{Income} - \text{Savings} = \text{Expenses}$  emphasizing the household budget in the microfinance economy.

### **Loan Products**

From a business perspective, loan products are designed for short turn around times. It is credit unions customer driven and will bring about credit unions customer loyalty. From an intellectual capital point of view, the regularity of the loan cycles makes this service brand and market asset a breeding ground for repeat business. Repeat business creates credit unions customer loyalty. Credit unions customer loyalty builds up bonds of solidarity and stores up social capital.

The training manual for member economic participation positions credit as the action of the principle of mutual help. Credit emphasizes productive purposes which increases both income and savings of borrower. Savings create wealth. Money begets more money, and that is entrepreneurship. Creditworthiness keeps the enterprise cycle moving thereby creating more wealth. The essential ingredient therefore is entrepreneurship and entrepreneurial skills at all levels in member economic social and political empowerment.

Microfinance basically has two faces, the imagery of savings and the imagery of credit. The for credit unions on savings for the institution sustainability is a plus factor for credit unions as member-based deposit taking institution as other MFIs would have this limitation. Within the institution itself however savings and credit are taken together and intimately intertwined. This differs from regular membership where access to these services would have a wider option. A common practice therefore in Microfinance is an integration of loan repayment with savings and group fund other than principal and interest on loan along the sequence of the loan cycles.

Loan pricing for credit design covers cost of funds (savings and shares), administration cost, risk cost and reserve fund to arrive at the interest rate. Surprisingly, experience shows interest rate is not a problem. Reports from the field on the microfinance scheme showed hundred percent repayments. The repayments at the same time build the wealth of the low income people. This continuous wealth creation is flavored on weekly meetings by the accumulation of social capital.

The repayment is member friendly by providing a venue and time for the Center meetings coinciding with technical and educational inputs making collection easier. Anchored on group responsibility with the goal of 100 percent repayment, efficiency, and self-discipline is tied up with group discipline. Financial discipline becomes the bridge for operational efficiency and quality service. From a management perspective, these are booster doses for organizational development and the building up of organizational culture.

### The Credit Union’s microfinance Innovation Program’s outreach and impact

#### Outreach

The latest consolidated report on the program on the 11 countries with selected 669 credit unions states that 1,413,600 ‘have less’ people are enjoying the benefit of Credit Unions.

Country Activities		CU Reaching out the poor		CU Application of CUMI	
		Number of		Number of	
		Credit unions	Actual 2010	No of Credit unions	CUMI 2010
Bangladesh	CCULB	450	105,000	45	72,100
Cambodia	CCF	45	37,000	45	32,200
India	MFCCOS	2,866	1,520,000	300	746,000
India	DPG	60	53,110	32	25,000
Indonesia	CUCO	825	320,000	65	62,000
Lao PDR	21	7,500	12	6,500	
Mongolia	MOCCU	217	22,789	18	18,200
Nepal	NEFSCUN	493	256,000	135	65,000
Philippines	NATCCO	220	762,000	65	130,000
Philippines	PFCCO	937	240000	45	73,000
Sri Lanka	SANASA	7,240	541,400	75	64,500
Vietnam	CCF	1,037	923,000	85	84,000
Myanmar	CCU	35	75,100	35	35,100
<b>Grand Total</b>		<b>14,446</b>	<b>5,622,953</b>	<b>669</b>	<b>1,413,600</b>

#### IMPACT

The CUMI program accelerate penetration of the entrepreneurial poor getting access to financial services concomitantly building up the institutional capacity of credit unions to ensure viability and sustainability.

The key results in institution building and developing sustainable microfinance program for the entrepreneurial poor are the following:

#### CONCLUSION

Microfinance innovation in Credit Union is revisiting the CU mission of providing financial services that is available to the community regardless of social status for their socioeconomic development. As

the Credit unions social responsibility, the ACCU is to build better communities through the credit union coops by making financial services available to everyone.

As a value-added service ACCU (as the regional organization for Credit Coops supporting the membership to reach potentials to be relevant to individual CU member) brought critical issues that affect the growth and sustainability of the Credit unions.

