

REPORT ON MICRO-FINANCE STUDY TOUR TO INDONESIA AND PHILIPPINES: 24TH
JANUARY TO 4TH FEBRUARY, 2005

1. INTRODUCTION

The Central Bank of Nigeria (CBN), in year 2004 drafted and presented to stakeholders a National Policy and Regulatory Guidelines aimed at providing a blue print for the orderly growth of the micro-finance sub-sector and for guiding and ensuring that micro-finance practice and activities conform to international standards and support the development of the entire economy. Given the importance of the sub-sector and to ensure the smooth take off and implementation of the policy, the United Nations Development Programme (UNDP) collaborated with the CBN to initiate and provide a practical experience through a study tour of other countries. The tour was designed to be undertaken by staff of the CBN charged with the primary responsibility of implementing the national policy for Nigeria. Six countries were selected in pairs of two each on the basis of socio-economic similarities and relevance. The countries were India/Pakistan, Indonesia/Philippines, and Uganda/Bangladesh. Two staff members of the Bank undertook the study to India/Pakistan, and three each to Indonesia/Philippines and Uganda/Bangladesh.

This report which gives a brief on the experiences of the Indonesia/Philippines team focuses on the overview of the economies of the countries, the roles and responsibilities of their Central Banks in promoting and developing micro-finance activities, active players in the micro-finance industry, comparative analysis of critical elements in the guidelines between Nigeria and the countries of study and important learning points for the Nigerian environment.

2.0 INDONESIAN EXPERIENCE

2.2 INDONESIAN MAIN GEO-ECONOMIC STATISTICS

Indonesia is a country of over 13,000 Islands with a population of over 200 million. The economy is driven by the oil sector, agriculture, trade, commerce and Micro, Small and Medium Enterprises (MSMEs). It has a land area of about 1.8 million square kilometers subject to volcanic eruptions. The population grows at about 1.5 %, literacy level is 88.5% while life expectancy stands at 69 years. The MSMEs dominate the economic landscape of the country contributing about 99.9% of total enterprises establishment, employing 99.4% of the work force and contributing 56.7% of the GDP. The rate of inflation was about 5% while about IDR9,000.00 exchanged for the dollar. The country's per capital GNP amounts to about \$900.00. As at December, 2003 the economy grew at 4.1%, lending rate stood at 16% and the GDP amounted to \$195.2 billion.

2.2 OVERVIEW OF THE INDONESIAN FINANCIAL LANDSCAPE

The Indonesian banking system comprises the Bank Indonesia, 138 commercial banks with about 7,685 branches and 2,157 rural banks with a total of 3,442 offices. The rural banks are the formal micro-finance providers in the country. The commercial banks are made up of 5 state owned banks, 26 local government banks, 76 national private banks and 31 foreign and joint venture banks. The commercial banks and the rural banks are governed by distinct regulatory guidelines and are supervised by separate Departments of the Bank Indonesia. The commercial banks in the country take care of the payment system and lending to high end of the market while the rural banks perform basically micro- services in favour of micro-clients. The rural banks also do not engage in payment functions. Other major players in the market are cooperatives and non-bank institutions like NGOs, pawnshops and other forms of associations.

The capitalization requirements for commercial banks is \$333.3 million. For the rural banks a four tiered capitalization requirement obtains. Four tiers prescribed on the bases of market competitiveness as follows: (i) \$556,000.00 for banks in the capital city of Jarkata, (ii) \$222,000.00 for banks in provincial capital of Java island and Bali or the regencies/ Municipalities of Bogor, Depok, Tangerang and Bekasi, (iii)

\$111,000.00 in provincial capital outside the regions in items I and 11 above and (iv) \$56,000.00 for banks outside regions referred to in items I, II and III3 above. The loan to deposit ratio in the country stands at 50%-60%. Cash Reserve Ratio stands at 5%, deposit rate at 6-9% and lending rate at 14-24%. The rate of inflation in Indonesia at the period of the tour stood at 5%-6%. The Bank Indonesia on behalf of the government gives 100% blanket guarantee to depositors while banks are expected to pay a risk premium of 4% based on their third party deposit liabilities. However, the country is already planning to establish a deposit insurance company to take care of depositor protection.

2.3 **THE ROLE OF THE BANK INDONESIA (BI) IN MICRO-FINANCE DEVELOPMENT**

The Bank Indonesia is the regulatory body for the banking system. Prior to 1999, the bank was saddled with several multi-pronged mandates but after the 1999 new Act, the core function of the Bank crystallized into the maintenance of monetary stability. With effect from that period, the financial system of the country was deregulated and thus the BI empowered to operate independent of government. The same Act forbids the government of Indonesia from borrowing from the Bank.

The Board of the BI is made of eight members namely, the Governor, a Senior Deputy Governor and six other Deputy Governors. The Governor is the Chairman of the Board of the Bank while the Senior Deputy Governor is the Vice Chairman. When a member of the Board of Governors is to be appointed, the incumbent Governor nominates 4 persons which could be from within or outside the Bank and present same to Mr. President. The President then selects two out of the four and presents to the Parliament which on the basis of fit and proper test approves one and present to the President for a four year term appointment renewable only once.

The involvement of the BI in micro finance development can be categorized into two historical periods namely, the Pre-1999 Central Bank Act and the Post-1999 Central Bank Act. During the former period, the Bank was involved in promoting priority sector lending primarily in favour of MSMEs and plantation agriculture. The government of Indonesia and the BI provided funds for these purposes at subsidized interest rates. Because of the importance of MSMEs to the economy of Indonesia, sectoral quotas in favour of this sector were stipulated by the government. Other policies that dominated that era included technical assistance provided by the Asian Development Bank through sponsored micro-credit project for the poor and near poor people of Indonesia, Self-Help Group Linkage to banks, promotion of rural and syariah banking.

The post 1999 Banking Act was enacted to enable the BI operate in line with international trends in central banking. Its principal object was a shift in multi-functional to core functional mandate aimed at reaching and maintaining the stability of the Rupiah (the local currency) through pursuance of monetary and financial system stability for Indonesia's long-term sustainable development. While the Bank no longer stipulates sectoral quotas, interest rates and does not engage in provision of refinancing funds for credit to priority sectors, its activities in the new Act focus on creation of enabling environment, information dissemination, promotion and supervision of micro-lending, technical assistance and capacity building for micro-finance providers and clients. For explanatory purposes the involvement of the Bank in recent times are in the following aspects:

(i) **Regulation and Supervision of Rural Banks**

In Indonesia, the rural banks (BPRs) are the formal institutions that are mainly charged with the responsibility for providing micro-finance services. The BI defined specific regulatory guidelines to guide the activities of the rural banks taking into consideration their specific characteristics and created a separate Department, the Directorate of Rural Bank Supervision that regulates and supervises the activities of the

banks. It collates monthly returns from the banks and conducts off and onsite examination with the aim of maintaining the soundness of the banks.

In order to promote depositor confidence in the rural banks, the BI on behalf of the government provides a blanket guarantee cover for the deposits held by the banks. The Bank, in pursuance of its supervisory function has been involved in liquidation of troubled banks and payment of third party deposits through the government guarantee programme. It assists in recapitalization programmes for illiquid banks and promotes in mergers and acquisition by banks.

(ii) **Promotion of Linkage Programme Between the Commercial Banks and the Rural Banks**

The BI promotes the establishment of a linkage programme between the conventional banks and the rural banks. The commercial banks have funds but do not have the branches, staffing, experience and capacity for micro-lending. The rural banks on the other hand have both locational and technical advantage for administering micro-finance services. The BI fosters a relationship between the two categories of banks with the aim of channeling funds from the conventional banks to micro-clients through the rural banks. Such relationship commences with invitation of selected conventional banks to the Head Office of the BI where necessary education of the workability of the linkage is given by both the BI and a bank that already enjoy such a benefit from the linkage programme. The linkage is consummated by the signing of a memorandum of understanding involving the parties after which business commences. The signing ceremony is normally publicized on the television and with full backing of the BI. The BI also provides technical training for the conventional banks on how to appraise a rural bank for the purpose of accepting it for the linkage programme. As of June 2005 a total of 924 rural banks had linkage arrangement with 24 conventional banks with a loan balance of about \$4.0 million. We in Nigeria might need to develop a guide for banks that may be interested in such a linkage programme.

