Mainstreaming Grameen Banking:

How Producers Bank Combines Sustainability with Outreach to the Poor in the Philippines

By Fabrizio Felloni, Hans Dieter Seibel and Andres Cornejo[1]

Published in:
Malcolm Harper & Sukhwinder S. Arora, eds., Commercial Banks in Microfinance. New Delhi, TERI Press 2005 (ISBN 81-7993-066)

Abstract

To Producers Bank, like other rural banks in the Philippines, Grameen banking is but a financial product which has to prove its effectiveness in terms of outreach and profitability. For two years, 1996-98, the bank experimented with microfinance at its own, but suffered delinquency problems. These were solved when the staff were trained at Card Rural Bank and the Grameen banking approach (GBA) was adopted. During four years of testing Grameen and non-Grameen products in parallel, it has embraced banking with the very poor with increasing enthusiasm. While most rural banks are unit banks of limited outreach, Producers Bank now has, thanks to Grameen:

- ✓ 12 branches
- ✓ 51,700 depositors (21,000 of them in GBA, accounting for 4% of deposits)
- ✓ 17,258 borrowers (12,519 of them in GBA, accounting for 13% of loans outstanding)
- ✓ a return on assets of 5.3% on Grameen and 1.5% on non-Grameen operations
- ✓ a return on equity of 105.6% on Grameen and 11.2% on non-Grameen operations.

It attributes its success in outreach and profitability to the quality of GBA training at Card Rural Bank; the adoption of GBA credit discipline, value formation, group and leadership training; vigorous marketing at doorsteps, taking the bank to the people; recycling deposits at the local level as its motto. Encouraged by this breakthrough in rural banking, Producers Bank now embarks on transferring key elements of GBA to its regular banking operations; graduating Grameen clients to individual loans; and building a Grameen franchising/Build-Operate-Transfer business as a rapid expansion strategy across the country. In November 2002, the CEO of Producers Bank addressed the Microcredit Summit in New York, disseminating his message of *sustainable outreach to the poor by rural banks*.

[1] The authors are, respectively, Associate Evaluation Officer, International Fund for Agricultural Development; Professor of Sociology, University of Cologne; and President and Chief Executive Officer of Producers Rural Banking Corporation. They are grateful to the Office of Evaluation of IFAD and the staff of Producers Rural Banking Corporation for their support. However, the opinions expressed in this case study are those of the authors only and do not necessarily reflect those of their institutions. The authors are also solely responsible for all errors and omissions.

Introduction

In many countries, Grameen replication has not fared well in terms of outreach and sustainability. There is no country where the Grameen Bank, reaching over two million poor women in groups of five and centers of 30 in Bangladesh, has been truly replicated. In the Philippines, rural banks and NGOs-turned-rural-bank have made Grameen banking a highly profitable product with rapidly expanding outreach to the enterprising poor and ultra-poor, mostly women. How did they do it? Producers Bank may serve as an example.

Poverty in the Philippines

With an estimated average income per capita of US$ 1 020, the Philippines is classified as a lower-middle-income country. It has a population of around 80 million (mid 2002), of whom 41% live in rural areas. Throughout the 1990s the gross national income has been growing at an annual average of 3.3%, a substantial increase from the average 2% in the 1980s. Inflation was also progressively under control at one-digit figures after the two-digit averages of the previous decade. In spite of good progress in the above macroeconomic indicators, the country has experienced persisting poverty: the overall poverty rate (percentage of households living below an income threshold) was estimated at 28.1% in 1997 and, virtually unchanged, at 28.4% in 2000.[2]

A Highly Differentiated Financial Sector

The formal financial sector in the Philippines is highly segmented, comprising commercial banks, thrift banks, rural banks and non-bank financial institution (mostly pawnshops). As of June 2003, there were 906 banks, including 42 commercial banks, 93 thrift banks and 771 rural banks, and 5,486 non-bank financial institutions.[3] Among the banking institutions, commercial banks accounted for 56.3% of the total number of bank offices and 90.3% of assets, thrift banks for 17% of offices and 7.3% of assets, and rural banks for 25.7% of offices and a mere 2.4% of assets. All banking institutions are subject to prudential regulation and supervision by the central bank, *Bangko Sentral ng Pilipinas (BSP)*. While the central bank is the supervisory body of banks, the *National Credit Council*, created in 1993 and located within the Department of Finance, has been the main promoter of policy reforms, particularly for microfinance.

