The Performance and Sustainability of Two Philippine Microfinance Institutions

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Executive Summary

Providing the poor with access to savings and credit services as a poverty alleviation strategy has gained prominence in the past ten years. This has resulted from the emergence of models that have shown increasing success in terms of their ability to reach the poor and in sustaining the delivery of financial services. However, a significant number of those engaged in microfinance services continue to struggle with the twin goals of outreach and sustainability. This is particularly true of the situation in the Philippines.

This study reviews the performance and sustainability of two Philippine NGOs that have not reached the scale of the more renowned models. These are the Alalay sa Kaunlaran sa Gitnang Luzon, Inc (ASKI) and the Kabalikat para sa Maunlad na Buhay, Inc (KMBI). The aim of the study is to gain a better understanding of the challenges facing microfinance institutions and the factors which are critical to their outreach and sustainability. It builds on the findings and addresses some of the limitations of a transaction costs study by Llanto and Chua (1996) which was also commissioned by The Foundation for Development Cooperation on behalf of the Banking with the Poor (BWTP) Network.

ASKI and KMBI are non-government, non-profit Christian development organisations that were set up in the mid 1980s with the primary thrust of alleviating poverty through microenterprise development and, more specifically, through the provision of credit to those without access to formal sources. Both NGOs adapted and evolved group-based lending methodologies that made use of mutual group guarantees as replacement for physical collateral.

The study starts with an assessment of organisational performance and proceeds to review the organisational strategies and processes that were instrumental in accounting for the organisations' performance. In assessing organisational performance, the study identified a set of quantifiable performance indicators, primarily financial and operational, and used these as the basis for comparing and reviewing the two organisations' performance.

Specifically, indicators for effectiveness, efficiency, and sustainability were identified. Effectiveness indicators included impact, responsiveness and outreach. Efficiency indicators included aspects of operational and financial efficiency. Operational and financial sufficiency as defined by the Consultative Group to Assist the Poorest (CGAP) appraisal format were major indicators used for financial sustainability.

This was complemented by an assessment of qualitative factors. These covered the areas of organisational vision, mission and strategy, expansion and branching methods, and organisational processes covering corporate governance, culture and learning processes and human resource management.

A review of the two NGOs' performance has shown that both ASKI and KMBI have demonstrated substantial progress towards increasing outreach and sustainability in lending to the poor. It has also highlighted several important factors in attaining such outreach and sustainability, many of which the two NGOs will still have to work on. Part of the rationale behind the choice of the two NGOs as subjects for this review was that their situation would reflect that of many existing NGOs, and that relevant lessons might be drawn from their

experience. It is hoped that this summary would provide useful insights for practitioners, donors, and policymakers.

Both NGOs have been able to evolve services that were fairly responsive to meeting the credit requirements of the poor. An important area is the need to be constantly reviewing and improving one's range of financial products and services.

Two approaches exemplify the range of the spectrum in which the issues of product/service responsiveness and appropriate credit methodology can be addressed. One is to have highly skilled field workers with the flexibility to respond to both the needs of the client and the challenges of microfinance. Perhaps the best example of this would be the informal money lender. However, under this mode, the field workers need to be very well equipped in evaluating clients, assessing credit risks, determining appropriate loan amounts and terms, etc. The other approach is to have fairly limited and standardised packages and systems and procedures such that the skills level required of field workers could be reduced. In one instance, the replication task is to multiply informal money lenders. In the other, the main task would be the replication of systems and procedures as in a franchising arrangement. What is important is that there is a fit between the requirements of the given task and the field worker.

The two NGOs reviewed had grown very rapidly in both client reach and the value of their loan portfolio. Compounded annual growth rates for the number of loans released since their start-up range from 59 per cent to 82 per cent while the growth in the amount of loans released grew by 59 per cent to 68 per cent per year.

Donor support played a crucial role in contributing to the two NGOs' outreach and movement towards sustainability. A review of AusAID's involvement in microcredit in the Philippines highlighted the important contribution of various AusAID microcredit support projects to Philippine microcredit NGOs in particular, and to the development of the Philippine microfinance sector in general. AusAID support was instrumental in the development and adaptation of models in start-up programs and in the growth and expansion of tested models.

A key contributory factor was AusAID's continuing support to selected NGOs for over a decade which no doubt helped move those NGOs from start-up to stabilisation, and to expansion. This support has also facilitated the NGOs' progress towards increased self-sustainability. The level of AusAID funding was significant in comparison to the NGOs' scale of operations.

A review of the two NGOs' experience highlighted several areas critical to expanded outreach which need to be addressed. Aside from a good product, there is a need to develop a credit delivery methodology that reaches the poor while meeting the challenges of lending to the sector without compromising portfolio quality and efficiency.

The two NGOs have successfully adapted group-based lending models to reach the poor and have employed methodologies that fall within the spectrum defined above. This is evidenced by the general profile of their borrowers, their low average loan size, and the high proportion of women among their clientele. Their relatively high repayment rate and fairly good portfolio quality also confirm this.

As the heart of a microfinance operation lies with its field workers, it is important to develop a model that would allow the field workers to reach their full capacity at the shortest time possible. This has then to be backed up by the necessary training infrastructure. Appropriate means of motivating and rewarding field worker performance also needs to be developed.