(iii) **Encouragement of MSMEs Desks**

The MSMEs occupy a very central position in the economy of Indonesia comprising about 99.9% of the total enterprise establishment in the country, employing about 99.4% of the total work force and contributing 56.7% of the GDP. While other sectors of the economy are subject to shocks from the vagaries of global recessions, the MSMEs have continued to maintain stability in growth and contribution to the welfare and development of the rural population. Even though lending to the sector through sectoral quotas had been abrogated, the BI promotes the funding of the sector through moral suasion. Every commercial bank in Indonesia is obliged to publish its contribution to MSME funding on the television, the newspapers and encouraged to establish an MSME desk to carry out that function. The people of Indonesia have over the years been known to demonstrate patronage for banks that support the MSME sector. The requirement for the publication of the status of the banks in MSME financing is being used as an advertisement and competitive tool by the banks. The BI also convenes collaborative meetings among the banks on regular basis on how to face the MSMEs challenge.

(iv) **Operation of a Credit Bureau**

Under the joint co-operation with the Asian Development Bank, the BI now operates a credit bureau aimed at maintaining a data bank for all borrowers in the country. Even though the project intends to provide coverage for all loans, only exposures equivalent to \$5,556.5 are presently covered. The credit bureau has an on line information technology system that enables particulars of borrowers to be transmitted to the data bank regularly. Efforts are also being made to promote/encourage the establishment of rating agencies for rural banks in the country.

(v) **Promotion of Appropriate Infrastructure for BPRs**

To promote the emergence of appropriate infrastructure, the BI has assisted in the establishment of Business Development Services (BDS), Rural Bank Associations, deliberations on a deposit insurance agency for rural and commercial banks. The BI is presently evolving the modalities for establishing an APEX BANK to function as a clearing house for the rural banks and play the role of the lender of last resort. The BDS are technical and training services providers that assist banks staff, clients and other stakeholders acquire necessary skills for micro-finance intermediation in the country. The BI assists in the establishment of the BDS, curriculum development and subsidization of their training programmes. The BDS assists the MSMEs on how to prepare business plans and make loan proposal to banks.

(vi) **Capacity Building Programmes**

The introduction of the rural banking programme in Indonesia had continued to pose serious challenges to both the regulators and operators in the area of capacity building in order to achieve the mandate of providing needed services to micro-enterprises. In order to bridge the technical skill gap, especially among directors of the banks the BI in collaboration with the Indonesian Banking Foundation, Rural Bank Association and GZT, a German Technical Aid Agency decided that an appropriate capacity building centre should be set up. In July, 2004 micro-finance competence centre, Bankakademie International was set up by the Indonesian Banking Foundation in Jarakata to carry out the function. The mission of the institution is to build capacity and set standards in terms of skills and competences for micro-finance managers in order to enhance the performance of the sector and increase outreach and quality of service to low-income people. The institute is being manned by a certification Board, National Curriculum Committee and Board of Management. It develops and provides high quality training materials, facilitate training for institutions and train the trainers. It also has a mandate to conduct professional examinations and issue micro-finance accredited certificates as a prerequisite for all directors of rural banks. To this effect, Regulation No.6/22/PBI/2004 dated August, 2004 was issued which made it mandatory for every director of a rural bank to undertake the training programme of the institute and pass examination at not less than 60% score before functioning as directors. Already all directors have been given up to 2008 to obtain the certificates.

The microfinance competence centre intends to collaborate with other privately accredited training service providers in the 7 regions of Indonesia. However, the examination materials and procedures would be centrally coordinated by the Institute. In year 2003, BI issued a regulation, which stipulated that BPRs should provide a minimum of 5% of total annual labour cost to educate and train its staff while it made a commitment to temporarily subsidize 50% of the training cost for a director in each of the rural banks.

(vii) **International Cooperation Initiatives**

The BI continued to play a crucial role in attracting the strong presence and influence of donors in the Indonesian micro-finance market. The GTZ has in particular, done some very impressive work in developing the industry in collaboration with the Directorate of the Rural Bank Supervision of the Bank. It has an office space in the BI. The GTZ initiative is anchored on four main pillars namely:

- Working with the BI, Federal and Regional ministries and other stakeholders to develop a common vision and policy on micro-finance,
- Enabling the rural banks to build financial infrastructure for effective payment system, establish an apex bank and provide effective linkage with commercial banks,
- Building Capacity for Chief Executive Officers of rural banks, staff of the BI and other stakeholders in the micro-finance industry, and
- Collaborating with the World Bank to extend micro-finance services to Eastern Indonesia where geographical limitation (long string of islands) has been a serious handicap.

In specific terms the following are activities carried out by the GTZ:

- Promoting the Self-Help Linkage Programme with banks as an overall development strategy,
- Building village level micro-finance institutions and assisting regional governments to support micro-finance development by giving them the technical assistance for developing micro-finance guidelines that take proper advantage of the peculiarities of the regions
- Assisting the Republic of Indonesia/BI to develop a global micro-finance law, rules and regulations and
- Offering technical support for developing strategies on micro-finance institutional building

On the possibility of support for Nigeria, the representative of the GTZ who spoke with the team disclosed that his agency was willing to offer assistance to any country that has high level of interest and commitment backed up by clearly defined and credible proposals. He promised to initiate an informal discussion of the Nigerian interest with his head office in Germany and advised that the study team should define categories of available micro-finance institutions and their needs and channel same to the GTZ in due course.

2.4 **THE MICRO-FINANCE SUB-SECTOR IN INDONESIA**

The providers and promoters of micro-finance services in Indonesia comprise the commercial banks, the rural banks, rural bank associations, cooperatives and non-bank financial institutions. Owing to time constraint the study concentrated on a major micro-finance offering commercial bank, the Bank Rakyat Indonesia (BRI), offering microfinance, the rural banks and the Rural Bank Association all of which are being regulated by the BI. In order to distil the specific learning points, the operations of each of them are discussed below.

2.4.1 **The Bank Rakyat Indonesia (BRI)**

(i) **Organizational Structure**

The BRI is a state owned bank, established in 1895 to provide banking services to the rural areas with emphasis on agriculture. It has one Head Office, 12 Regional Offices, 323 branches, 64 sub-branches, 3, 916 units and 238 service posts nation-wide. At the top of the bank's organizational structure is the Board of Commissioners made of the President Commissioner and three others. The Board of Commissioners oversees the activities of the Board of Directors and gives advice on strategic decisions, work plan, annual budget and compliance with the articles of association and other relevant organizational and national laws and regulation. They also undertake tasks as requested by the shareholders in annual general meetings, monitor and improve the quality and appropriateness of the bank's financial report. Next to the Board of Commissioners is the Board of Directors Comprising of seven persons as follows:

- The President Director,
- Director of Operation,
- Director of Medium-scale Business and Government subsidized Programme,
- Director of Compliance,
- Director of Credit Control,
- Director of Finance and International Business and
- Director of Micro and Retail Business.

The Board of Directors manages the company in accordance with the Articles of Association and represents the BRI inside and outside the court. In order to discharge its statutory functions, the Board of Directors constituted four main committees. The first is the Risks management Committee which is responsible for formulating and reviewing policies and strategies for keeping risks of the bank at an acceptable level and maximizing the bank's profit. The second is the Asset-Liability Committee, responsible for managing the

assets and liabilities, liquidity, interest rate, investment and maturity gaps of the bank. The third committee, the Credit Committee gives approval on credit facilities and extension up to a level already determined by the Board of Directors. The fourth Committee (Information Technology Committee) formulates the policies on technology risks, ensures that the bank is current and updated on technology advances and prepares/approves IT needs necessary for carrying out the operational requirements of the bank and its customers.

The Republic of Indonesia still holds 59% of the shares of the bank with the remaining part subscribed to by the members of the Board of Commissioners and Directors, and the general public. Assets of the bank amounted to \$11.11 billion.

After the Head Office other organizational levels include:

- **Regional Offices:** They are 12 in number and are responsible for monitoring the financial performance of the BRI Unit Desas from reports sent to the Branch Offices. They are expected to also take corrective action when appropriate, recruit for and carry out periodic audits of the Units.
- **Branch Offices:** Supervises the units under its jurisdiction and hosts an Assistant Micro-Business Manager, who in turn supervises the credit functions of the Unit Managers and to whom the Unit Managers sent monthly reports.
- **BRI Unit Desa:** The profit unit of the BRI is headed by a Unit Manager, 1 Credit Officer (400 targeted borrowers), 1 teller (250 targeted average daily cash transactions and 1 Desk man (150 average daily book transactions).
- **Village Service Post:** Comprises of two staff, a deskman and a teller. The service post is expected to collect savings and loan payments and receives loan applications (though not making loans) on behalf of the Unit Desa.