The Microfinance Sub-sector: towards a more conducive policy environment

According to the definition of the National Credit Council, microfinance in the Philippines is geared to *"the viable and sustainable provision of a broad range of financial services (savings and credit) generally, by the private sector to poor and low-income households engaged in livelihood and microenterprise activities using non-traditional and innovative methodologies and approaches (e.g. non-collateralized cash-flow based lending). The maximum individual loan amount provided for microfinance loans is P 150,000.* [circa US$ 3,000]. [4]*"* Similar to the fragmentation which characterises the overall financial sector, microfinance institutions can be divided into: (i) formal financial institutions, comprising rural banks and thrift banks subject to prudential regulation and central bank supervision ; (ii) semiformal institutions, such as cooperatives and NGOs, facing limitations to savings mobilisation and some registration requirements but no special prudential regulation and supervision [5]; and (iii) informal financial institutions such as the ubiquitous rotating

[2] Sources: The World Bank (2002), Economist Intelligence Unit (2001), the Philippines National Statistical Coordination Board (2002).

[3] Source: Bangko Sentral ng Pilipinas webpage /www.nscb.gov.ph. Thrift banks (also called private development banks) serve small and medium scale enterprises outside the national capital region and are privately owned. Rural banks are small local banks, originally conceived (1952) as unit banks, with lower capital requirements than thrift banks, and only recently allowed to open branches. Rural banks are either privately or cooperatively owned.

[4] NCC Policy paper, July 2002. For the purpose of the present paper, we will adopt an exchange rate of Filipino Pesos (P) 53.22 for 1 US$. It corresponds to the average IMF exchange rate for the months of June and July 2001, which represents the "central" year in most of our time series.

[5] Cooperatives can mobilise savings from their members but not from the public. NGOs are allowed to collect savings from their borrowers only provided that they do not exceed the outstanding balance of loans (National Credit Council Policy Paper, July 2002).

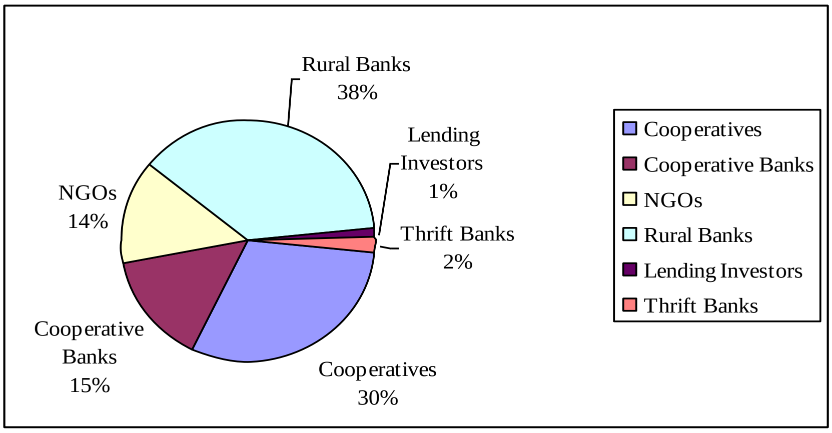
savings and credit associations (*paluwagan)* and moneylenders, without registration, regulation and supervision requirements.[6]

During the 1970s and 1980s microfinance followed the characteristic supply-led directed credit approach whereby loans were provided to rural households at below-market interest rates. Programs proved to be financially unsustainable and biased towards relatively better-off clients. Building upon the lessons learned in the 1980s and following the creation of the National Credit Council (1993), clearer policies and guidelines against directed credit programs emerged. They culminated in 1999 with the Executive Order 138, which mandated government non-financial institutions to terminate credit programs and government financial institutions to remove caps on interest rates and adopt market-based pricing. More recently (2002), the National Credit Council launched a new policy for microfinance.