Beyond the field worker level, a branch viability model that puts together the credit methodology, an appropriate field officer 'ramp up' plan, and systems and procedures for autonomous branch operation must be developed and tested. The two NGOs are at the stage of fine-tuning their models for significant expansion.

Fulfilling the requirements described above would prepare an organisation for expansion. Otherwise, expansion may come at the cost of a deteriorating loan portfolio quality. In this regard, it may be prudent to launch a phased and controlled expansion, with deliberate alternation between periods of growth and consolidation.

Whether an organisation is in expansion mode or not, an essential element of any microlending operation is the quality of its loan portfolio. Thus, an organisation has to ensure that the elements of ensuring and maintaining a good quality loan portfolio are in place. This includes product design, credit delivery methodology, field staff development, and the supporting systems and procedures including an effective account information system. The review of the two NGOs' experience revealed the potential negative impact of changes in methodologies, clientele and internal systems on loan portfolio quality, and the need for these to be undertaken deliberately and tested thoroughly.

The analysis of the two NGOs' efficiency performance highlighted the importance of managing the interplay among loan size, staff efficiency and salary structures. In 1996, ASKI's client to field staff ratio stood at 151 clients per staff while KMBI achieved 268 clients per field staff in 1996 and climbed further to 290 for the first eight months of 1997. However, the two NGOs' transaction costs did not show a consistent pattern over time. This was due to the interplay of several factors: efficiency of new staff and their position on the learning curve, salary adjustments, stage of expansion, and changes or adjustments to the lending methodology. In principle, a microfinance institution should aim to be a very low cost, low overhead operation.

It also reinforced the importance of cultivating repeat business as a means towards increasing efficiency. In this regard, the two microfinance institutions reviewed would have to reduce their ratio of operating expenses to loans outstanding by at least half to be at par with the more successful international models. This would be possible by both increasing worker efficiency and increasing the amount of loans outstanding per client (which should be the result of repeat borrowing).

ASKI had not reached full operational sufficiency as its operational sufficiency level in 1996 was 0.74 (excluding the cost of funds) and 0.57 (including cost of funds). Its financial sufficiency level stood at 0.57. KMBI on the other hand attained full operational sufficiency in 1996 and 1997. Its operational sufficiency level in 1996 was 0.96 and 1.36 in 1997 (excluding the cost of funds) and 0.90 in 1996 and 1.27 in 1997 (including cost of funds). Externalising the cost of self-help group formation further improved the two NGOs' levels of operational and financial sufficiency.

Viability scenarios were used to estimate the required levels of client to field staff ratios to attain operational and financial sufficiency and earn a 10 per cent return on equity. This was done using the two NGOs' existing staffing pattern, cost structure, loan sizes and loan loss rates. The results showed client to staff ratios ranging from 348 to 188 for ASKI and 405 to 236 for KMBI. If complemented with improvements in the average loan size, these are scenarios within the reach of both NGOs.

The review of financial viability showed the need for appropriate pricing, and for maintaining a good income yield in addition to maintaining high efficiencies and a good quality portfolio. KMBI's experience has proven that both operational and financial sufficiency are attainable objectives for microfinance organisations with a similar scale of operations. The earlier viability scenarios presented in Llanto and Chua's transaction cost study (1996) were in fact validated by KMBI's actual experience in 1997.

Several other qualitative factors seemed to also play a role in facilitating the two NGOs' progress towards eventual sustainability. In the experience of both NGOs, the commitment of the Board and its key officers, including the executive director, to the mission of the organisation plays an important role in contributing to the sustainability of the institutions. Tangible manifestations of Board commitment include the willingness of board members to take on joint and several signatures to guarantee a commercial bank clean loan. The Board also plays a crucial role in making strategic decisions at critical junctures that clarified the role, purpose, and direction of these organisations.

Both organisations have been very explicit in stating their Christian orientation and commitment to the poor. They have also instituted mechanisms such as regular prayer meetings and retreats to share this commitment to staff. Because of this, the two organisations have frequently grappled with the issue of compassion in lending. As both push towards viability and sustainability, it is important that they not lose track of the original reasons for their existence. They should constantly strive to integrate such values into their strategies and programs. They must also continue to grapple with the tensions arising from perceived incompatibilities between the requirements of sustainability and that of reaching the poor.

This value orientation of the two organisations has been considered by staff as a key motivating factor for their joining and remaining in the organisation. It has also been considered a key factor in contributing to the organisations' performance.

The experience of the two NGOs also highlighted the importance of the ability to learn and adapt. Both organisations were able to weather hard times and went through various stages of development and change over their ten-year life. An NGO's flexibility has always been considered an important strength in development work. This has certainly worked to the advantage of both NGOs. In the case of both KMBI and ASKI, it seems that a key factor contributing to this ability is the respective Executive Directors' efforts to put in place organisational opportunities for regular assessments, reflection, and learning. They have also made extra effort to involve key staff into the process. As both gear up for expansion, it is again important that this ability is not traded off in the pressure for standardisation.

Finally, the experience of the two NGOs highlights the need and importance for organisations to make deliberate and strategic choices about their involvement in microfinance. These areas include: the choice of target clientele, range of products and services with the need to initially focus and build up a core strength or competence, vision for the client system and its relationship with the microfinance organisation, thinking ahead about expansion and replication and the demands of such, particularly its implications for the legal structure.