(ii) **Turn Around Strategies and Operational Principles**

Traditionally, the bank was used as a vehicle for channeling government subsidized loans to rural farm dwellers up to 1984. Many of the loans to the farmers were eventually not repaid and this threatened the sustainability of the bank. With effect from 1984, government interference in the activities of the bank was discontinued, the bad agricultural loans were absorbed, partial divestment of state ownership of the bank was embarked upon and the bank was empowered to operate on purely commercial principles, mobilize its deposits, source for funds, and charge interest as dictated by market forces. Before this time, the bank had already established a wide branch network and what remained was the competencies necessary for offering services in those branches in a profitable manner. As part of the turn around initiatives of the bank, each of its branches was charged to operate as profit centres with individual financial statements. Full-time training centres with a new micro-finance curriculum, and performance incentives were put in place as necessary conditions for taking on the task of a fully self-sufficient micro-finance system.

Some of the basic operational principles that helped the bank to achieve effective service delivery and impressive performance include:

- Diversification of Products

The products offered by the bank include general rural credit loans (Kupedes); deposits (demand and time deposits, rural and urban savings); money transfers, utility bills and salaries. The savings principles include safety, ease of withdrawal, convenience, lottery prizes and positive interest rates.

As of September, 2004, the bank had an outstanding loan balance of \$2.03 billion, 3,151,908 borrowers, average loan size of \$644.4 compared with a total deposit of \$3,434.23 million made by 30,911,202 with an average deposit of \$111.1.

- Favourable loan conditions and terms

Loan size-\$2.75- 5,555.6

Loan collateral- only for loans in excess of \$222.2

Loan term- working capital (maximum of 24 months

Investment (maximum of 36 months)

Fixed income (maximum of 60 months)

Interest rate- 2%/month/flat rate

Prompt repayment incentive- 0.5%/month

Life Insurance- premium paid by the BRI

- Appropriate Incentives

Borrowers

-Guarantee of future loans

-Interest rebate

-Life insurance

Employees

-Profit-based Bonus Plan

-Unit Achievement Competition

-Incentive for collecting written off loans

- Realistic loan Reserve Requirements

1% of (all loans outstanding-arrears)

5% of (all special mention loans)

15% of all substandard loans

50% of all doubtful loans

100% of all loss loans

The transformation that took place in the BRI, a formally fully owned state bank has been a case study for many countries that intend to undertake policy decisions for moving their sick/loss incurring state owned banks into efficient and sustainable institutions. The Nigerian Agricultural Cooperative and Rural Development Bank (NACRDB) owned by the Federal Government and the Central Bank of Nigeria, is presently operating on the philosophy of the pre-1984 BRI. It has extensive rural branch network, is fully owned by government and targeted at rural economic activities. The interest rate is 10% against an inflation rate of 16%, a situation that cannot but cause capital erosion, inability to meet operational costs, need for continued subvention and unsustainability. The negative impact of such a trend is on the present beneficiaries who stand the risk of disrupted service when the bank has no funds to continue operations.

From the Indonesian experience, what is important to clients of micro-finance institutions is not really the interest rate but quick, easy, convenient and continued services. Government role should be restricted to areas that will make investment of micro- clients and the institutions efficient. This could include offering efficient extension services, providing ready and appropriate inputs markets for agricultural borrowers, and providing roads, water, electricity, telecommunication to improve the operations of rural branches. The political will to reform is in the long-term best interest of government and the citizens. From world wide experiences, subsidized credit programmes of government have never had success stories. It is therefore

high time the government began to gradually divest its interest in institutions such as the Bank of Industry, the NACRD, other state and Federal owned institutions and free them to operate on competitive and commercial principles.

(iii) **Brief Report on a Unit Desa Visit During the Study Tour**

A Unit Desa, in Cipayun, established in 1995 was visited during the trip. It is located in a typically rural area. The unit is managed by four staff including a Unit manager, a loan officer, a teller and a Deskman. Operations in the unit were in line with the BRI laid down operational principles and procedures. Even though, there were delineation of duties, each branch staff was expected to acquire the skill to carry out all the functions over time. The approval limit of loan for the Unit Manager was \$666.7 while loans above this were appraised by the loan officer and sent to the Assistant Manager, micro Business unit of the Branch Office for approval.

The customer base of the Unit comprised of 750 borrowers and 7,400 savers with a total of \$388,888.9 outstanding portfolio and \$744,444.4 savings. About 50% of the loans of the branch were granted to traders. The default rate was 6.7% while 5.8 were non performing.

2.4.2 **Rural Banks- Bank Perkreditan Rakyat (BPR)**

Akin to the community banking programme and the proposed licensed Micro-Finance Institutions in Nigeria are the BPR in Indonesia. The BPR is derived from Indonesian language, Bank Perkreditan Rakyat which mean banks for giving credit to rural people. The Act Number 7/1992 of the Republic of Indonesia on Banking as amended by Act Number 10/1998 is the legal basis for the BPR. Article 13 of the said act stipulates that the business of rural banks shall comprise the following:

- Mobilizing funds from the public in form of deposits, comprising time deposits, savings, and/or other equivalent form;
- Providing credits;
- Providing finance and placement of funds based on sharia principles in accordance with regulations stipulated by the BI;
- Placing funds in BI Certificates (SBIs), time deposits, certificates of deposits, and/or savings in other banks.

However BPRs shall not perform the following businesses:

- Accepting demand deposits and participating in clearing payment systems;
- Doing business in foreign currencies;
- Equity participation
- Doing business in insurance; and
- Conducting business other than those permitted as stated above.

The historical antecedents to the BPR as now obtains in Indonesia dates back to the Dutch colonial period up until October, 1988. Several types of financial institutions were established by different levels of government as limited liability companies, partnerships, cooperative enterprises, foundations and associations. However, government launched the banking deregulation package known as Pakto, 1998 with several policies that streamlined their operations and represented improvements over preceding legal and regulatory norms.

As of June, 2004, there were a total of 2, 157 BPRs with a network of 3,442 offices. Out of these, 88 conduct businesses on sharia principles. In terms of legal entity, 1,332 of the banks are incorporated as limited liability companies, 768 as regional government enterprises, and 57 as cooperatives. However, their

spread has not been even, as 85.3% of the banks were concentrated in Java and Bali areas. Efforts were being made through international cooperation initiatives to reverse the trend.

In terms of performance of the rural banks, some remarkable growth had been recorded over the years. For instance business volume rose from \$722,222.2 in December, 2001 to \$1.6million (122.7%) as of June, 2004. In the same vein, their loan portfolio increased from \$544,444.4 in December, 2001 to \$1.2million (114.4%) as of June, 2004. Also, the banks recorded substantial growth in third party funds mobilization comprising time deposits and savings. The total third party funds of the banks as of December, 2001 amounted to \$475.6 million and \$1.1 billion as of June, 2004 representing 131.2% increase. The performance levels indicate efficient operation, increasing public confidence and promising prospects for the rural banking programme in Indonesia.

The banks did not participate in the clearing system but plans were under way to institute an apex banking arrangement that will facilitate appropriate clearing house transaction and act as banker of last resort to the rural banks.

2.4.2.1 Brief on Rural Banks Visited

Two rural banks were visited during the trip namely BPRALSalaam located at Jl Cinere Raya Block A No. 42, Limo 16514, Depok and BPR NURANI KAMI located at Jl. Margasatwa No. 36 Jakarta Selatan. Both banks carried the acronym BPR, similar to the recommendation to add

Micro-Finance Limited at the end of the names of licensed micro-finance institutions being proposed for Nigeria.

The comparative critical positions of the two banks are as follows:

Table 1: **Comparative Analysis of BPRALSalaam and BPR NURANI KAMI**

S/No	Critical Items	BPRALSalaam (A)	BPR NURANI KAMI (B)
1	Year established	October, 2001	1991
2	Capital as at December, 2004	\$255,555.56	\$222,222.22
3	Number of Shareholders	127	7
4	Number of Loan Customers	3,500	202
5	Number of Depositors	500	13
6	Number of savers	10,000	0
7	Number of cash centres	4	0
8	Population in Catchment area	500,000	Not available
9	Competition level in catchment areas	7 branches of commercial banks and 30 rural banks	7 branches of commercial banks
10	Linkage with commercial banks	Linked with 5 commercial banks	No linkage with any commercial bank
11	Director composition	6 comprising one commissioner, three other Board members, one Managing Director, and one Executive Director	3 comprising one commissioner, one Director and one Executive Director
12	Number of staff	14	17
13	Average cost of funds	12.3%	6%
14	Loan Duration	1 to 5year	Not available
	Lending rates	24%	18%
15	Loan repayment rate	98%	99.9%
	Average loan portfolio	\$3,333.33	\$ 4,933.33
	Strategic Vision	To be one of the top 5 BPRs in 2010	To open 1 new branch, 2 cash offices and increase capitalization to IDR5 billion
17	Services rendered	Time deposits, savings, credits,	Time deposits, savings, credits,
18	Strategic Products We should capture their loan and deposit values as at end	<ul style="list-style-type: none"> • Micro insurance for loan customers • 2% discount to good borrowers • Door to door services • Motor cycle loans for effective loan officers at zero% interest • Raffle draws for customers and awards • ATM services 	Not clearly defined
19	Lending to single borrower	10%	Not available
	Loan Authorization procedure	IDR1-5 million to be approved by the Committee level at the branch and by Commissioner for loans above	Not vailable

	Profit for the year ended Dec. 2004	???	IDR257 million
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Source: Information gathered from branch staff

From the above table it can be seen that bank A is more strategically positioned in the market, having a broad shareholder base (127), capitalization (\$255,555.6) as against shareholder base of 7 and capitalization on \$222,222.2 recorded for bank B. It has more pragmatic approach to customer service delivery and satisfaction as revealed through its outreach of 3,500 loan customers, 500 depositors, 10,000 savers and the attendant clearly defined vision and incentives for good performance by loan officers and clients. However, bank B has plans to increase the number of staff and customer base to be able to substantially penetrate the market and increase its outreach. During discussions with bank B, there were language barriers which inhibited the collection of the information marked “Not Available in the above table.