Parallel to the evolution in public policies, microfinance has emerged as an element of anti-poverty and community development approaches promoted by non-government organisations (NGOs). Some of them have specialised in microfinance and a few have established formal banks, thus laying the ground for more sustainable operations and showing that poor clients can be served on a commercial base. Originally cautious towards the growth of a new industry, the central bank has showed a more encouraging attitude towards microfinance in recent years, for example by allowing some exemptions from regulation concerning unsecured loans, providing rural banks with more freedom to branch out and by opening a rediscounting window for microfinance (2001).

Two innovations were instrumental to increase microfinance outreach: the attempts to replicate the Grameen bank approach and the creation of the *People's Credit and Finance Corporation (PCFC)*. A first attempt to replicate the methodology of the Grameen Bank in Bangladesh was initiated in 1989 by the Agricultural Credit Policy Council (ACPC), an Agency of the Department of Agriculture. A typical example of a surviving directed credit program, in the mid-1990s, it was found unsustainable due to caps on interest rates and exorbitant operating costs. But in 1997, the Asian Development Bank (ADB) and the International Fund for Agricultural Development (IFAD) launched a country-wide Grameen replication project, the Rural Micro-Enterprise Finance Project, without any interest rate restrictions within a more liberalised policy environment. The two donors also financed a new specialised apex organisation, the People's Credit and Finance Corporation (PCFC), as the national wholesaler of funds to microfinance institutions in the Philippines. PCFC displayed a remarkable degree of autonomy and enforced high repayment rates from its 162 clientMFIs, a heterogeneous group of rural banks, thrift banks, cooperative banks, multi-purpose cooperatives and NGOs. Producers Rural Banking Corporation is one of the microfinance institutions refinanced by PCFC.

Distribution of Grameen replicators in the project, June 2002



[6] However, for moneylenders, the central bank has opened an avenue to recognition and respectability: as so-called 'lending investors', which register with the central bank but are not supervised.

A New Rural Bank in Nueva Ecija Province: the Producers Rural Banking Corporation

The province of Nueva Ecija is located within the Eastern rim of Central Luzon, some ninety kilometres from Manila. Predominantly an agricultural area, (it has been dubbed the "rice basket of central Luzon"), with paddy and vegetables as major crops, the province is highly vulnerable to fluctuations of agricultural prices. Agricultural land tends to be concentrated in the hands of few large farmers, while smallholders and landless households rely on wage labour and seasonal labour. In 2000 32% of households in Nueva Ecija were below the poverty line .[7]

The Producers Rural Banking Corporation (hereafter, *Producers Bank*) was established in 1995 in San José City (Nueva Ecija) by Mr. Andres Cornejo, a certified public accountant and owner of a pawnshop who had retired from the position of Treasurer and Chief Financial Officer at the *First Philippine Holdings Corporation*. With an investment of P 5million (approximately US$ 100,000), operations started on 27 November 1995 in a small rented facility, with financial products copied from rural banker-friend.

Act One: Expanding by Capturing Untapped Savings

As a small player, the newly born bank was facing the competition of existing banks in deposit taking and lending. In search of a niche, rapid expansion and outreach to potential clients ignored by formal financial channels appeared as the only avenue to survival and perhaps prosperity. After only one year of operations, Producers Bank filed a request to the central bank to open new branches, and three branches were opened within 1996.

At the center of its strategy was a savings mobilisation campaign to reach household who had met never before with bank staff. The strategy included (a) house-to-house visits, whereby bank staff would visit local communities on non-working days,(b) raffles for depositors, with a ticket for every P 2,000 (US$ 38) deposited; (c) special children's deposit products (with little give-aways); (d) promotional "*fiestas*" when opening an a new branch (with T-shirts, umbrellas, caps, etc. for every P 5,000 – circa US$ 94 - deposited, in addition to raffle tickets).