In Asia, the issue is about 900 Million people living in poverty. The reality check points to generally middle class membership in Asia Credit unions and membership penetration only .34 percent. For credit unions, touted as the “darling of development economics”, the outreach to the “HAVE LESS” segment of the market remains a significant challenge as it had been 150 years before.

Traditional Microfinance in Credit Unions is patterned in the Model of Schultze-Delitzsch, Raiffeisen, Wollemborg and the Rochdale pioneers. Particularly in Germany it has proven its power to alleviate poverty. Application of Traditional Microfinance in Third World Countries in Asia in the present globalized set up and new economic order and, the continuing disruptive technologies, remain an ongoing concern of Microfinance Innovation of Credit Unions in Asia.

Microfinance Innovation in Credit Unions in Asia is mapped out in two streams – institutional through INDECUA and operational through the Microfinance Innovation Methodology. Microfinance Innovation on a deeper level covers paradigm, metaphor and methodological shifts in credit unions in Asia.

Methodology of Microfinance Innovation is enriched by alignment of membership-based institutions in Microfinance with the civil society best practice and corporate governance in the banking sector. For credit unions on saving differentiates credit union Microfinance Innovation from other non-bank based MFIs. Savings is an empowerment tool, and serve as counterpoint to erratic market forces. Microfinance Innovation is part of Credit Union Cooperative movements’ “strategic renewal”. This is coupled to Institutional Development which establishes prudential standards in the regulatory framework.

Intercountry and intracountry preliminary reports on outreach and impact of the Microfinance Innovation Methodology and program give credence to adapt the program. Microfinance Innovation in Credit unions is the movements’ “corporate” social audit institutionalized. This work as contribution to alleviate the burgeoning poverty in the Asia region is part of the Credit Unions reclaiming of its original constituency and market. It is back dropped in today’s’ strategic marketing; it is for credit unions on an original vision. It is in itself, the movement’s version of a “strategic renewal”.

Self-help groups are the basic units of solidarity, the building-block of social capital. Self-help groups are strategic business and management units. Microfinance Innovation as corporate social audit and the integration of self-help and solidarity groups provide the natural constituency and habitat for an emerging redefinition of social research

The challenge to leadership and management of Credit unions is to delicately balance individual members’ motivated self-interest with the credit union goal-seeking organizational behavior (not necessarily profit) its survival instinct and its capacity for self-protection. The understanding of ideology and national competitiveness (among member countries) is a must to understand adaptability of microfinance management tradition. German firms with a communitarian for credit unions are geared on “strategic conquest” and the “social market” economy. Anglo Saxon firms are profit maximizers (individualist) and practice the free market economy. The ideology of individualism involves for credit unions on property rights, competition to meet consumer need, limited state end scientific specialization.

In the age of the dualities of prosperity and poverty and the minimalist-maximalist dichotomies of development, the Credit Unions/Cooperative must market their traditional cooperative competitive

advantage as best in its class. Good Governance, best practice and advocacy for an activist state align credit union with third sector of economy and civil society.

Microfinance innovation seen in proper perspective is revolutionizing CU/Coop management by its appropriate traditional distinctive feature as both social enterprise and entrepreneurial organization restating in the 21<sup>st</sup> century, the original cooperative values which are primarily innovative and basically radical.

Ranjith Hettiarachchi Chief Executive Officer  
Association of Asian Confederation of Credit Unions  
8th Floor, U Tower Building,  
No. 411, Srinakarin Rd., Suanluang,  
Bangkok 10250, Thailand  
Email [ranjith@aaccu.coop](mailto:ranjith@aaccu.coop)  
Tel: (66)-2-7044253-54  
Fax: (66)-2-7044255  
Website: [www.aaccu.asia](http://www.aaccu.asia); [www.aaccu.coop](http://www.aaccu.coop)



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39 Maliwan Mansion, Phra Atit Road

Bangkok 10200, Thailand

Tel: (66-2) 280 0195

Fax: (66-2) 280 1524

E-mail: [apraca@apraca.org](mailto:apraca@apraca.org)

Website: [www.apraca.org](http://www.apraca.org)