2.4.2.2 Rural Bank Association and Apex Bank

The Rural Bank Association (RBA) was a voluntary initiative of the BPR in Indonesia and served as an umbrella association that enabled them to actively participate in the banking system of the country. Three types of the association existed as follows:

- Perbarindo for limited liability BPRs,
- Perbaminada for regional government owned BPRs, and
- Asbisindo for BPRs operating on sharia principles

The RBAs perform the following functions:

- Partner with the BI in the supervision and regulation of the BPRs
- Provide consultation, technical assistance and mediation between the commercial banks and BPRs in their linkage programmes,
- Participate in conducting training programmes with certification and other forms of programme
- Conduct research such as base line survey and blue print for the BPRs
- Conduct research on best practices for the BPR operational system and
- Set up a BPR data base and information sharing arrangements.

The RBAs operate through a Board and derive their funds from membership fees. The Boards of the RBAs meet at regularly determined periods while an annual general meeting of representatives of members hold once a year. The three association are championing a common course of the apex bank for the BPRs.

3.0 THE PHILIPPINES EXPERIENCE

3.1 THE PHILIPPINES MAIN GEO-ECONOMIC STATISTICS

The Philippines is a country of about 7,107 Islands with a population of about 80 million. The economy is driven by agriculture; trade; commerce; Micro, Small and Medium Enterprises

(MSMEs) and tourism. It has a land area of about 299,404 square kilometers. The tourism industry dominates the economy of the country. The rate of inflation was about 7.6% while about 55 Pesos exchanged for the dollar. The deposit rate was 1% while lending rates stood at 24% per annum.

3.2 OVERVIEW OF THE PHILIPPINES BANKING INDUSTRY

The Philippines banking system comprises the Bangko Sentral Ng Philipinas (BSP), universal banks, commercial banks, thrift banks, rural banks, microfinance banks, cooperative banks and specialized government banks. Micro-finance activities in the country are dominated by the thrift banks, rural banks, micro-finance banks, and cooperative banks. The specialized development banks which are mainly government owned banks such as the Land Bank of the Philippines, Development Bank of the Philippines and Small Business Guarantee and Finance Corporation provide whole sale funds for the micro-finance offering institutions in the country. The rural banks are the formal micro-finance providers in the country. There about 33 commercial, universal and foreign owned banks in the country and about 800 rural banks out of which 600 are adjudged to be strong. An embargo had been put on bank licensing in the Philippines but for microfinance banks. The commercial/universal banks and the rural/thrift/cooperative/microfinance banks are governed by distinct regulatory guidelines and are supervised by separate Departments of the BSP.

Table 11: Capitalization Requirements of Banks in the Philippines

Bank Type	capital requirement in Pesos	Capital Requirement in Dollars
Universal	4,950,000,000	90,000,000
Commercial	2,400,000,000	43,636,364
Thrift banks		
Head office in Metro Manila	325,000,000	5,909,091
Head office outside Metro Manila	52,000,000	945,455
Rural Banks		
Within Metro Manila	26,000,000	472,727
Cities of Cebu and Davao	13,000,000	236,364
1st, 2 nd and 3rd class cities and 1st class municipalities	65,00,000	118,182
4th, 5 th and 6th class cities and 2nd, 3rd and 4th class municipalities	3,900,000	70,909
5th and 6 th class municipalities	2,600,000	47,273

Source: Bagko Sentral Ng Philipinas Regulatory Circulars

The capitalization requirement for universal banks stood at \$90.0 million while that for commercial banks is \$44.6 million. Thrift banks came next in capital requirements with those in Metro Manila requiring \$5.9million those outside Metro Manila requiring \$0.94 million. Rural

banks were allocated five tiers of capital on the bases of business challenges of the area of location and what is needed to confront those challenges in terms of capital (see table 1). The capitalization requirements for a microfinance-oriented bank is (i) in case of a rural bank to be established as a micro-finance bank, the minimum paid-up capital of 5 million pesos or \$90,909.1 or the applicable capitalization requirement for a new rural bank which ever is higher and (ii) the capitalization requirement under existing regulations in the case of a microfinance oriented thrift bank. The table show that capital requirements for bank could be graduated on the basis of location and competitiveness. The same posture obtain for Indonesian rural banks and supporting the need for the capital requirements for the microfinance institutions in Nigeria to be graduated along the same lines.

3.3 THE ROLE OF THE BANGKO SENTRAL NG PHILIPINAS (BSP) IN MICRO-FINANCE DEVELOPMENT

The BSP was set up on January 3, 1949. It assumed an independent and autonomous central monetary authority status pursuant to the Philippines constitution and the new Central Bank Act of 1993 which provided the platform for the restructuring of the old Central Bank of the Philippines (CBP). At the top of the Bank's organizational structure is the Monetary Board (MB) comprising of the Governor as Chairman and six others. The Monetary Board members are full time staff of the BSP and are responsible for corporate policy decisions of the Bank. There are also three Deputy Governors that supervises several Departments grouped into sectors. The first is the Deputy Governor Banking Supervision Sector (Economic Research, Treasury, International Operations, Loans and Credit, Asset Management, Branch Operations and Cash Department). The second is Deputy Governor Supervision and Examination Sector (Supervision and Examination Department I in charge of commercial banks and specialized government banks including their subsidiaries, Supervision and Examination Department II in charge of regular commercial banks, foreign banks and their subsidiaries, Supervision and Examination Department III in charge of savings and mortgage banks, private development banks, stock exchange, Supervision and Examination Department IV in charge of rural banks). There is a Micro-Finance Unit domiciled in the Department in charge of rural banks. The Third is the Deputy Governor Resources Management Sector (Human Resources, Information Systems and Technology, Comptrollerhsip, Administrative Services, Building Management, Security, Investigation and Transport).

In year 2000, the BSP declared microfinance as its Flagship programme for reaching the low income groups in the country, empowering them to acquire productive assets, expand their businesses and alleviate poverty.

(i) Enactment of Specific Regulatory Guidelines For Rural /Microfinance Banks and Department to Enforce Compliance

The BSP has actively supported the expansion of microfinance in the Philippines by issuing several circulars that recognize microfinance as a specialized banking service, issuing appropriate regulatory requirements for microfinance operations of banks, and creating incentives for the banking system to go into microfinance. The Bank has set up a Microfinance Committee that is responsible for internalizing and institutionalizing microfinance examination

and supervision procedures. The Microfinance Committee is headed by the Deputy Governor of the Supervision and Examination Sector and has representatives from the Office of the Governor, the BSP Institute, Supervisory Reports and Studies, Economic Research, Loans and Credit Departments. Pursuant to the Monetary Board Resolution No. 40 dated January, 2001, the BSP issued a circular on the implementation of the general banking law of 2000 on microfinance activities. The essential parts of the guidelines are as follows:

- That micro-finance loans are small loans granted to the basic sectors of the economy and other loans granted to the poor and low income households for their microenterprises and small businesses so as to enable them raise their income levels and improve their living standards.
- The maximum principal amount of microfinance loans shall not exceed ₱ 150,000 (\$2727.3) which is equivalent to the maximum capitalization of microenterprises in the Philippine Republican Act 8425.
- That these loans are granted on the basis of borrowers cash flow and are typically unsecured.
- That interest on such loans shall be reasonable but shall not be lower than the prevailing market rates
- That such loans shall be granted in favour of the landless laborers, small marginal farmers, rural artisans, weavers, the self employed in the urban informal market, medium farmers/small entrepreneurs etc.