In the effort to bridge the gap between the potential demand and the actual supply of financial services, Producers Bank started testing credit products tailored for low-income clients. The first step was that of offering small individual short-term loans, up to US$ 100 for working capital to some 500 micro-entrepreneurs: street vendors, small store and repair shop owners. Maturities were 30-90 days; instalments were daily, weekly or monthly, depending on the cash flow, payable either at the bankor at doorsteps combined with deposit collection.

Act Two: Commercialising Grameen, from Social Service to Financial Product

In 1998 PCFC proposed to Producers Bank to participate in the new national-scale Grameen Replication project. The exposure to this programme gave Producers Bank something they had not yet been able to find: a a standardised set of financial products which were relatively easy for the bank management to understand, for the field staff to implement and "sell", and for low-income clients to access.[8] Following positive feedback from a fieldtest, Producers Bank created a specialised lending

---

7 The Philippines National Statistical Coordination Board (2002).

8 First experimented in Bangladesh by Prof. Yunus in the mid 1970s, the Grameen banking approach consists of releasing small loans (and some limited ancillary financial services) to groups of 5 borrowers. Groups are federated into centres (including 20 to 50 borrowers). Credit is provided to individual members, while the repayment of loan is made through frequent (normally weekly) instalments guaranteed by the group. This technique replaces "material" collateral with peer "pressure", since group members can receive larger loans when all the members have fully and timely repaid all their instalments. The absence of collateral requirements reduces (although does not completely eliminate) barriers to entry for very poor and landless households, while peer pressure reduces the usual problems connected with asymmetry of information

portfolio for Grameen clients, the *Livelihood Support Programme*, with separate accounts. while conventional clients had access to the standard individual loan and deposit products, the new for microfinance clients, the following typical Grameen products were available:

(a) solidarity group loans provided to individuals but guaranteed by a group, without collateral, with a 6-month maturity and weekly repayments;[9]
(b) compulsory savings to be deposited in weekly instalments and remunerated at an annual interest rate of 2%, not withdrawable before a client leaves the programme;
(c) an insurance package in case of accident or death of the borrower.

In addition to these standard Grameen services, Producers Bank offers its microfinance clients the following products and options: individual voluntary saving accounts, individual loans, discount cards and the possibility of staying in the programme without borrowing. Innovative features include the following:

- Grameen clients are offered individual voluntary deposits according to a client's capacity, which are not part of the standard Grameen compulsory savings accounts.

- Individual loans are offered as a part of a graduation strategy to clients with good repayment to expand their business or access consumer loans. Within the traditional Grameen system, clients who intended to make relatively larger investments in fixed equipments would face the opposition from other group members, unwilling to guarantee larger amounts. Moreover, weekly repayments would not have matched the typical cash flows for medium-term investments. Although only few clients have been able to-date to take larger loans, the opportunity of access to individual loans has been appreciated.

- Discount cards are non-financial products sold to Grameen clients for an annual fee of P 500 (US$ 10), which give right to discounts of 2% to 5% at local grocery, drug, hardware and spare parts stores.

- The option of staying in the Grameen system without borrowing was granted as a measure to reduce the loss of clients and lower the dropout rate, a typical problem of Grameen banking. The Grameen approach assumes that clients want to borrow increasing amount of loans. In reality, clients may not always be willing to immediately take further loans.

In many cases, the Grameen approach has been used by NGOs in community development, using credit as the main propeller of change accompanied by non-financial services. Producers' Bank turned the Grameen approach into a profitable commercial product offered on a profit-making base and focusing on the financial component only: a genuine contribution to the formation of social capital in microfinance.[10]

The Grameen approach has provided Producers Bank with an entry point to the market segment of poor income households which was previously inaccessible to the bank, and with a method to enforce strong credit discipline based on peer pressure and the commitment of groups and centre leaders. Producers Bank was initially stimulated by access to refinancing sources through PCFC; but it would have soon abandoned the approach had it not found it profitable in the first place.

---

between the lender and the borrower and leads to high repayment rates: well above 95% when the approach is well implemented.

[9] The size of the first loan is about US$ 100.Upon full and timely repayment, it increases by in subsequent loan cycles up to a ceiling of US$ 500. Higher loans are not allowed under the Grameen lending window refinanced by PCFC; but Producer Bank offers larger-size individual loans to borrowers with a good track recored..

[10] For a deeper analysis of Grameen banking in the Philippines from a social capital perspective, see Quiñones & Seibel 2000 and 2001.

It is also interesting to highlight that, while there was a transfer of knowledge and capacity from conventional banking practices to the microfinance portfolio, the process of cross-fertilisation happened also in the other direction. One of the requirements to obtain funds from PCFC was that of administering "means test" questionnaires to applicants, in order to ensure that their household income and assets did not exceed a ceiling of P 10,000 (US$ 188) per month, corresponding approximately to the national poverty threshold for a household of six members. The management learned to use the questionnaire as an instrument to improve knowledge of clients' cash flow, vulnerability to shocks and repayment capacity. It was used as a decision tool to better select between clients who could immediately qualify for individual lending and riskier clients who would better fit into group lending. The management of Producers Bank reckons that the exercise was instrumental to also instil better practices in loan appraisal within their conventional lending programme. Finally, the bank now considers offering a Grameen franchising or build-operate-transfer service to other financial institutions. The package could consist of Producers building and initially operating a new microfinance programme and then transferring the ownership (for a commercial fee) of the portfolio to a partner financial institution, after reaching the break-even point.

Act Three: Focus on Human Resources and Management Information Systems

The management of Producers Bank soon learned that, to ensure high repayment rates and, ultimately, the profitability of its operations, two important preconditions were to: (i) promote a high degree of professionalism and commitment of staff and (ii) set up a functional monitoring system which would provide the management with timely information on operations' performance.

Particular emphasis is given to selecting and training of field staff, measuring and remunerating their performance. Staff members represent the bank in rural areas and the image of the bank much depends on their integrity and capability to interact with potential clients. In particular, account officers are the bank staff operating at the field level and responsible for approving loans and collecting weekly instalments. A system of incentives has been created that is commensurate to the repayment performance managed by account officers: they are entitled to 2% of the principal of fully and timely repaid loans, while their area and headquarter supervisors receive 0.75% and 0.25%, respectively. In addition to pecuniary rewards, highly performing staff members are also offered on-the-job training or are encouraged to attend seminars at local business schools. As a result, the average outstanding portfolio per account officer increased by 112% (from US$ 11,600 to US$ 24,700) between 1999 and 2003.

The need of an effective monitoring system has also been one of the early concerns. Monitoring is essential to the management in order to spot early delinquency problems, develop the banks' policies and financial products and reduce the scope for misbehaviour or fraud by field staff. Copies of collection sheets signed by the account officers are left with the Grameen centre at the closure of the meeting, while official repayment receipts are given to the borrowers at the next meeting. A computerised tracking system is used to encode transactions at the branch level; and account officers are expected to submit weekly written reports, consolidated at the branch level and sent to the headquarters to be summarised into monthly progress reports. Reporting requirements include:

(a) indicators of outreach (number of borrowers, number of groups and centres served);
(b) indicators of loan disbursement and repayment (amount released and outstanding);
(c) indicators of overall portfolio quality (repayment rate, past-due rate, portfolio at risk);
(d) indicators of productivity (borrowers and value of outstanding loans per account officer).

Monitoring is done through "management by exception", that is, concentrating on delinquent accounts.

Financial Performance: Rapid Growth without Massive Delinquency

From 1999, the first year of implementation of Grameen-based microfinance, to 2003, the growth of Producers Bank's financial operations has been impressive. The financial data (Table 1) reveal that the number of microfinance clients with outstanding loans has increased from 2 900 to 44 000 (+1409%), the value of outstanding Grameen loans from US$ 196 500 to US$ 3.4 million (+2340%) and the value of Grameen deposits from US$ 43 000 to US$ 580 000 (+1775%).