The bank had specifically defined guidelines and performance standards (Portfolio Quality-P, Efficiency-E, Sustainability-S, Outreach-O acronymed Peso the country's national currency) for the supervision of the major players in the microfinance market ie, rural, thrift, cooperative and microfinance banks and regularly issues regulatory guidelines on micro-finance activities. It has accordingly modified its manual of examination to include microfinance operations and enforcement is carried out by the Supervision and Examination Department IV quite separate from that of regular banks. A consultant had been hired by the BSP who is currently working on the establishment of a Microfinance Unit for the Bank. The Unit coordinates relevant activities such as briefing, exposures, training, workshops and other advocacy activities. The Bank has a technical committee that recommends to the Monetary Board, appropriate policy and regulatory initiatives in support of microfinancing within the banking sector.

(ii) **Promotion And Advocacy**

Micro-finance issues were strongly supported by the members of the Monetary Board and highly promoted by the Governor who was conferred with a National Honours Award in January this year for his contribution to microfinance development and poverty alleviation. These issues featured regularly at various meetings of the top management of the BSP and the bank undertook regional tours, holds seminars, made presentations and speeches to promote microfinance best practices to all stakeholders and increase the knowledge and appreciation of microfinance. The Bank is at the vanguard of government's financial market reform policies and advocacy of the following:

- Adoption of market-oriented financial and credit policies, interest rates on loans and deposits,
- Termination of subsidized government and other subsidized programmes
- Termination of direct lending by government agencies implementing agricultural credit programme
- Greater role of the private sector in the provision of financial services
- Moral suasion on banks to extend at least 6% of their portfolios to small enterprises and 2% for medium businesses

(iii) **Concensory Licensing Window**

The BSP partially lifted the moratorium on the issuance of licences for opening of new thrift and rural banks and branches to accommodate microfinance oriented banks. Circular 273 series 2001 states inter alia “ the Monetary Board, in its Resolution No. 147 dated 25th January 2001 approved the partial lifting of the general moratorium on licensing of new thrift and rural banks to allow entry of microfinance-oriented banks”. Thus new thrift and rural banks can only be licenced if they have a pledge to offer 50% of their portfolios for microfinance activities defined as loan of an average of \$909.1

(iv) **Implementation of Specialized Micro-Finance Promotion Schemes and Initiatives**

As part of its strategies to promote microfinance activities the BSP:

- provide liquidity assistance to microfinance oriented banks through its rediscounting facility to refinance credits extended by banks to their clients,
- Redesigning an appropriated Credit Bureau which it intends to initially manage and transfer to the private sector in due time,
- Encrypted the United Nations Year of Micro-Credit 2005, sustainable microfinance for the Filipino Entrepreneurial poor in its 20 pesos (most widely circulated) denomination of its national currency,
- Intensive training and capacity building for the core group of micro-finance bank examiners and manager of microfinance oriented banks.
- Proposing and working on the establishment of rating agencies in the country.

(v) **International Cooperation Initiatives**

Various technical assistance from donors abound in the Philippines. The United States Agency for International Development (USAID) is involved in the funding and implementation of the Micro-enterprise Access to Banking Services (MABS), a programme designed to assist rural banks develop the capability to profitably provide both loan and deposit services to micro enterprises. Also, in 2002 and 2004, the USAID provided technical assistance to the BSP Microfinance Committee to assist in drafting proposed changes to the Banks manual of examination in order to incorporate microfinance operations and training BSP examiners in the implementation of the draft examination procedures.

The International Finance Cooperation (IFC) has engaged in partnership with a local bank to establish a microfinance thrift bank, the Asian Development Bank (ADB) provides concessional loans to the Peoples Credit and Finance Cooperation (PCFC) and the United Nations' Development Programme technical support through the Microstart programme.

3.4 **THE MICRO-FINANCE SUB-SECTOR IN THE PHILIPPINES**

The microfinance sub-sector in the Philippines is being driven by several partners. The major players are the following:

- Microfinance Institutions (MFIs)

3.4.1 **The Micro-Finance Banks**

One of the steps taken by the government and the BSP in support of microfinance development was the opening of a licensing window for banks called Micro-Finance Banks. The major activities of these banks are micro in nature. This is the only category of banks that are being currently licensed in the country. The rural banks, Non-Governmental Organizations and other financial institutions with “low-end of the market focus” are being encouraged to transform and obtain the micro-finance bank licenses.

The capital requirements are as follows:

Location of Bank	In Pesos	In Dollars
Metromanila	26,000,000.00	472,727
Cities of Cebu and Davao	13,000,000.00	236,364
In 1st, 2nd and 3rd class cities and 1st class municipalities	6,500,000.00	118,182
In 4th, 5th and 6th class cities and in 2nd, 3rd and 4th class municipalities	3,900,000.00	70,909
In 5th and 6th class municipalities	2,600,000.00	47,273

The capital base proposed in the Nigerian National Micro-Finance Policy and Regulatory Guidelines, about \$151,515.2 is close to the average of the three middle strata in the Philippines which is about \$142,000.

(i) **Visit to CARD Bank and Customers**

One of the NGOs which transformed into a bank was the Centre for Agriculture and Rural Development (CARD). Up to 1997 CARD operated as an NGO but now has a CARD NGO microfinance, CARD bank, CARD Mutually Beneficial Association, CARD Training Centre and intends to go into marketing and housing finance activities in the near future. Its many activities are supported by the vision of operating a Mutually Reinforcing Institution (MRI) that provides

services required to fully empower the micro-clients to actively participate in economic activities. The Briefs on each of the activities being performed include:

- **CARD NGO Micro-Finance:** About 70 branches perform NGO micro-finance services. Gives credit and mobilize savings from members only but when matured to carry out deposit mobilization from the public, an application to convert such a branch to CARD bank branch is forwarded to the BSP and the conversion effected. The MFI believes that it is easier for it to start new branches as an NGO branch and convert than getting an approval from the BSP to directly open a bank branch.
- **CARD Mutual Benefit Association (MBA):** This is an association to which all CARD NGO and CARD bank clients are members. Premium is collected by the bank and the NGO from the clients, remitted to the MBA and administered as life insurance, providence fund and provide medical care for members. Life Insurance premium is 1 cent a week while loan insurance is 3 cents a week. The life insurance covers mental disability, accident and members are entitled to receive determined amounts when affected. When a member dies, the MBA determines his/her outstanding balance and remits it to the CARD bank or the NGO.
- **CARD Training Centre:** The Centre started in 1989 and has plans to transform to an international development training centre. It provides theoretical and practical training for all CARD clients. Each of the clients of the NGO and bank is required to undergo a 2-day seminar before acceptance as customer. Also provides regular need-based capacity building programmes for members on better feeding, education, asset acquisition etc. It is also the training centre where CARD bank and other affiliate agencies are trained on microfinance operations, standards for choosing clients, loan appraisal methods, leadership, group dynamics, communication and credit discipline.
- **CARD Bank:** CARD started as an NGO in 1986 with the original vision of providing empowerment for the poor in the rural areas by setting up a bank owned by the poor and for the poor. On 25th September, 1997, it obtained a micro-finance banking license by which token all its portfolio were to be 100% micro-finance. Originally lending was administered in favour of men and women groups but it was observed that the men groups defaulted in attending meeting and in loan repayment while the women attended meetings regularly and achieved 100% repayment records. The women were found to attend meetings, training programme and handled finances more prudently. In later years, lending to women groups was 70% while men loan accounted for 30%.

Original fund for the CARD bank was provided by the NGO and some Board members but the shares were being divested in favour of its clients, two of which now sat on the Board of the Bank. CARD bank board is headed by the Managing Director and Heads of other functional agencies of CARD. The Board members meet twice a month.

All CARD bank clients must fulfill the following conditions:

- ✓ Have per capita income of not more than \$27.3 per month,
- ✓ Have total productive assets of \$1,818.2,
- ✓ Is not a regular employee of any organization,
- ✓ Aged between 18 to 60 years,

- ✓ If married she must be the bread winner of the family i.e. 50% of family income comes from her,
- ✓ Be willing to be a group member,
- ✓ Attend the 24hrs Compulsory Group Training (CGT),
- ✓ Pass the Group Recognition Test (GRT),
- ✓ Be willing to attend weekly Group Centre Meetings, pledge to save at least \$0.7 a week, repay all loan installments regularly all time,
- ✓ Be willing to abide with other rules and regulations of CARD

CARD bank has 9 bank branches nationally, pays 2.5% interest on savings and charge 24% on its loans. The bank has attained 100% financial self-sufficiency and borrows from privately owned wholesale fund suppliers and other international and local organizations.

(ii) Brief Report on a micro-Finance Bank Branch, CARD Bank located in the Laguna Province

The branch of the bank was initially an NGO branch before it was converted to a bank. It had a total staff strength of 10, 7 females and 3 males. The staff composition are: a branch manager, a branch accountant, and loan officers and clerical staff. Total outstanding loan customers were 4,384 valued \$5 million. The Portfolio At Risk for the branch is 2.6% amounting to \$14,545.5.

Factors that contributed to the success of the branch included the following:

- Strong client discipline achieved through regular training and meetings supervised by bank staff,
- Zero delinquency tolerance policy and inculcation of this to staff and clients
- Commitment of staff achieved through regular training, exposure and attractive incentive and reward system,
- Regular quarterly provincial meetings to share ideas and to assess performance of CARD affiliates and award rewards for those that score well in Audit ratings
- Decentralized loan approval process, Branch Manager can approve up to \$909.1, \$909.2 to \$1,363.6 by the Area Manager, \$1,363.6 to \$1,818.2 by Executive Manager at the Head Office and loans above by the Board.
- Simplified loan documentation procedure, involving half a page, cash flow based approval procedure quick approval and disbursement.
- Group lending technology.

A meeting of one of the group customers was attended by the team during the trip. Meetings are often attended by branch staff. Proceedings of the meeting featured opening prayers, recitation of pledge of loyalty to the ideal of the group and of the bank, attendance taking, submission of letters of excuse from those who could not attend, minutes of previous meeting, and review of loan and savings position of members. Starting with 33 centre members in 2002, the strength declined to 23 as at the time of the meeting as a result of relocation, transfers and migration. The group members of all centres of the branch of the bank meet for their convention annually for the purpose of reviewing operations and awarding prizes to best performing groups.

Group officials comprise the Centre Chief, Secretary, Treasurer, Project Manager and Auditor. Loan applications are to be signed by the loan applicant, her husband and the Centre Chief. It takes about one week to get approval. Group meetings last for about 30 minutes. The group has a fund to assist members who have problems with loan repayment or who find themselves in other difficulties.

The main activities engaged in by group members include fish farming, fishing, meat processing, buying and selling, provision stores etc. One of the group members who started with \$91.0 had increased her loan amount to about \$146.00 as at the time of the visit. She had increased the number of family fish ponds from two to six and fingerlings from 4,500 to about 5,500, sells processed meat, has stable business and has enough to concentrate on savings alone. In a related development, an individual client of the bank who was a graduate of another group stated that she was 8 years a group client but decided to stay alone after her loan amount had increased and business expanded. With \$36.4 initial loan, she had a credit line of about \$2,727.3 as at the time of visit. Staff of her bakery business increased from 2 to 13 and had ready market for various kinds of confectionaries produced from the bakery.

3.4.2 Rural Banks

The history of rural banks in the Philippines dates back to the early fifties. They were established to provide finance in support of rural economic activities with agriculture occupying the centre stage. The rural banks were established on the philosophy behind the establishment of the community banks in Nigeria. The capital requirement of the rural banks was stratified like the case of Indonesia based on the level of demand imposed by the business level in each strata and what would be required by the banks to competitively operate in such areas. They are the same as that for micro-finance banks stated earlier on.

With the promulgation of a national policy on microfinance in 2000, the rural banks in the Philippines are being encouraged to focus on micro-finance activities in their operations by making about 50% of their loan portfolio in microfinance loans i.e. average of \$909. Even though there are no new banking licenses being granted to banks in the Philippines, licences can be granted to any rural or other banks or company that is willing to get a micro-finance banking license. The BSP provides support to the banks by way of capacity building and training.

3.4.2.1 Brief on Visit to Bangko Kabayan (Rural Bank)

The Bangko Kabayan (BK) is located at Ibaan in Batangas province of the Philippines. The word Kabayan means people from the same province. The BK (business name adopted in 1997) was established on August 19, 1957 as Ibaan Rural Bank to amongst others (i) provide access of the people of Ibaan to affordable credit, (ii) instill the value of savings, (iii) stimulate private investment, (iv) promote growth and development, and (v) improve the standard of living in the area. The Bank's mission statement is anchored on providing satisfaction at four strategic levels as follows:

- Commitment to continuous growth and development of officers and staff, thus enabling them to have a better quality of life while attaining corporate goals,
- Commitment to providing optimum returns to stakeholders through judicious management of their investment while fulfilling community development aspirations,
- Commitment to maintaining sincere and meaningful alliances with strategic partners towards mutual economic and social benefits, and
- Commitment to community partnership in total development.

The bank had 9 branches and a total of 128 employees, 24 of which were engaged in micro-finance functions. According to the Chief Executive Director of the Bank, micro-finance activities was treated with undue caution until about 1998 when the BSP came up with a regulatory framework that recognized micro-finance as a legitimate banking activity and an effective tool for poverty alleviation. Following this, the BK planned and eventually commenced micro-finance services in 2001. Since that time, it had posted a progressive micro-finance performance. The loan portfolio in the sub-sector increased from about \$41,818.2 to over \$700,000.00 as of December, 31, 2004. At the same time the Portfolio at Risk (PAR) declined from about 2.5% to about 1.2%. The micro-finance lending contributed about 24% to the net income of the bank in year 2004 (against 9% of the total loan portfolio) attesting to the fact that micro-finance is a profitable business. In terms of savings, micro-savers accounts balance stood at about \$0.5 million, representing 3.0% of a total deposit liability of \$16.1 million reported as at December 31, 2004.

The bank adopts the group (Kabayan) and individual (Kapitan) lending technologies in its savings and credit. Out of a total micro-savings balance of \$0.5 million, group savings accounted for \$0.32 million (71.0%) while the individual savings accounted for \$0.13 (29.0%). The total loan portfolio to groups amounted to \$0.36 million (52.2%) while the individual loans was \$0.32 (47.8%). The repayment rate under the group loans was 100% while that of individual was about 98.0%.

From the discussions held with the branch some of the strategies that accounted for its impressive performance in the micro-finance services included the implementation of the following:

- **Committed leadership:** The major shareholders are highly committed to inspiring and motivating staff to achieve the goals and aspirations of the bank,
- **Rigorous staff recruitment system:** Employment is based on performance in the examinations administered by the Bank.
- **Staff and client incentive and fringe benefit policies:** Staff shares performance based profit, receives cash allowances if their loan portfolio meet certain performance standards and benefit from generous loan privileges
- **Zero delinquency tolerance policy:** Staff, loan officers and clients are properly educated on the policy of the bank that loans repayment schedules should be adhered to always
- **Life assurance policy (Mutual fund for all loan clients to assist in the event of death):** At point of disbursement of any group loan, 300 pesos is deducted per group, this is pooled together, when a client dies, members are all in addition mandated to contribute

20 pesos each, from this pool some money is withdrawn to settle the balance of the loan of the deceased customer and the balance remitted to members of his/her family

- **Group lending technology:** The group assists in monitoring of members and because of regular meetings when the position of each member accounts will be reported, no member wants to default. Where there are genuine defaults, members rally round to assist in meeting the repayment schedule of the defaulting customer to avoid any negative report reaching the bank
- **Regular staff training:** The bank is committed to regular training programme in collaboration with the Micro-enterprise Access to Banking Services (MABS)
- **Favourable loan conditions:** Interest rate of 24% per annum, repeat lending for good clients, cash flow based, stepping up of loan amounts for good borrowers, quick approval and disbursement
- **IT based loan tracking and monitoring:** The bank maintains an IT system that gives loan officers warning signals and taking corrective actions, each borrower is handed over a copy of the loan amortization schedule on which basis repayments are made.

In order to have testimonials of the contributions of the bank to the lives of clients, a group and an individual customer were visited and interviewed during the visit. The briefs on each are as follows:

(i) Group Customer

The group, Bango Centre group which came into existence in May 2001 comprise of eight sub-groups and 54 members, all women. Each sub-group has a group head while the main group has five officials comprising the Centre Chief, Secretary, Treasurer, Auditor and Project Coordinator. The meeting proceedings involved opening prayers, recitation of loan commitment, and status reports from sub-group heads on the level of their savings and amortized payments. Where a sub-group member is not able to meet the weekly repayment schedule, the other members contribute and repay on her behalf and this is reported at the meetings. The meeting which holds weekly lasts for just one hour and this is affordable for members. The group has a joint structure for their meetings and sponsor joint projects.

As a testimonial, one of the group members disclosed that she was on the ninth loan cycle. Beginning with \$91.0 at the first cycle she was able to improve her business (peddling of wares). Her ninth loan cycle amount was \$818.0. From barely anything at the start, the family business had grown, income had increased and they now own a tricycle.