As of 2002, Grameen clients represented around 80% of the bank's borrowers and 40% of savers but only 12% of the outstanding loans and 4% of savings. This is because the average outstanding loan of regular clients was 28 times higher than than of Grameen clients and the average savings account 15 times higher.

Between 1999 and 2003, the average value of outstanding loans per Grameen borrower has hovered around US$ 77 and the average savings per depositor around US$ 14, , ie, 7% and 1%, respectively, of the average GDP per capita, suggesting that the target clientele has been represented by very poor households without any mission drift over five years. Collection rates have been 98% and above and past due ratios have never exceeded 5% (Table 1). In sum, it can be said that rapid growth has not been associated with soaring delinquency rates; and the bank has managed to defend the loan portfolio against deterioration.

Table 1 Producers Bank – Grameen Operations Outreach and Repayment Indicators

	1999	**2000**	**2001**	**2002**	**2003 (October)**
No. of clients with outstanding loans	2,919	5,678	12,223	19,037	44,037
No. of clients with savings	2,919	7,699	14,463	26,332	51,358
Amount of outstanding loans (US$)	196,548	451,146	1,068,877	1,379,736	3,403,721
Amount of savings accounts(US$)	43,712	90,286	271,772	368,457	581,839
Average outst. loan per client (US$)	67.3	79.5	87.4	72.5	77.3
Average savings per client (US$)	15.0	11.7	18.8	14.0	11.3
Collection Rate [a]	98%	98%	99%	99%	99%
Past Due Ratio [b]	3%	5%	1%	5%	1%

Source: Producers Bank (2003)

a. Percentage ratio between total loan principal collected and total principal due

b. Percentage ratio between the past due amount and the value of average outstanding loans

Data on the productivity and profitability of Grameen operations show decreasing operating costs ratios (a sign of improved efficiency) and loan loss ratios (Table 2). [11] The most telling indicator of profitability is the Return On Performing Assets (ROPA) of Grameen operations, which is 5.6% in 2001 and 2.0% in 2002 - compared to 1.5% in 2001 and 1.7% in 2002 for the whole bank. Grameen banking is thus substantially more profitable than regular banking!

Table 2. Producers Bank - Grameen Operations Productivity and Profitability Indicators

	2001	**2002**	**2003**
Operating costs ratio [d]	17.8%	8.3%	
Loan loss ratio [e]	3.3%	2.5%	
Operational Self-sufficiency [f]	132.0%	117.2%	
Return on performing assets (ROPA) [g]	5.6%	2.0%	

Source: Producers Bank (2003)

d Percentage ratio between administrative and staff costs and the value of average outstanding loans

e. Percentage ratio between loan loss provision and the value of average outstanding loans

f. Percentage ratio between financial revenue and the sum of operating costs, financial costs and loan loss provision (as interest rates paid on PCFC loans are now at market level, OSS is practically equivalent to financial self-sufficiency)

[11] It is interesting to note that ROPA computed for the entire (Grameen and 'conventional') loan portfolio of the bank was 1.5% in 2001 and 1.7% in 2002.

g. Percentage Ratio between net financial income and assets (excluding fixed assets)

The apparent decline in productivity between 2001 and 2002 may by due to transient factors such as short-term business cycle fluctuations, but also to declining effective interest rates, as an outcome of slowly emerging competition with other formal and semi-formal lenders. However, in spite of increasing competition, effective interest rates are still very high, due to the combined effect of monthly flat interest rates of 2.5%, up-front fees and compulsory interest rates. We have computed that effective interest rates paid by clients for loans of P 5,000 P (US$ 94), P 10,000 (US$ 188) and P 15,000 (US$ 282) would be, respectively, 120%, 92% and 77%. Yet microentrepreneurs can pay their instalments, a sign of the high marginal profitability of their investments.

Maintaining profitability while facing the entry of competitors in the same market segments will be one of the future challenges. Certainly the bank has so far made good progress: after only 7 years of operations and almost unaffected by the 1997 Asian crisis, it is ranked as the 13th rural bank in the Philippines in terms of assets and has received several awards for its financial performance, organisation and management.