(ii) Individual Customers

Mr. Domingo Fesalbon, the individual borrower of the bank commenced banking relationship in 2003 when the number of customers demanding his cassava cake increased beyond his scale of operation at that time. His first loan in 2003 was \$455.0 dollar while in 2004 it had increased to about \$2,727.00. The customer had increased the size of his cassava farm, his processing machines, purchased a vehicle to transport raw material and finished products, owns a shop and had been able to send his daughter abroad.

3.4.3 Micro-Enterprise Access to Banking Services (MABS) Programmes/Rural Bank Association

In the 1990s, various stakeholders showed interest and commitment to the micro-finance project in the Philippines. The Government of the Republic of Philippines introduced various structural, institutional and administrative changes in its grassroots development programmes. The central bank drafted a right policy and regulatory guidelines backed up by top level management support and involvement. These created fresh interest in the existing micro-finance based institutions and sparked off the establishment of new ones. Challenges began to mount on offering services that was in tandem with international best practices and the goals and aspirations of stakeholders. Fortunately, the Philippines was endowed with indigenous experts with wide international experiences and who were willing to provide assistance to address the challenge. In collaboration with the United States Agency for International Development's Chemonics project and the BSP, the Rural Bank Association founded the MABS to assist in the drive to make the microfinance revolution in the Philippines a success.

The MABS works with privately owned rural banks to assist them to develop the capability to profitably provide financial services (loans and deposit) to the micro-enterprise sub-sector. It is jointly implemented by the United States Agency for International Development (USAID) and the Rural Bank Association of the Philippines (RBAP), with oversight of the Office of the President through the Mindanao Economic Development Council. The MABS has defined and propagated an effective approach to providing micro-finance services. This approach focuses on character based cash flow lending, zero tolerance to loan delinquency, internal control and fraud prevention techniques.

Ten basic steps are involved in the institutionalization of this approach namely:

- (i) **Institutional Assessment of participating Bank :** Determining the bank's existing and potential capability to set up a profitable microfinance operation.
- (ii) **Senior Bank Managers' Orientation:** Involves a two day programme designed to familiarize senior staff including interested Board members with the MABS approach.
- (iii) **Selection and Training of the Microfinance Unit Staff:** Engaging and training of a competent Microfinance Unit Manager and loan Officers.
- (iv) **On-the-Job Training of Microfinance Staff:** Over a six month period, the MABS consultants provide intensive training and technical support to staff of the microfinance Unit of the bank
- (v) **Survey of the Bank's Microenterprise Market:** Types and number of microenterprises in the service area of the client bank and its branches.
- (vi) **Microfinance Product Development:** Microfinance savings and loan products are developed based on the findings of the market survey.
- (vii) **Business Planning for the Microfinance Unit:** Determination of operational costs, deposit and loan targets, outreach goals, anticipated growth rates and their consolidation into a workable business plans.

- (viii) **Microfinance Technology and Systems Installation:** Banks are assisted by MABS consultants to install MABS approach systems, required operational manual and Management information system.
- (ix) **Implementation Begins:** Under MABS guidance, the bank releases its first MABS microfinance loans and begins mobilizing deposits.
- (x) **Monitoring of the Micro-Finance Unit:** An 18 month programme of on-going monitoring, advice and troubleshooting to the bank's microfinance Unit.

In addition to the above, MABs offers a regular training and technical assistance programme designed to sharpen the product development skills of the Microfinance Units of the participating banks. The programme consists of four modules covering Senior Management Orientation, Market Research, Product Development, Loan Administration and Management and Product/Operational review. MABS has set a performance standard for all its participating banks on the basis of which awards are made annually for the bank that makes the best score. As of 29th December 2004 a total of 72 rural banks with 204 units participated in the MABS programme. The outstanding loans amounted to 72,315 in number and \$9.6 million in value. The Portfolio At Risk (PAR) at 30 days was 3.99%.

4.0 **Comparative Analysis of Essential Licensing and Regulatory Requirements for the BPRs and the proposed guidelines for Nigeria**

The aim of this section is to determine the extent of commonality and deviations between the regulatory guidelines of the Indonesian micro-finance system and that proposed for Nigeria. Only very critical elements of both guidelines are compared between both countries. The table below illustrates the comparisons.

Table III: **Comparative Analysis of Essential Licensing and Regulatory Requirements for the BPRs and the proposed guidelines for Nigeria**

S/No	Critical Items	BPR Guidelines- Indonesia	Micro-Finance Bank Guidelines- Philippines	MFI Guidelines- Nigeria
1	Parties Eligible to Establish	<ul style="list-style-type: none"> • Indonesian citizens • Indonesian legal entities wholly owned by Indonesians • Regional Governments • Two or more of any of the above parties 	<ul style="list-style-type: none"> • Philipinos for rural and cooperative banks • Foreign voting stock ownership of up to 60% for thrift banks 	<ul style="list-style-type: none"> • Nigerian citizens • Nigerian legal entities wholly owned by Nigerian
2	Requirements of Paid-Up Capital	<p>Four tiers prescribed on the bases of market competitiveness as follows:</p> <ul style="list-style-type: none"> • \$556,000.00 for banks in capital city of Jarkata • \$222,000.00 for banks in provincial capital of Java island and Bali or the regencies/ Municipalities of Bogor, Depok, Tangerang and Bekasi • \$111,000.00 in provincial capital outside the regions in items 1 and 2 above • \$56,000.00 for banks outside regions referred to in items 1, 2 and 3 above 	<ul style="list-style-type: none"> • \$472,727 for Metro Manila • \$236,364 Cities of Cebu and Davao • \$118,182 for 1st, 2nd and 3rd class cities and 1st class municipalities • \$70,909 for 4th, 5th and 6th class cities and in 2nd, 3rd and 4th class municipalities • \$47,273 for 5th and 6th class municipalities 	<p>Only one tier recognized with a capital requirement of \$145,000.00</p> <p><i>It might be wise to consider the tiered approach to the capital requirements along Federal Capital and Lagos; State capital and Local Government Areas.</i></p> <p><i>This might give a wide range of choices to investor, help them to properly conceive their market niche and check regulatory arbitrage.</i></p>

S/No	Critical Items	BPR Guidelines- Indonesia	Micro-Finance Bank Guidelines- Philippines	MFI Guidelines- Nigeria
3	Time Frame to meet capital requirements	<ul style="list-style-type: none"> 40% in 2006 70% in 2008 100% in 2010 	To be fulfilled before issuance of license	Condition for licensing of the MFI at the point application is filed
4	Capital Adequacy Ratio	<u>Tier 1+ Tier 2</u> *100=8% Risk Weighted Assets	<u>Tier 1</u> *100= 10% Risk Weighted Assets	<u>Tier 1</u> *100= 10% Risk Weighted Assets
5	Single Obligor Limit	20% of the capital of the BPR for borrowers not connected with the rural bank and 10% for parties connected with the rural bank	25% of the net worth of the banks	Not more than \$7,299.3 or N1million
6	Provisioning Requirements	Asset classification is more detailed but are as specified in section 4.4.03 of the Summary of Regulations on Rural Banks. The provisioning requirements are: <ul style="list-style-type: none"> Current 0.5% Substandard 10% Doubtful 50% Loss 100% 	<ul style="list-style-type: none"> General provision=1% for all microfinance loans 1-30 days=10% (Unspecified) 31-60 days=20% (Doubtful) 61-90 days and loans restructured once (Substandard)=50% 91 days and above and loans restructured twice (Lost)=100% 	<ul style="list-style-type: none"> Performing risk assets=1% provision 1-30 days past due (substandard)=20% provision 31-60 days past due (doubtful) =50% provision 61-90 days past due (lost) =100% provision

Source: Summary of Regulations Concerning Indonesians Rural Banks, Philippines MicroFinance Banks and National Policy and Regulatory Guidelines for Nigeria

There are no major deviations in the critical regulatory requirements itemized in table 2. While in Indonesia a tiered capital requirement was employed on the basis of businesses competitiveness, the proposed guidelines for Nigeria recognized a uniform capital requirements for all licensed MFIs. The capital requirement of \$145,000 prescribed for Nigeria is similar with the average of the middle two tiers for the Indonesian rural banks which amounts to \$166,500.00. Even though the issue of tiering was tabled as a suggestion during the International Validation Summit on the policy held in March, 2004, it was dropped for lack of consensus. It might be necessary to give a second thought to that concept as a fall out of the study tour.

All other requirements do not show any major difference to warrant special mention and treatment.

5.0 **MAJOR LEARNING POINTS FROM THE STUDY TOUR**

5.1 **Capitalization requirements**

The capital requirements for the commercial banks in Indonesia is IDR3 trillion or \$333.3million. This is higher than the N25 billion or \$182.5 million being proposed for the Nigerian banks. However, the demand for banking services in Indonesia exceeds that of Nigeria as indicated by the countries population of over 200 million, over 85% literacy rate and of thriving MSME sector. Also, in the Philippines the capital requirements for universal banks was \$90.0 million while that for commercial banks is \$43.0million, and just adequate for its 80 million people.

The countries adopted a tiered approach to the licensing and regulation of rural and microfinance banks, the equivalent of the MFIs being proposed for Nigeria. Even though the proposed capital requirements for the MFIs in Nigeria is adequate and appropriate for a start, there may be need to consider a tiering system that maintains the ₦20.0million at the lowest level but recognizes higher requirements for state capital and Federal capital/Lagos situated MFIs.

5.2 **Linkage of MFIs and Similar Institutions with Banks**

In the two countries paucity of funds with the microfinance banks existed and the policies took steps to bridge the gap. In Indonesia there is a linkage programme between commercial and rural banks to enable the later source for whole sale funds from the former while in Philippines, the land and development banks and the PCFC provide needed wholesale funds for the microfinance oriented banks. In Nigeria, the universal banks have the liquidity and funds that could service small scale borrowers but lack the requisite human resources and branch network to optimize the benefits accruable from that market while the MFIs, community banks have the human resources and branch network for penetrating the micro-clients. It would be worthwhile to fashion out an appropriate and attractive model for the linkage to be promoted and encouraged in Nigeria. This will create room for the MFIs to source for loanable funds from the banks for on-lending to micro-borrowers.

5.3 **Establishment of a Credit Bureau**

Because of the peculiar characteristics of microfinance practice, both countries policies have provision for credit bureau. In Indonesia, the BI had a credit bureau located at its Directorate of Rural Bank supervision. The Bureau maintains an on line data bank for loans in excess of \$555.6 with a plan to later cover loans of less amount. The idea is to nurture the bureau to a stage of maturity and later outsource it. Micro-Finance activities in Nigeria are really very volatile because of tendency for sharp practices. Information storage and dissemination will curb such excesses and since Central Bank of Nigeria is at the frontier of the country's micro-finance revolution, conceiving such a long term confidence building project assumes paramount importance in the Bank's initiatives. In the Philippines the BSP was making serious plans to establish a credit bureau with the hope of nurturing to maturing and later handing over to the private sector. A credible Bureau that is particularly manned by the CBN is very essential in the Nigeria situation. With the established CBN branch net work it will be easy for the MFIs to send their loan positions to the branches of the CBN where they could be fed on-line to the Bureau at the Head office until such a time that necessary IT capacity is built.

5.4 **MFI Certification Institution**

In Indonesia there is a microfinance certification institutions (Bankakademie International) while the Philippines maintains a Micro-Enterprise Access to Banking Services. In Nigeria, micro-finance practice is hampered by lack of appropriate skills and the proliferation of quack institutions. As the new regulatory guidelines matures, the time is also ripe for setting up of standards for the institutions, their directors and managers, develop sound curricular, train practitioners, conduct examinations and award certificates on which continuance of practice would be based. This will on the long run build sound institutions, committed personnel and sustainable service delivery in the industry. The Central Bank of Nigeria should collaborate with relevant stakeholders to determine the certification institution, sponsor more detailed study of the procedures and modalities for the training programmes from the Indonesian and Philippines perspective and ensure implementation.

5.5 **Transformation of the Nigerian Agricultural Cooperative and Rural Development Bank**

The BRI which is now one of the strongest banks in Indonesia was formally a fully owned state bank. It traditionally held the special assignment from government to provide banking services, particularly subsidized directed credit to the rice farmers and other rural economic activities on behalf of government. The arrears and losses assumed high levels that could have closed down the bank but for the political will on the part of the government to reform the bank and allow free hand to manage the bank for cost effective operations. In 1983, government embarked on gradual withdrawal of its interest and following deregulation of the economy it allowed the bank to recruit its staff, determine its customers and services and charge rates appropriate to the industry. The government of the Philippines has already commercialized its Land Bank, freed from interference and charged with whole sale funding responsibility to the microfinance oriented banks. There is also the Refinancing facility operated by the BSP in favour of the banks.

In Nigeria it is recommended that the CBN should champion the cause of full deregulation and commercialization of the activities of the NACRDB as a shareholder. This is already recommended in the policy. The bank should be allowed to reposition itself for deposit mobilization and general purpose commercial interest credit to worthy borrowers. As a matter of fact, interest rate subsidy as is being practiced in the NACRDB perpetrates capital erosion/frequent injection syndrome and operational shocks that badly hurts the clients it is supposed to serve. Since the CBN knows more on the necessity for reforming the bank, it should tenaciously advocate this need until such a point the political will to reform the bank is consummated.

5.6 Publication of Investment of Banks Under the Small and Medium Industries Equity Investment Scheme (SMIEIS) and Setting up SMIEIS Desks

The Small and Medium Industries Equity Investment Scheme is a joint initiative of the banks at the instance of the CBN and the Federal Government. As a new project, there are bound to be challenges on the implementation of the programme. The CBN should evolve necessary strategies for its successful implementation. In Indonesia for instance, the banks publish their investments in MSMEs on quarterly basis and this has been an effective precondition for customer patronage in the banks. A bank that fails to publish or performs poorly is telling the public that it has no interest in supporting the economy, and in response, customers begin to withdraw their accounts from such banks in favour of those with impressive MSMEs programme. In addition, the BI convenes selective dialogues between banks that have desk offices on MSMEs and those that do not, allows discussion and foster commitments at top management levels of the banks. In the Philippines, the BSP fostered an agreement among the universal and commercial banks to extend 6% and 2% of their loans to small and medium enterprises, respectively.

The banks in Nigeria could be made to reach an agreement on the need to publish their investments under the SMIEIS and MSMEs loans for public good while the CBN should promote meetings between good performers and bad ones in moving the Scheme forward.

5.7 Technical Cooperation Initiative

During the visit, it was observed that the German Technical Aid Agency, the GTZ, had gigantic technical aid programmes in Indonesia. This was based on Indonesia's impressive record in micro-finance projects such as the reformation of the BRI, promotion of rural banks and the existence of many informal institutions. Huge funding and technical support are being channeled to the microfinance sub-sector by the USAID, Asian Development Bank (ADB), International Finance Corporation (IFC) and other donors in the Philippines for training and shareholding.

The study team had a chance meeting with technical staff of the agency in charge of PROMFI (Promoting Micro-Finance Institutions) project and made enquiries on how Nigeria could attract the level of assistance which Indonesia was receiving. The advice was that Nigeria should articulate its specific micro-finance demands and channel same to the Head Quarters of the

Agency in Germany. To this extent, it is necessary that following the launching of the policy, a dialogue with the agency should be initiated.

6.0 CONCLUSIONS AND RECOMMENDATIONS

The visit to the Indonesia and Philippines was an exercise that yielded very fruitful and eye opening results on the implementation of the proposed policy and regulatory guidelines for Nigeria. Accordingly, the team was able to understudy the roles of the BI and BSP in the promotion of micro-finance industry in the countries, the institutional types and have been able to synthesize important issues that require adoption by the CBN and other stakeholders in the Nigeria situation.

It is recommended that as part of the strategies to facilitate the effective implementation of the Nigerian policy the following should be pursued:

- Adopting a tiered capital requirement for licensed microfinance institutions in Nigeria,
- Fashioning out an appropriate and attractive model for a linkage to be promoted and encouraged between universal banks and the MFIs in Nigeria to create room for the MFIs to source for loanable funds for on-lending to micro-borrowers.
- Establishing a Credit Bureau to embark on credit information storage and dissemination to curb sharp practices by fraudulent clients.
- Establishing a certification institution to determine standards for the MFIs, their directors and managers, develop sound curricular, train practitioners, conduct examinations and award certificates on which micro-finance practice would be based.
- Championing the cause of full deregulation and commercialization of the activities of the NACRDB, repositioning it for deposit mobilization and general purpose commercial interest credit to worthy borrowers.
- Reaching an agreement on the need to publish investments of banks under the SMIEIS and MSMEs loans for public good and promoting educative meetings between good performers and low ones in propagating the creation of properly manned desk to carry out SMIEIS activities.
- Articulating specific micro-finance demands, fostering donor meetings and involvement in supporting projects and programmes that would promote the quick development of microfinance sub-sector in Nigeria.

**CENTRAL BANK OF NIGERIA,
FEBRUARY, 2004**