The Clients: Gender and Poverty Depth

The former sections have illustrated the enormous growth in the breadth of outreach (defined as the number of clients served by the bank). Beyond simple head counting, other dimensions of outreach are commonly explored in the literature on microfinance: gender and "poverty depth". As women suffer from several forms of relative deprivation in many developing areas, a high proportion of female clients is normally seen as an indicator of success of microlending programmes. Grameen-based projects typically have a majority of women borrowers and the same is true in the case of microfinance clients of Producers' Bank: 99% are women, against about 50% among non-Grameen clients. Grameen methodology requires strict attendance of weekly centre meetings to pay loan instalments and rural women are more willing to accept these opportunity costs.

A third outreach dimension to be explored is the profile of the typical borrowers and their poverty depth. Most borrowers had a *sari-sari* (small grocery) shop as their main activity, followed by clients engaged in petty trade (street vending) and food processing. The majority of clients had more than one micro-enterprise activity: this happened for about 3 out of 4 borrowers with at least three loan cycles. The usual combination was that of a typical micro-business as first activity (sari sari or petty trading), combined with small livestock raising (pig or poultry). The option of two or more activities, each of them with different cash flow patterns is a risk management strategy to even out cyclicality effects and help smoothing consumption .

A common proxy of relative wealth of clients of microfinance programmes is given by the ratio of the average outstanding loan over the GDP per capita. In the case of Producers Bank, the ratio has been hovering around 7% between 1999 and 2003 without an appreciable increase, probably due to the raising number of clients with a first loan, but also suggesting that there has not been any substantial change in the targeting strategy. This value is lower than averages computed for both formal and informal microfinance institutions in South-Easter Asia: respectively 50% and 14%[12]. In spite of these remarkably small loan sizes, it has been claimed (and recognised by the management of the bank) that the microfinance lending operations have difficulties in targeting the poorest segment of the population. In the majority of cases, this means that the poorest and the most remote areas are more difficult (and costly) to reach. [13]

---

[12] Micro-banking Bulletin, November 2002.

[13] In fact the selection of clients involves at least three stages. First there is an implicit self-selection process, by which households decide whether to apply or not to apply for membership in a Grameen group. Information problems are minimal as the microlending programme is widely publicised and talked about. However, households without regular income may be discouraged from borrowing by weekly instalments. Second comes the screening of loan applications, which normally requires that clients be physically healthy, have some previous experience in microbusiness, and have a regular cash flow . This is done as a precautionary measure to

For these reasons, the 'enterprising poor' represent the bulk of the clients. Efforts to enhance the participation of applicants with little or no micro-business experience achieved mixed results. The most significant lessons learned from the experience are that: (i) microfinance institutions need to start with conservative targets in terms of poverty depths lest they have to face high default ratios and put their sustainability at risk; (ii) micro-credit is a valid anti-poverty instrument for many but not all households: the poorest may perhaps better benefit from appropriately developed savings products as well as non non-financial services; (iii) reaching progressively poorer clients requires some market research and innovative financial products.

Main benefits to clients

One of the assumptions underlying donor support to microfinance programs is that they would significantly propel enterprise growth and household income, thereby stimulating the local economy and creating new job opportunities. Although some cases of remarkable business growth were observed, our experience suggest that such assumptions are not justified. Few (roughly 15% to 20%) of the microenterprises served by Producers Bank display the potential to become small or medium-sized. Many of these microenterprises such as small shops and street vending are characterised by a low equity base and face a high degree of competition. Furthermore, not all microfinance clients are business people: some are not so much interested in expanding micro-enterprises but simply in diversifying household income sources or coping with temporary liquidity problems. In terms of impact, it was observed that:

- Household had a preference for diversifying (horizontally) their business rather than expanding them;
- Increases in enterprise and household income have not been dramatic but seasonal and business cycles fluctuations have been reduced, smoothing cash flow and household consumption;
- Given the fungibility of money, Grameen loans have often represented a support to the overall household budget rather than a targeted intervention on specific economic activities. Part of the loans have been used to face temporary illiquidity (e.g., paying for school fees, unforeseen household expenses or loans from moneylenders), without leading to extensive delinquency problems.[14]

Future Challenges

We have presented the case of a small bank which has started penetrating the the market of the rural poor in the Philippinesin search of a competitive niche. This was inspired by the offer of a suitable financial product, namely Grameen Banking, and access to a source of refincing. While social motives were not alien to the bank, financial activities were conducted on a commercial base. The bank has experienced a fast growth and has so far been able to keep credit delinquency under control and preserve profitability.

Notwithstanding its good performance, Producers Bank is also exposed to challenges and risks. First, the bank will have to control the dropout of clients due to the rigidity of the Grameen approach and its credit bias. Producers bank has responded to this need by graduating clients to the individual loan window and by allowing clients to deposit savings without borrowing. In the future, however, the bank might have to introduce further innovations.

Second, the bank will soon face stronger competition. Producers bank has for some time benefited from a local near-monopoly. But competition is emerging: by operators who offer a wider range of services, not necessarily lower interest rates. This brings about two risks : losing clients to competitors; and a deteriorating microfinance portfolio, as clients may borrow from several sources.

---

avoid massive delinquency problems but may lead to the exclusion of poorest households. A third important step is the peer-selection process: as in any case of joint liability, groups members may refuse access to applicants they judge unreliable even though they have passed the bank's screening.

[14] The bank's loan officers have adopted a pragmatic attitude, by not interfering too much with loan useas long as households meet theirrepayment requirements.

Third, the increasing size and complexity of microfinance operations may raise organisational challenges. Producers Bank has a separate accounting system for its microfinance portfolio but not a separate management and organisational line. In the future a specialised divisional structure might be needed.

Fourth, an outgrowing financial institution needs a further injection of capital. At present, as for most rural banks in the Philippines, Producers Bank's equity is concentrated in the hands of few stockholders, while, in the future, the bank's ownership may have to become more differentiated.

The social capital of Grameen banking in the Philippines: a wider perspective

Successful Grameen replicators in the Philippines, among them Producers Bank, share a least the following three sound practices, constituting the core social capital of the original Grameen approach:

- high moral commitment of leaders based on values enforced through training
- peer selection and peer enforcement, precluding adverse selection and moral hazard
- credit discipline, including weekly instalments; rigid insistence on timely repayment; and repeat loans of growing sizes contingent upon repayment performance.

The most promising replicators are those who have experimented with modifications to the classical replication model, constituting additional social capital dimensions:

- (rural) bank status
- deposit mobilisation through differentiated products
- differentiated loan and insurance products which cover all costs and yield a profit
- client differentiation through larger-size loan and deposit products for non-poor members (generating additional loan capital) and graduation opportunities for the poor.

References

ACPC (1995), *An Evaluation of the Grameen Bank Replication Project in the Philippines.* Manila
Christen, Robert P. (1997), *Banking Services for the Poor. Managing for Financial Success*. Acción, Washington DC

Drake, Deborah and Elisabeth Rhyne (2002), *The Commercialization of Microfinance : Balancing Business and Development*..Kumarian Press, Bloomfield CT

IFAD (2002), *Interim Evaluation of the Rural Micro-enterprise Finance Project in the Philippines,* International Fund for Agricultural Development, Rome

Llanto, Gilberto (2002), *Philippines,* in *The Role of Central Banks in Microfinance in Asia and the Pacifi.,* Asian Development Bank, Manila Quiñones, Benjamin R., and Hans Dieter Seibel (2000, 2001), *Social Capital in Microfinance: Case Studies in the Philippines*. Policy Sciences 33/3-4 (2000):421-433; reprinted in John D. Montgomery and Alex Inkeles, Social Capital as a Policy Resource. Kluwer, Boston (2001): 195-207

Zeller, Manfred, Meyer Richard L. and, eds. (2002), *The triangle of microfinance: financial sustainability, outreach and impact.* International Food Policy Research Institute, Washington, DC